

## A GOVERNMENT ENTREPRENEURSHIP PROGRAM OF THE MAYAGÜEZ REGION

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### ABSTRACT

Entrepreneurship training and education programs are increasingly undertaken by not only educational institutions but also by state and national government units. An evaluation of the effectiveness of such programs would be useful in improving the quality and success of these programs. With this point of view this study involves an assessment of the performance of the entrepreneurship program undertaken in the Mayagüez region by the AAFET unit of the government of Puerto Rico (AAFET is an acronym of the Spanish title which in English stands for “Administration for Training Future Entrepreneurs and Workers”). The Mayagüez region program which covers the western part of Puerto Rico is one of three regional programs covering the island of Puerto Rico.

This investigation involves the identification of the number and type of entrepreneurs initiated in this program, their survival rate, the performance and problems facing the ones that are continuing to operate. Information and data about the firms is collected using both telephone and personal interviews of the owners of these enterprises. A well designed set of questions are used to conduct telephone interviews of the entrepreneurs initiated under this program to obtain relevant information about the performance of the enterprise. This is followed by selecting a random sample of 23 enterprises from this program and conducting personal interviews to obtain in depth information and data.

Analysis of the data and other information is used to draw conclusions about the performance of these enterprises and the effectiveness of the AAFET program. An assessment of these enterprises contribution to employment and economic output is also made. Recommendations to improve the training program and methods to provide continuing assistance to ongoing enterprises developed under this program to become successful are developed. The study looks into the possibility of extending the recommendations developed here to the other two regional centers of Puerto Rico.

### INTRODUCTION

It is now generally recognized that a country's economy and economic growth are strongly influenced by the dynamism of their entrepreneurial environment. Reynolds et al (1999) present a consolidated conceptual model that includes both general national, and entrepreneurial framework conditions developed in a GEM (Global Entrepreneurship Monitor) report. The model indicates how a country's entrepreneurial capacity contributes to its economic growth. In the 2001 GEM Executive report Zacharakis et al identify two categories within the total entrepreneurial activity (TEA) within a country. The two categories are identified as:

I) Opportunity Entrepreneurship and II) Necessity Entrepreneurship. Opportunity entrepreneurs are those that start a business to take advantage of a business opportunity. They have an innovative idea and want to explore it and take advantage of an opportunity in the market place. Candidates in this category tend to be educated and are employed or employable. On the other hand those that have no better choice for work or have to find alternate means to survive and support themselves are necessity entrepreneurs. Here entrepreneurship is motivated by need.

Schumpeter (1947, 1949) describes the entrepreneur as creating disequilibrium in order to profit from it. He sees the function of the entrepreneur as one to revolutionize patterns of production by exploiting an invention or innovation. However it is not easy to teach an individual to invent a creation that will cause an economic disequilibrium. In contrast to the entrepreneur as essentially an innovator Kirzner (1973, 1982) argues that an entrepreneur might simply identify an opportunity for profit rather than create one. Hence the Kirznerian entrepreneur can benefit from general education and managerial training. This paper describes and analyzes attempts to train young people to become entrepreneurs in the Kirznerian sense. They can also be considered as necessity entrepreneurs, as described by Zacharais et al.

## **THE AAFET PROGRAM**

In an effort to provide education, training to young people between the ages of 18 to 29 the PR government created a "Service Organization of PR" in August of 1990. The operational component of the department of human resources of PR reorganized the work of the "Service Organization of PR" and in 1999 changed its name to AAFET, an acronym for its Spanish title "Administración para el Adiestramiento de Futuros Empresarios y Trabajadores" (Administration to Train the Future Entrepreneurs and Workers).

The AAFET program consists of three distinct components of activities namely: 1) Vocational Technical Program, 2) Job Corps Program and 3) Economic Development Program. The vocational technical program is based in 13 vocational institutes, the Job Corps program is conducted in 3 Job Corps centers, and the economic development program is divided into three regions. The activity of interest in the present investigation is the Economic Development Program of the western region.

### **Western Region of Puerto Rico**

Puerto Rico, an island lying between the Caribbean sea and the Atlantic ocean (18° 15'N, 61° 30' W) is made up of a total area of 8,959 sq. km. land and 145 sq. km. water (Approximately 180 km East-West and 50 km. North-South) with a population of 3.8 million. The western region considered in this study represents the entire west coast and extends inland approximately 50 km. It consists of 14 cities mostly along the coast line which is nearly flat while the interior of the island is extremely hilly. The population of the western region is approximately 576,874. Mayagüez which represents the principal city in the west is the fifth largest city in P.R. with a population of 98,434. The number of business establishments in the western region as determined in a study (2002) under the P.R. Commerce Department add up to 24,414.

## **Economic Development Program**

The Economic Development Program is made up of the micro enterprise sub program and the entrepreneurial development program of the Work Investment Act (WIA). The micro enterprise sub program is funded and supported by the PR Government while the Entrepreneurial Development Program is supported by the U.S. federal government.

The state program and the WIA program are designed to provide training and education to young people to start a business and manage its operation. While both programs give basically the same training material there are some distinct differences in the approaches taken by each of these with respect to the topics covered in the training, the distribution of materials and the duration of the program.

The state program takes a very direct approach to educate and orient the students. It goes directly to train participants in the basics of business functional areas of accounting, finance marketing, and personnel management. The fire department, health department, and the administration of rules and permits (ARPE) agencies visit them during their training period to educate them about the different permit requirements to start a business in Puerto Rico. This program extends over a period of 3 months.

The WIA program includes all the aspects of the state program. In addition the program puts more emphasis to develop and improve the self esteem and motivation of the participants, and help them with their personal issues as much as possible. The program dedicates more time to their training to help and guide the participants to develop their business proposal. The program is more people oriented, focusing on the development of the individual so they will be more receptive, ready, and open to the training materials. This program extends over a period of 5 months and is thus 2 months longer than the state program.

The two programs in their training cover the basics of starting and managing an enterprise. The areas covered include the following topics:

- Strategies of planning and managing a small business.
- Preparing job description, staffing & managing employees.
- Assessing the market and competition.
- Promotion, Publicity & Public Relations.
- Identifying customers & creative sales.
- Revenues, costs and cash flows.
- Budgets and accounting records.
- Regulations, Permits and Agencies.

These topics are covered in a set of manuals along with a series of exercise. During the training program the students discuss cases relating to the different topics, and complete the exercises. They prepare questionnaires, make market analysis presentations, practice sales techniques, and prepare budgets and cash flows.

At the end of the AAFET and WIA programs the participants are expected to have familiarized with the essential aspects of starting a business and operating it. They hand in a portfolio containing materials and projects they have completed in each of the courses. Following this the students develop a business plan of a business they want to start and submit it for approval and funding support. The staff of AAFET and WIA evaluate the plans and recommend those that are considered acceptable for financial support. The AAFET program participants whose business plans are successful receive a sum of \$900 to start their business. The successful WIA program participants receive a sum of \$1,100 for their startup.

## **INVESTIGATION**

The current investigation is based on a study of a sample of 63 enterprises initiated through the AAFET and WIA programs of the western region. The sample was drawn from a list of 205 enterprise listing provided by the Mayagüez center. This list of 205 is derived from the total number of enterprises initiated in the AAFET and WIA programs over the years 1990 to 2003. The two programs together initiate about 100 startups each year. Thus the total population of enterprises initiated over this period in the western region is approximately 1,300. Information for 40 in the sample of 63 of these enterprises was obtained using telephone interviews and the remaining 23 involved personal visits & interviews. A questionnaire designed for both of these interviews was used to collect the following information about these enterprises:

- Is the enterprise continuing its operation in 2005 or is it out of business.
- The start up date of the operating business.
- The number of employees when it started and the number now.
- Performance of the business operation during the first year and its performance now.
- Expectations of its continuing operation and growth in the future.
- Current sales volume.
- Major problems facing the business.
- Nature of assistance and needs of the entrepreneur and the enterprise.

The information generated from these interviews involves both qualitative & quantitative data. The analysis of the information is as follows. (Summary data obtained from the interviews is given at the end of the paper in tables)

### **Survival**

Of the 40 enterprises whose telephone numbers were available 13 were successfully contacted while 12 did not respond even after several attempts (4-5), and 15 were out of service. The 22 personal visits resulted in 12 enterprises being out of business and 10 were continuing in their operation. The results show:

Sample size  $n = 63$

Successfully continuing operation in 2005: 23

Enterprises no longer in operation: 40

Survival rate of enterprises in the sample over the period (2003-2005) of 2 years: 36.5%

### **Years in business**

The surviving enterprises range in their length of operation from 2 to 18 years with a mean of 6.9 years. Since 50% of these businesses are more than 4 years in operation their chances of continuing survival are good.

Table 1

### **Sales revenues**

In spite of this length of business operation a substantial number (48%) of these enterprises have gross revenues of \$35,000 or less. Only 22% of these enterprises have gross revenues exceeding \$100,000. Sales revenues of these enterprises range from a yearly low of \$5,200 to a high of \$600,000. The median sales volume of the sample is \$44,200. (The median value is used to describe the central tendency of the sample sales volume since there are some extreme values. Extreme values in a sample affect the mean as a measure of its central tendency.)

These enterprises can be group into three categories:

- |   |     |
|---|-----|
| 1. Enterprises with sales revenues less than \$35,000           | 48% |
| 2. Enterprises with sales revenues between \$35,00 to \$105,000 | 30% |
| 3. Enterprises with sales revenues greater than \$105,000       | 22% |

Table 2

Table 3

### **Employment**

Most of the enterprises namely 70% have just 1 employee. The remaining 30% have 2 or more. The average number of employees at the start of these businesses was 2.1 while the average now in 2005 is 3.8 employees per business. Even so a few of these business 13% have substantially fewer employees now than when they started. These businesses find that it is not easy to find good reliable workers and monitor their performance.

Table 4

Table 5

### **Business status**

While 52% of the enterprises felt that their business is in good or very good condition, all of them indicate that they will continue to operate in the next year or many more years. In terms of the future almost 50% of them expect to grow rapidly or moderately.

Table 6

### **Problems facing the enterprises**

Some of the problems identified by the respondents are as follows:

A large number of enterprises (48%) indicated that the major problem they faced; in continuing their business operations or to expand their operation, was in obtaining commercial loans. Often they had to seek personal loans and even in these situations they received little help from the regional offices and they found the process to be very time consuming.

The next major problem appears to be obtaining proper facilities with necessary utilities. A total of (39%) said they faced the problem of finding a proper location. Other problems identified relate to marketing to identify customers (13%). Finding appropriate employees who are dependable, honest and hard working was a problem faced by 17% of the businesses.

### **CONCLUSIONS AND RECOMMENDATIONS**

A major problem of the present study has been the difficulty of obtaining adequate and proper data and information. The list of enterprises contained only 20% of the businesses with telephone numbers. Further there is lack of information concerning the relation between the list of 205 enterprises and the approximate 1,300 total start ups. It was difficult to design a random sample; the sample drawn in this study is a convenience sample and thus limits inferential analysis.

A one sample runs test was made to evaluate the randomness of the convenience sample used in this study. The runs test is used to determine whether the order or sequence of observations in a sample is random. The null hypothesis is: The items in the sample are generated randomly. The critical values of R (number of runs) are 5 for the lower tail and 17 for the upper tail of the distribution. When the observed value of R falls between 5 and 17, the decision is to not reject the null hypothesis. Here the value of R was 14, the decision is to not reject the null hypothesis. Not enough evidence is provided to declare that the data are not random.

Even considering the sample as random we can only draw inferences about the 205 enterprises and will not be able to make any reliable statistical inferences about the population of 1,300 enterprises initiated by the Mayagüez region. (Efforts to determine the nature of the list of 205 from the 1,300 startups is currently being made).

Using the sample information as a pilot study we can draw some conclusions and make recommendations to improve the AAFET and WIA programs.

In a paper on "Entrepreneurship education and training in Canada: a critical assessment" Ibrahim and Soufami (2002) find that the small and medium size enterprises suffer from a considerably high failure rate that is largely attributed to the lack of management skills & planning which can be improved by providing training and education in the business areas. They

go on to develop a conceptual framework for entrepreneurship training which could be adopted in improving the training of AAFET & WIA participants.

In order to ensure the success of even a micro enterprise potential candidates approved for receiving financial support from the state or federal government need to exhibit to some extent entrepreneurial traits associated with successful entrepreneurs; traits such as need for achievement, independence, control, and willingness to accept reasonable risk in view of the uncertainty in the marketplace with respect to many aspects of operation of an enterprise. In the context of providing management skills ensure that potential entrepreneurs in their educational and training programs acquire the skills of developing strategy, financial planning, and cash flow management, marketing to enhancing sales, and networking to establish contacts in the business community and the government agencies.

Another major problem of the AAFET and WIA programs is the limited follow up of the enterprises initiated through their training and financing activities. Lack of personnel has resulted in limited information about the first year performance of these enterprises and (little or) no information in their succeeding years. In order to evaluate the success of this program it is extremely important that a mechanism be set up where by the following activities can be undertaken.

- A planned number of contacts by Mayagüez region personnel during the 1<sup>st</sup>, 2<sup>nd</sup> and 3<sup>rd</sup> years of operation of the business enterprises. They could undertake 12 visits the first year, 6 the second year and 3 the third year to collect basic information about the business operation and their problems.
- Schedule a seminar every 3 months inviting all the enterprises in each region and provide information and solutions to deal with some of the common problems faced by many of the businesses and identified during the visits by the personnel.
- Revise the curriculum to provide training and practices to learn proper book keeping and accounting procedures.

**Table 1: Years of Business Operation**

| # of years in business | Mean of years | # of Companies |
|------------------------|---------------|----------------|
| ≤ 2                    |               | 4              |
| 2.1 to 3.0             |               | 5              |
| 3.1 to 4.0             | 6.87          | 2              |
| 4.1 to 5.0             |               | 3              |
| > 5.1                  |               | 9              |
| <b>Total</b>           |               | <b>23</b>      |

**Table 2: Distribution of Sales**

| Categories of Sales   | Frequency | Percent (%) | Average of Years in Operations |
|-----------------------|-----------|-------------|--------------------------------|
| Less than \$35,000    | 11        | 48%         | 3.18                           |
| \$35,000 to \$100,000 | 7         | 30%         | 10.14                          |
| More than \$100,000   | 5         | 22%         | 10.40                          |
| <b>Total</b>          | <b>23</b> | <b>100%</b> |                                |

**Table 3: Sales Volume**

| Sales Volume (Annual) |           |
|-----------------------|-----------|
| Mean                  | \$85,890  |
| Median                | \$44,200  |
| Minimum               | \$5,200   |
| Maximum               | \$600,000 |

**Table 4: Employee Distribution**

| Class | Class Limits  | Employees |           |
|-------|---------------|-----------|-----------|
|       |               | Start     | Now       |
|       |               | Frequency | Frequency |
| 2     | 1 and under 2 | 16        | 10        |
| 3     | 2 and under 3 | 1         | 4         |
| 4     | 3 and under 4 | 3         | 2         |
| 5     | 4 and over    | 3         | 7         |
|       | Total         | 23        | 23        |

**Table 5: Average of Employees**

|      | Employees Start | Employees Now |
|------|-----------------|---------------|
| Mean | 2.1             | 3.8           |

**Table 6: Current Business Status**

| Current Business Status | Distribution |     | Sales    |          | Average of Years in Operations |
|-------------------------|--------------|-----|----------|----------|--------------------------------|
|                         | Freq.        | %   | Average  | Median   |                                |
| Very Good or Good       | 12           | 52% | \$89,523 | \$49,000 | 6.75                           |
| Average or Poor         | 11           | 48% | \$81,927 | \$18,000 | 7.00                           |
| Total                   | 23           |     |          |          |                                |

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## TYPOLOGIES OF INFORMAL VENTURE CAPITAL INVESTORS IN SWEDEN

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### **Abstract**

Earlier research has indicated that the informal venture capital market is highly heterogeneous, and that there are several different kinds of investors. However, only a handful of authors have tried to develop typologies of informal investors, to reach a deeper understanding of markets characteristics and functioning. The purpose of this study is to estimate the size of informal venture capital market in Sweden and to analyze its structure by making a categorization of informal investors and identifying differences and similarities between those categories. The aspiration is to determine the distinguishing characteristics of different types of informal venture capital investors in term of background characteristics and investment behaviour. This study is the first to be based on a large representative sample of a countries population, allowing robust categorization and statistical nationwide generalizations.

## INTRODUCTION

Informal venture capital, i.e. private individuals who invest risk capital directly in unquoted companies in which they have no family connection, has gained a major significance in the financing of the entrepreneurial start-ups and growth firms. The Global Entrepreneurship Monitor Report recognizes informal venture capital as the single most important source of new ventures financing, filling the gap between founders, family and friends, and institutional venture capital funds (Reynolds, 2003). In the United Kingdom informal venture capital investors make ten times as many investments and invest four times as much capital as the institutional venture capital investors. Apart from investing money, informal investors contribute their commercial skills, entrepreneurial experience, business know-how and contacts taking a hands-on role in the company (Mason and Harrison, 1995).

Informal investors often undertake the investments that institutional venture capitalists find unattractive, due to high uncertainty and small size of investments. Informal investors are only partly motivated by financial rewards, and therefore can make more risky investments. Furthermore, the transactions costs can be minimized due to the administration costs being small, which makes it justifiable to invest smaller sums of money (Landström, 1993a). Few venture capital firms are prepared to make investments under one million dollars, meanwhile much smaller resources are needed to finance an entrepreneurial start-up and early stage expansion. According to an analysis of the Inc500 “America’s fastest growing private companies” in 2000, 16 per cent of those firms started with less than \$ 1 000, 42 per cent with \$10 000 or less, and 58 per cent with \$ 20 000 or less (Reynolds, 2003). Most of the fastest growing firms in US have therefore started without any financing from institutional venture capital funds.

Several attempts have been made to estimate the size of informal venture capital market, most of them in the US (e.g. Wetzel, 1986; Arum, 1987, Gaston and Bell, 1988; Gaston, 1989), but some even in Canada (Riding and Short, 1987) and in the UK (Mason and Harrison, 2000a). Those studies have provided useful insights in the scale of informal venture capital market in those countries. The estimates have however been based on components like the number of start-ups that supposedly needed external financing and the proportion of informal investors in the population, and the result vary considerably dependant on the assumptions made (Gaston and Bell, 1988). Therefore the more reliable approaches to estimate the scale of the market are needed (Mason and Harrison, 2000a).

In addition, earlier research has indicated that the informal venture capital market is highly heterogeneous and that there are several different kinds of investors (see Gaston, 1989; Coveney and Moore, 1998; Sørheim and Landström, 2001). However the researchers have been mainly interested in one particular group of informal investors, namely the so called “business angels” – investors with high investment activity that contribute considerable resources to the companies they invest in. Thus we have no deeper knowledge about informal investors other than “business angels”, i.e. those investors who make a small number of investments, and those who contribute small amount of resources to the investment object. They are nonetheless the prevalent group of informal investors that have been largely neglected in previous research (Reynolds, 2003). Mason and Harrison (2000b) point out the importance of separating the different types of informal investors from each other, to reach a better understanding of the market. Sørheim and Landström (2001) claim correspondently that by dividing informal investors into several categories, one achieves a more exhaustive picture of informal investors than by viewing them as one homogenous group.

## AIMS AND CONTRIBUTIONS

Despite a long history of research on the informal venture capital in the US and several European countries, the scope and the structure of the market is still a highly unexplored matter (Mason and Harrison, 2000b). Only a handful of authors have looked into the structure of informal venture capital market and tried to develop typologies of informal investors. The classifications are however eclectic, and the methodology used has not been elaborated. The lack of studies on typologies of informal investors can be explained by the difficulties involved in identifying the investors, which makes it problematic to create sufficiently large representative samples (Mason and Harrison, 2000a). In this study informal investors are identified by screening a large random sample of adult population in Sweden. This method of identifying the informal investors is rather costly and time-consuming, and the method is rarely used in studies of informal investors. Based on this methodological approach, the purpose of this study is to estimate the size of informal venture capital market in Sweden and to analyze its structure by making a categorization of informal investors and identifying differences and similarities between those categories.

The aspiration is to determine the distinguishing characteristics of different types of informal venture capital investors in term of background characteristics and investment behaviour, and to quantify the impact of each investor group on the Swedish market. This study is the first to be based on a representative sample of a country population, allowing robust categorization and statistical nationwide generalizations. Further, it gives a more exhaustive and nuanced picture of informal venture capital market structure, functioning and characteristics.

Mason and Harrison (1997) argue that such an analysis could make a significant practical contribution by making it easier to advocate the introduction of specific public and private

measures, which can positively affect the efficiency of the informal venture capital market. A more detailed picture of this market also could help entrepreneurs with the decisions about which type of informal investor to search for.

This paper contains seven sections. In the following section I will present the frame of reference of the study, followed by a description and discussion of the method used. Thereafter the introduction to Swedish market is presented to give a picture of context of the study. The empirical findings are presented in the subsequent section, including description of the sample, categorization, analysis of categories and extrapolation of the result to the Swedish population of informal investors. The final section contains the conclusions and the discussion of results.

## **FRAME OF REFERENCE**

We have a rather good understanding of the characteristics of so called “business angels” through 20 years of research within the field. The first attempt to describe the extent and character of the business angel market was made in the beginning of 1980s by William Wetzel at the University of New Hampshire in the US. After a couple of years Wetzel’s research was followed by a number of other studies from USA (Arum, 1987; Haar et al., 1988; Gaston and Bell, 1988). Informal investors started attracting international attention in the late 1980s and the beginning of 1990s, and research surveys were carried out in Canada (Short and Riding, 1989), the UK (Mason et al., 1991) and in Sweden (Landström, 1992). On the base of this research some international comparisons have been made on the later stage, primarily focusing on the characteristics of “business angels” in different countries (Harrison and Mason 1992, Landström, 1993a). This is what Mason and Harrison (2000b) call “first generation studies”.

In the recent years the research has become more extensive and sharply focused. The “second generation studies” are characterized by an increased interest in the informal venture capital process (Riding et al., 1993, Mason and Rogers, 1997), and a stronger focus on policy issues (Mason and Harrison, 1995, Wetzel and Freear, 1996), but we have also seen an introduction of theoretical approaches in the research such as portfolio management theory (Norton, 1990, Harrison and Mason, 1991), decision-making theory (Landström, 1995, Feeney et al., 1999), agency theory (Landström, 1993b, Fiet, 1995) etc.

### **The scope of informal venture capital market**

The first attempt to estimate the size of informal venture capital market was made by Wetzel (1986) on the US data. Wetzel used what came to be called the *market-based approach*, and based his estimation on two assumptions. On the one hand he estimated the proportion of the start-up companies that needed external financing to 5 per cent, and the amount raised by those companies to \$ 200 000 each. On the second hand, he estimated the proportion of informal investors in the population by looking at the Forbes 400 Richest People in America. He further assumed that those investors would make one investment every two years, and that the average amount invested is \$ 50 000. This gave a total number of 100 000 investors who invested \$ 5 billion. Wetzel (1986) himself acknowledged that the calculations were crude, based on the extrapolation of fragmentary data. However this estimates played an important role in establishing the informal venture capital market as a legitimate field of study, and draw much attention from policymakers (Mason and Harrison, 2000a).

Arum (1987) and Gaston (1989) tried a different approach of quantifying the informal venture capital market called *firm-based approach* (Mason and Harrison, 2000a). A random sample of

SMEs in US was taken to identify those that had raised finance from informal investors. The percentage share of firms raising informal venture capital was extrapolated to the total number of firms in the US, and then multiplied by the total number of investors per firm. The amount invested was calculated using the average size of investment from the initial sample, and further divided by the investment holding period to obtain the annual amount of investment. The final estimation of the number of informal investors in the US was 720 000, and the annual flow of informal venture financing was estimated to be \$ 32.7 billion (Gaston, 1989).

A third approach to estimating the size of informal venture capital market is the *capture-recapture approach* used by Riding and Short (1987). The method is based on measuring the number of times each investor in the sample is mentioned by other investors. The number of informal investors in the studied region (Ottawa-Carleton) was estimated to 87 investors. This is however a very problematic approach in several senses. Due to the regional nature of informal venture capital market, the result cannot be extrapolated to the national level. Further, the approach does not provide information on the number of investments made or the funds invested by the identified population of informal investors (Mason and Harrison, 2000a). Finally, the result depends on the willingness of the investors to give the names of other investors known to them (Lumme et al., 1998).

Finally, Mason and Harrison (2000a) introduced a different approach to measuring the scope of the informal venture capital market. They looked at the “visible part” of the informal investors – those registered in the business angels networks. After calculating the registered number of investors (5 651 in 1999-2000), they made an adjustments for over- and undercounting, and estimated the percentage share of all informal investors that are members in the business angels network. The assumptions made in those adjustments are however crucial for the result. Dependent on the

estimated proportion of registered investors, the results varied between 20 000 informal investors that invested £ 500 million, and 80 000 informal investors that invested £ 2 billion.

### **Typologies of informal investors**

All these studies are however largely concentrated on the group of “business angels”, and we have rather limited knowledge about the informal venture capital market as a whole. Some attempts have however been made to explore and analyze the diversity of informal investors. Gaston (1989) was the first one to identify different kinds of informal investors. He suggested that the informal venture capital investors can be divided into ten distinctive groups based on their background and investment behaviour. Gaston looked especially into investors’ personal characteristics, market activity, investments portfolios and investment goals. However it is not clear what method the author uses to identify those ten groups.

Coveney and Moore (1998) segment informal investors market and identify six groups of informal investors, four active and two passive. The authors choose investment activity, in terms of number of investments and total funds invested, and investors financial and business background as primary criteria to distinguish between the four active types of investors. Another two of identified groups are “virgin” and “latent angels” – those that either never have made investments in unquoted companies, or that currently are not making investments. Coveney and Moore create the detailed profiles of different types of informal investors, allowing for entrepreneurs seeking funds to identify the most appropriate investor. Yet the authors neither describe how the groups are identified, nor do they show the relative distribution of the investors among those groups.

The most recent effort to segment informal venture capital market was made by Sørheim and Landström (2001). Authors identified four types of informal investors by dividing the investors according to their investment activity and competence. The investment activity level is measured as number of investment made and the funds invested, including both former and planned investment. The competence is measured as education and professional and entrepreneurial experience. The empirical findings show that there are considerable differences between the four identified groups of informal investors, regarding among other things the information sources used in the decision process, the level of involvement in the investment, investment horizons etc.

From previous research on diversity of informal venture capital investors we can conclude that several distinctive types of informal investors can be identified, where investment activity level is often used as one of the segmenting variables, together with some background variable(s) of the informal investors. Another common feature of the previous studies is that they suffer from the same methodological shortcomings. In their review of Mason and Harrison (2000b) was concluded that “the single most important methodological problem in undertaking research on the informal venture capital market arises from the great difficulty in finding business angels” (p. 228). The studies have mainly been based on “sample of convenience” whose representativeness could not be verified. The existing estimates of the informal venture capital market are based on extrapolation of fragmentary data (see e.g. Wetzel, 1986; Gaston, 1989), so the more robust estimates of the informal venture capital market are needed.

## METHOD

### Data collection

In this study the data on individuals' investment propensity has been gathered from the large random sample of Swedish population. There are two main purposes with the research design in this study. First, due to statistically random sample being used, both the size and the characteristics of informal venture capital market in Sweden can be determined. Second, there are no pre-requisitions in choosing the investors (e.g. no minimum investment or involvement activity requirement), which makes it possible to capture the variety of investors.

The study started with a random survey of 24 166 private individuals between 18 and 79 years to determine the number of informal venture capital investors in this group. The purpose was to find out how many individuals have within the last five years made non-collateral investments in unquoted companies to which they do not have any family connections; the number of investments made and the amount invested, as well as some background information. The survey was carried out externally by RUAB (Swedish Radio Surveys) and completed March the 31st, 2004. This is the largest sample ever been used in studying informal venture capital investors, and due to its statistical representativeness, the results are extrapolated to the whole population of informal venture capital investors in Sweden.

After the preliminary survey we were able to identify some 861 (3.56 per cent) persons that claimed to have made informal venture capital investments. Each individual were then asked if they were willing to participate in a longer telephone interview. Those 548 who agreed to participate in the second phase of this study were contacted during summer and fall 2004, to get detailed

information about their investments. Out of these, it was possible to establish contact with 396 individuals (72.3 per cent response rate). From this group, 114 did not fulfil the criteria for the informal investors. Some of them have never made investments in unquoted companies; others made investments through intermediaries (such as investment banks and insurance companies) or invested money in a family member's company. 28 individuals did not want to participate, and finally 254 (64.1 per cent) were qualified as informal venture capital investors (see Table 1).

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Table 1 about here  
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### **The survey**

All the interviews were made by phone and the structured set of questions was used. The questionnaire consisted of three major sections: general investment activity, three recent investments and background information. After the data were gathered and screened for missing values and data quality, following items were decided on for further analysis (see Table 2).

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Table 2 about here  
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## The cluster analysis

Cluster analysis classifies objects (respondents) so that each object is very similar to others in the cluster with respect to some predetermined selection criterion (Hair et al., 1998). Cluster analysis was chosen as a tool for categorization of informal investors in accordance with the purpose of the study.

Based on the previous research (Gaston, 1989, Coveney and Moore, 1998, Sørheim and Landström, 2001) I have chosen to use the informal investors' level of activity as a main dimension for the analysis. As a second segmenting dimension I have chosen the investors' activity in the company that they invest in. According to the definition, "business angels" are hands-on investors (Mason and Harrison, 1995) with high investment activity that contribute considerable resources to the companies they invest in (Sørheim and Landström, 2001). This implies that investment activity, in terms of number of investments made and the contributed resources, and the investor's involvement in the object of investment are central for distinguishing between "business angels" and other informal investors (see Table 3).

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Table 3 about here

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For the purpose of the analysis I will make a distinction, between who the informal investors are, i.e. background characteristics, and what they do, that is investment behaviour. In the first stage of the analysis the informal investors will be divided with respect to the segmenting variables, and in

the second stage the groups will be compared on the basis of investors' background and investment behaviour, to analyze differences between groups.

As shown in the Table 3 there are two items describing investment activity level (total funds invested and total number of investment) and only one item describing investors involvement in the firm. Therefore the items that describe investment activity level are translated into an index ranging from low (0) to high (2), while investor's involvement can have a value of either (0) or (1). Both variables were standardized before the clustering procedure to make sure that they have the same impact on the formation of clusters.

Selecting the number of clusters is central for the outcome of the analysis. The hierarchical clustering procedure shows the process of cluster formation. In the first step the N-1 cluster solution is produced, where N is the number of objects. In each subsequent step, the number of clusters decreases by one, finally resulting in one cluster (Norusis, 1992). The process of cluster formation can be illustrated in the dendrogram, which shows the construction of the hierarchy (Hair et al., 1998). The dendrogram indicates that the most appropriate number of clusters, which in this case showed to be four.

The selection of number of cluster can also be based on the theoretical or intuitive conceptual assumptions (Hair et al., 1998). The four-cluster solution seems most appropriate since there are two variables ranging from low to high activity that can be combined in four possible ways.

Therefore, using the knowledge on previous categorizations, and to enhance the comparability to other studies (Coveney and Moore, 1998; Sørheim and Landström, 2001) I have decided to accept the four cluster solution.

After the cluster analysis was completed and the four groups were formed, the remaining issue was to make a comparison between groups with respect to those variables that were not used in the clustering. Values in each group were compared in pairs with Independent Samples T-test, using cluster membership as a grouping variable.

### **Strengths and weaknesses of the study**

This study's strength lies in the fact that it is based on a large random sample of informal investors. This is a first study within the area of informal venture capital conducted on a representative sample of a countries population. This means that the results can be extrapolated to the whole population of informal venture capital investors in Sweden. The categorization captures the whole variety of informal investors in Sweden and reflects their actual characteristics.

Another methodological strength is that the data gathering was conducted through telephone interviews. The response rate is very high (64.1 per cent) compared with similar studies in other countries (Sørheim and Landström, 2001, Harrison and Mason, 1992). Furthermore, the personal contact with the respondent reduces risk for the misinterpretation of the questions.

Finally, all data on investment behaviour is based on the actual investment history rather than hypothetical assumptions. This enhances the objectivity and reliability of the data.

The weakness of this study is that the data are gathered solely from the respondents own words. Neither the investment activity nor the background information has been double-checked with the tax authorities. I chose this way of gathering data because of my belief that not all investment

activity is registered, and because of the difficulties to gain access to non-public information through tax authorities.

## **THE SWEDISH CONTEXT**

### **Entrepreneurship and Swedish economy**

Small firms dominate Swedish business and industry, and 99 per cent of all firms have less than 50 employees. The SME sector accounts for 59 per cent of total turnover and employ 58 per cent of the private sector workforce. SMEs have become an increasingly important source of employment and growth as large enterprises no longer create the same number of jobs due to globalization and rationalization of operations (Lundström, 2003).

However, even if small firms are important for Swedish economy, the number of new firms is quite low. The 2003 Global Entrepreneurship Monitor ranked Sweden 31 out of 37 nations in its Entrepreneurial Activity Index (TEA). About 2 per cent of adults in Sweden are currently trying to start a business, and 2.1 per cent are involved in the ownership of a new firm that is less than 42 months old (Reynolds, 2003). Sweden's overall TEA index puts it in the group of low entrepreneurial nations. It is therefore a high priority for Swedish government to support the SME sector, to ensure a stable level of employment and long-term economic growth. The lack of access to finance is considered to be one of the important obstacles to the establishment and development of entrepreneurial ventures.

## **SME financing in Sweden**

A Swedish study by Landström and Winborg (1995) shows that the majority of small firms are reluctant to external equity financing, and that banks are the most important external financial source for small businesses in Sweden. The study is based on the financial data from 320 companies and shows that 86 per cent of the firms rely on bank financing, capital from family and friends are used by 10 per cent of the companies, institutional venture capital by 5 per cent, and only 3 per cent of all companies used to some extent the informal venture capital financing. This implies that Swedish firms rely on venture capital to a lesser degree than their counterparts in the US (Landström and Winborg, 1995).

The difference between Sweden and the US regarding the extent of venture capital reliance can be explained by the fact that the financial systems in those countries are based on two different traditions. Sweden along with Germany, Austria and France has a credit-based financial system which implies a high reliance on debt financing, unlike the US and the UK that represent capital market-based system and are much more equity-oriented (Gerschenkron, 1966 in Zackrisson, 2003).

The difference in use and supply of venture capital, especially the informal venture capital, in Sweden and US can also be explained by philanthropy, which is seen as a part of the American spirit (Acs and Phillips, 2002). While entrepreneurship is the creation of wealth, the informal venture capital investments can be seen as the reconstitution of wealth. This is consistent with Acs and Phillips (2002:190) definition of philanthropy as “giving money or its equivalent away to persons and institutions outside the family without definite or immediate quid pro quo for purposes traditionally considered philanthropic”. Given the high risk associated with informal venture capital

investments, philanthropy can at least partly explain the scope of informal venture capital in the US.

## EMPIRICAL RESULTS

### Data set

Individuals in the final data set have an average age of 47 years (min=18, max=79), 77 per cent are married and nearly half have children under age of 20. The percentage share of men in the data set is 80 per cent. Individuals are quite highly educated, as 86 per cent of them have graduated from high school (Swedish average = 47 per cent), and 62 per cent have some kind of higher education (university or corresponding) (Swedish average = 29 per cent).

About half (49 per cent) of the individuals in the data set are entrepreneurs, some of them with multiple start-up experience, so called “habitual entrepreneurs” (MacMillan, 1986, Westhead and Wright, 1998). Average number of start-ups for those with entrepreneurial background is 1.92 venture (min = 1, max = 15) (see Table 4).

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Table 4 about here

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Individuals' potential to make investments is dependent on their disposable income and wealth. Wealth and income is quite moderate within the group, where 80 per cent of households<sup>1</sup> have assets worth less than \$ 267 000, and 77 per cent have income less than \$ 100 000 per year. The median wealth is \$ 67 000 – 133 000, and the median income is \$ 67 000 – 100 000 per year.

Investment activity varies substantially between individuals in the data set. The majority of the individuals (58.5 per cent) are fairly low active investors with only one investment, and only 4 per cent have made more than ten investments (see Table 5). The majority of investors have invested between \$ 1 000 and \$ 9 999 (see Table 6).

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Table 5 about here

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Table 6 about here

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The informal investors in the group are mostly passive investors. Only 27 per cent of all investors have taken an active role in at least one of companies that they invested in. Regarding the most recent investment made by the individuals in the data set, their involvement in the company is reflected in Table 7.

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<sup>1</sup> Household's rather than individual's income and wealth is measured because of my belief that this is a better estimate of capital available for the investment purposes.

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Table 7 about here  
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Finally, an important factor to consider when analyzing investments is individuals' risk propensity. It has been previously stated that informal venture capital investors make more risky investment than venture capital funds (Landström, 1993a). Consequently, prevailing number of investments is expected to take place in the early stages of company development, when the risk for failure is the largest. As illustrated in Table 8, 57 per cent of all investments are made in the seed, start-up and early development stages, and very few investments are made in the established and stable companies.

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Table 8 about here  
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**Extrapolation of the empirical results**

To calculate the total number of investors in Sweden, the number of investments made and the total funds invested, the results from the sample were extrapolated to the adult population of Sweden. According to Statistics Sweden, the adult population of Sweden at the end of 2004 measured as number of individuals in the age of 18 to 79 years was approximately 6 590 000 individuals.

Out of 396 people that were interviewed 114 were not investors. Under the assumption that the same proportion of people who answered “yes” to the screening question in reality were not investors, the actual number of investors within the sample would be 613 or 2.54 per cent, which is also an estimate of the percentage share of informal venture capital investors in adult population of Sweden. The confidence interval has been calculated to approximately 2.34 - 2.73 per cent, and the number of informal investors in Sweden was estimated to between 154 000 and 180 000. The total funds invested by each group are calculated by multiplying the average investment with the total number of investments in each group. The total amount invested by all categories of informal investors is between \$ 11.65 and 13.6 billion, as showed in Table 9. This is about 40 - 45 per cent of the total funds managed by institutional venture capital funds in Sweden, which at present are around \$ 31 billion (SVCA, 2004).

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Table 9 about here

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### **Categorization of informal venture capital investors**

According to the purpose of this study this section presents the categorization of informal investors. The results of the cluster analysis yielded in the following informal investor categories (Figure 1).

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Figure 1 about here

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The definitions of different categories of informal investors on the basis of Figure 1 are following:

- (1) “Micro investors” are characterized by low investment activity and low involvement in the company that they invest in. This means that they make few informal investments, invest small amounts of money and otherwise do not make any sufficient contributions to the investment object in terms of skills and expertise.
- (2) “Fund managers” show high investment activity in terms of funds invested and number of investments made, but have mostly a passive role in the companies that they invest in. This means that they provide considerable financial resources, but otherwise do not take any active roll in the investment company.
- (3) “Mentors” have a low investment activity level, but are actively involved in the companies that they invest in. They contribute with professional expertise and entrepreneurial experience, but their financial contribution is rather small.
- (4) “Business angels” are the most active of all informal investors. They contribute both knowledge and skills to the companies that they invest in, and they show high investment activity in terms of funds invested and number of investments made.

### **Analysis of categories of informal venture capital investors**

Looking at the demographic characteristics of informal investors we can see some major differences between the identified groups of informal investors (see Table 10). There is a considerable difference in the percentage share of men between groups. Among “mentors” and

“business angel” there is a significantly higher proportion of men (96 per cent) than in the “micro investors” group (73 per cent). There are also variations between groups regarding age of the investors. “Fund managers” showed to be older than both “micro investors” and “mentors” with a median age of 52.5 years, compared to respectively 45.5 and 45 years.

Informal investors appear to be rather highly educated, with 62 per cent having some form of higher education. The analysis showed that “business angels” are considerably higher educated than the three other groups of informal investors with a median value of the “university degree”, while there was no difference in the education level among the remaining three groups.

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Table 10 about here

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Informal investors have as expected quite high entrepreneurial activity, where about half of investors have entrepreneurial experience from one or several start-ups. The entrepreneurial activity range from 44 to 60 per cent between groups, which didn't show to be a significant variation.

“Business angels” and “fund managers” are better-off than other informal investors groups with a significantly higher net worth than both “micro investors” and “mentors”. Further, both “business angels” and “mentors” have significantly higher income than “micro investors”. Moreover “business angels” also have higher income than “fund managers”.

Differences and similarities between groups regarding their investment behaviour can in many cases be explained by variables “investment activity” and “involvement in the company” used in

the cluster analysis. Yet, there are relations that have not been captured during the clustering process.

“Micro investors” together with “mentors” have low investment activity measured as number of investments made and funds invested, in opposite to “fund managers” and “business angels” who have high investment activity, as predicted by cluster analysis. “Business angels” however invest considerably more money than “fund managers”, while “mentors” invest more money than “micro investors” and make more investments than them (see Table 11).

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Table 11 about here

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Table 11 shows that all four categories of informal investors tend to make investments in rather early stages of development, with start-up or early development as median values. Furthermore, Table 11 indicates that “business angels” tend to invest in earlier stages of development than both “mentors” and “micro investors”. The T-test showed however that difference is significant only in relation to “micro investors”, but not to the other groups.

The overall “investor involvement” level is 27 per cent, and according to the definition of the groups, “mentors” and “business angels” take an active role in the companies that they invest in, while “micro investors” and “fund managers” do not. Yet there is a difference in what role the “active” investors take. Analysis showed that “business angels” are involved in the companies that they invest in mostly as members of the board, while “mentors” generally take consultant positions.

The categories of informal investors can be summarized in the following way:

(1) Micro investors:

- are typically young (median = 45.5 years), have a largest percentage share of women (27 per cent) and tend to have a lower income and net worth than other investor types;
- have the lowest investment activity, take no part in the companies that they invest in and tend to invest in the early development stage of company development.

(2) Fund managers

- are the oldest group of investors (median = 52.5 years), have a near median percentage share of women (21 per cent) and have high net worth and moderate income;
- have high investment activity level but do not take any active role in companies that they invest in and tend to invest in the start-up stage of the company development.

(3) Mentors

- are the youngest (median = 45 years) and male-dominated (96 per cent men) group of investors with low net worth and moderate income;
- have low level of investment activity, but are actively involved in the companies that they invest in, usually taking a consultant position and tend to invest in the early development stage of company development.

(4) Business angels

- have an age near median and are a male-dominated group (96 per cent men) with high net worth, high income and a higher education level than the other categories of investors;

- have high investment activity level, take an active role in the companies that they invest in, usually as members of the board, and tend to invest in start-up stage of company development.

I was not able to identify any differences in level of entrepreneurial experience between groups.

## **CONCLUSIONS AND IMPLICATIONS**

### **Theoretical contribution**

The major contribution of this study is the estimation of the size of informal venture capital market in Sweden, and the categorization of informal investors. The number of informal investors was estimated to 2.34 – 2.73 per cent of adult population in Sweden, or between 154 000 and 180 000 investors. Those individuals have totally invested between \$ 11.65 and \$ 13.6 billion.

Four distinctive groups of informal investors were identified based on their level of investment activity and involvement in the companies in which they invest. The differences and similarities between groups were analyzed with respect to background and investment behaviour variables. By including such variables as gender and age, the important background characteristics of investor categories were captured. The categorization captures the whole variety of informal investors due to absence of methodological pre-requisitions when identifying the investors.

## **Policy implications**

Given the credit-based nature of the financial market in Sweden, the scope of informal venture capital market is surprisingly large. This means that informal investors should be considered important suppliers of start-up and growth financing in Sweden, and that their investment activity should be supported and stimulated.

Different informal investors categories are expected to respond differently to public and private efforts introduced to stimulate the informal venture capital market (Sørheim and Landström, 2001). Establishing the “arenas” where entrepreneurs and investors could meet might be beneficial for the investors with high level of investment activity, i.e. “business angels” and “fund managers”, as they may be interested in gaining access to a larger range of investment opportunities, thereby reducing their search costs. The introduction of “match-making” services might be beneficial even for “mentors” that take interest in investments that they make, but do not seem to fully use their investment potential. “Micro investors” however appear to be very little interested in the access to new investment opportunities judging by their low investment activity and no involvement in their investments. They can be stimulated by tax incentives which make investments in unquoted new ventures more attractive.

## **Acknowledgements**

I would like to thank Swedish Business Development Agency (NUTEK) and Swedish Foundation for Small Business Research (FSF) for the funding that made this research possible.

## TABLES

Table 1. The sample developmental process

| <i>Category</i>                                   | <i>Total</i> | <i>Percent</i> | <i>Percent</i> | <i>Percent</i> |
|---|--------------|----------------|----------------|----------------|
| Individuals randomly sampled                      | 24 166       | 100%           |                |                |
| Number of “Yes” answers to the screening question | 861          | <b>3.56%</b>   |                |                |
| Agreed to participate                             | 548          | 2.27%          | 100%           |                |
| Failed to establish contact                       | -152         |                | 27.7%          |                |
| Interview completed                               | 396          |                | <b>72.3%</b>   | 100%           |
| Not investors                                     | -114         |                |                | 28.8%          |
| Refused to participate                            | -28          |                |                | 7.59%          |
| Informal venture capital investors                | 254          |                |                | <b>64.1%</b>   |

Table 2. The questionnaire

| Section                       | Items   |
|-------------------------------|---|
| General investment activity   | Investment potential<br>Total number of investments made<br>Total funds invested  |
| Three recent investments      | <i>Last investment</i><br>The year of the last investment<br>The funds invested<br>The stage of development of the firm<br>The information source used<br>The investment decision-making criteria<br>The industry of the firm<br>Investors involvement in the firm<br><i>Second last investment</i><br>...<br><i>Third last investment</i><br>... |
| <b>Background information</b> | Entrepreneurial experience<br>Wealth<br>Income<br>Civil status<br>Number of children under age of 20  |

Table 3. Operationalization of investment activity level and investor’s involvement

| Variables                     | Items                                 | Measurement     |
|-------------------------------|---------------------------------------|-----------------|
| Investment activity level     | Total funds invested \$67 000 or more | No = 0, Yes = 1 |
|                               | Total number of investments 4 or more | No = 0, Yes = 1 |
| <b>Investor’s involvement</b> | Investors involvement in the firm     | No = 0, Yes = 1 |

Table 4. Entrepreneurial background

| Number of start-ups | Frequency | Percent |
|---------------------|-----------|---------|
| 0                   | 128       | 50.6 %  |
| 1                   | 72        | 28.5 %  |
| 2-3                 | 28        | 15 %    |
| 4 or more           | 15        | 5.9 %   |
| <b>Total</b>        | 253       | 100 %   |

Table 5. Number of investments per individual

| Number of investments | Frequency | Percent |
|-----------------------|-----------|---------|
| 1                     | 148       | 58.5 %  |
| 2 – 3                 | 66        | 26.0 %  |
| 4 – 9                 | 29        | 11.5 %  |
| 10 or more            | 10        | 4.0 %   |
| <b>Total</b>          | 253       | 100 %   |

Table 6. Funds invested per individual

| Funds invested     | Frequency | Percent |
|--------------------|-----------|---------|
| \$ 0 – 999         | 35        | 13.9 %  |
| \$ 1 000 – 9 999   | 124       | 49.4 %  |
| \$ 10 000 – 99 999 | 69        | 27.5 %  |
| \$ 100 000 or more | 23        | 9.2 %   |
| <b>Total</b>       | 251       | 100 %   |

Table 7. Investors' involvement in the company (the last investment).

| Investors role      | Frequency | Percent |
|---------------------|-----------|---------|
| CEO                 | 7         | 2.8 %   |
| Member of the board | 21        | 8.3 %   |
| Management position | 8         | 3.2 %   |
| Consultant          | 21        | 8.3 %   |
| Passive             | 196       | 77.5 %  |
| <b>Total</b>        | 253       | 100 %   |

Table 8. Investments in the different stages of company development

| Stage of development           | Frequency | Percent |
|--------------------------------|-----------|---------|
| Seed                           | 45        | 17.8 %  |
| Start-up                       | 51        | 20.2 %  |
| Early development              | 49        | 19.4 %  |
| Expansion                      | 78        | 30.8 %  |
| Established and stable company | 30        | 11.9 %  |
| <b>Total</b>                   | 253       | 100 %   |

Table 9. Extrapolation of empirical results

| Category of investor | Total number of investors in Sweden | Total number of investments | Total amount invested      |
|----------------------|-------------------------------------|-----------------------------|----------------------------|
| Micro investors      | 95 000 – 111 500                    | 125 000 – 146 500           | \$ 600 – 700 Million       |
| Fund managers        | 17 500 – 20 000                     | 111 500 – 130 000           | \$ 1 300 – 1 550 Million   |
| Mentors              | 28 000 – 33 000                     | 47 000 – 55 000             | \$ 400 – 450 Million       |
| Business Angels      | 13 500 – 16 000                     | 78 500 – 92 000             | \$ 9 300 – 10 900 Million  |
| <b>Total</b>         | 154 000 – 180 000                   | 362 500 – 424 000           | \$ 11 650 – 13 600 Million |

|                     |      | Investor's involvement                                    |   |
|---------------------|------|---|---|
|                     |      | Passive   | Active  |
| Investment activity | High | <b>(2) Fund managers</b><br>11% of the investors          | <b>(4) Business angels</b><br>9% of the investors |
|                     | Low  | <b>(1) Micro investors</b><br><b>62% of the investors</b> | <b>(3) Mentors</b><br>18% of the investors        |

Figure 1. Categorization of informal investors

Table 10. Demographic characteristics of the informal venture capital investors (\*=median)

| Variables                     | Total               | Micro investors<br>N=154 | Fund managers<br>N=28 | Mentors<br>N=45     | Business angels<br>N=22 |
|-------------------------------|---------------------|--------------------------|-----------------------|---------------------|-------------------------|
| Gender(1)                     | 80 % men            | 73 % men                 | 79 % men              | 96 % men            | 96 % men                |
| Age*(2)                       | 47                  | 45.5                     | 52.5                  | 45                  | 47.5                    |
| Education*(3)                 | Some university     | Some university          | University degree     | Some university     | University degree       |
| Entrepreneurial background(4) | 49 %                | 44 %                     | 52 %                  | 60 %                | 59 %                    |
| Wealth*(5)                    | \$ 67 000 – 133 000 | \$ 67 000 – 133 000      | \$ 133 000 – 267 000  | \$ 67 000 – 133 000 | \$ 267 000 – 533 000    |
| <b>Income*(6)</b>             | \$ 67 000 – 100 000 | \$ 33 000 – 67 000       | \$ 67 000 – 100 000   | \$ 67 000 – 100 000 | \$ 100 000 – 133 000    |

- (1) Significant difference between group 1 and groups 3 and 4 on 0.05 level. Significant difference between group 2 and group 3 on 0.05 level.
- (2) Significant difference between group 2 and groups 1 and 3 on 0.05 level.
- (3) Significant difference between group 4 and groups 1, 2 and 3 on 0.05 level.
- (4) Difference not significant.
- (5) Significant difference between group 2 and groups 1 and 3 on 0.05 level. Significant difference between group 4 and groups 1 and 3 on 0.05 level.
- (6) Significant difference between group 1 and groups 3 and 4 on 0.05 level. Significant difference between group 2 and group 4 on 0.05 level.

Table 11. Investment activity and involvement in the company (\*=median)

| Variables                             | Total             | Micro investors<br>N=154 | Fund managers<br>N=28 | Mentors<br>N=45   | Business angels<br>N=22 |
|---------------------------------------|-------------------|--------------------------|-----------------------|-------------------|-------------------------|
| Number of investments(1)              | 2.4               | 1.3                      | 6.4                   | 1.7               | 5.8                     |
| Funds invested(2)                     | \$ 75 000         | \$ 6 000                 | \$ 76 000             | \$ 14 000         | \$ 686 000              |
| Stage of development*(3)              | Early development | Early development        | Start-up              | Early development | Start-up                |
| <b>Involvement in the company*(4)</b> | 27 %              | No                       | No                    | Consultant        | Member of the board     |

- (1) Significant difference between all groups on 0.05 level except group 2 and 4.
- (2) Significant difference between all groups on 0.05 level.
- (3) Significant difference between group 1 and group 4 on 0.05 level.
- (4) Significant difference between group 3 and group 4. Groups 1 and 2 are not active by definition.

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## **WOMEN IN ENTREPRENEURSHIP**

### **PROFILE OF WOMEN ENTREPRENEURS IN A WAR-TORN AREA: CASE STUDY OF NORTHEAST SRI LANKA**

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## **ABSTRACT**

This study examines the demographic profile of 'Tamil' women entrepreneurs in the NorthEast of Sri Lanka who became entrepreneurs as a result of war. Five main areas of interest was examined, namely, i) characteristics of these women entrepreneurs; ii) factors that spurred them into entrepreneurship; iii) their challenges; iv) their measures of success; and v) the demographic profile of these women entrepreneurs. Findings indicate that a large percentage of these women were highly entrepreneurial who were motivated into entrepreneurship to get a better life, be self-reliant and support their families. Many of them went into business only after having lost their husbands at war. Most of these women were married with children and business was seen as a means to an end. These women were educated with a minimum secondary-level education and were involved in businesses such as livestock farming, office services and craft / textile which did not require a high capital outlay and expert skills and knowledge of the business. A large majority of these women were in business for the first time and most of them rated their businesses as successful ventures. Their measures of success were self-fulfilment, and a balance between family and work.

The findings of this research are important for several reasons. The women entrepreneurs of the NorthEast are seen as a powerful driving force for the economic development of the country. However, they lack basic training and development programmes which will be able to transform them into skilful and expert entrepreneurs. Presently, they initiate entrepreneurial ventures based on their own expertise, advice from friends and family, and some aid from their local NGO. INGOs, Donor Agencies and UN Agencies can play a critical role in the upliftment of the socio-economic status of this group of women entrepreneurs.

## INTRODUCTION

The NorthEast of Sri Lanka has been an area that has been ravaged by war for more than two decades now. The war, the result of an ethnic conflict between the Tamils and the Sinhalese of Sri Lanka, has impeded socio-economic development and growth in the NorthEast. Within this region, there has been a sustained struggle for liberation and creation of a separate homeland. The “Tamil Tigers”, as they are more commonly known as, are the defacto government in the NorthEast of Sri Lanka today. After a Ceasefire Agreement that was signed in February 2002, the NorthEast has had the assistance of international non-governmental organisations (INGOs), local non-governmental organisations, donor agencies and foreign government intervention in the socio-economic development of the NorthEast.

Women have played a prominent role in the struggle for liberation as well as for the economic development of the NorthEast region. With a population of approximately 1.8 million, women constitute slightly more than forty percent of the total population. The focus of this study will be on the women entrepreneurs in the NorthEast of Sri Lanka. The women of the NorthEast have been victims of war in different ways. They are often direct victims, being killed, raped or maimed in the process of conflict. There have also been women combatants and the ‘famous’ “suicide bombers” originated from the NorthEast. Women close to armed conflict are often widows, their menfolk having been killed at war. As members of female-headed households, they face an uphill task in fighting to survive and in bringing up their children. It is this category of women that this study will focus on - women who became entrepreneurs as a result of war. There will be five main areas of interest that will be examined: i) characteristics of these women entrepreneurs; ii) factors that spurred them into entrepreneurship; iii) their challenges; iv) their

measures of success; and v) the demographic profile of these women entrepreneurs. The area in focus will be the eight districts in the NorthEast region, namely, the districts of Jaffna, Mullaitivu, Trincomalee, Batticalao, Amparai, Vavuniya, Mannar and Kilinochchi.

## **PROBLEM STATEMENT**

Numerous studies have been undertaken on women entrepreneurs worldwide but none of them have focused on women entrepreneurs in the NorthEast of Sri Lanka. A series of SEED (Small Enterprise Development) working papers by the International Labour Organisation (ILO) has focused on South Asian countries as in Nepal, India, Bangladesh, Pakistan and Sri Lanka, but not on the NorthEast of Sri Lanka. Most studies on Sri Lanka have looked largely at the 'Singhala' women of Sri Lanka and not on the 'Tamil' women of the NorthEast of Sri Lanka. The 'Tamil' women entrepreneurs, a major driving force in the economic development of the NorthEast, is a group of women that has been neglected in past research and needs to be highlighted to attract international aid and assistance for women entrepreneurship development. They are a different breed of women, women who have been subjected to war and women who have come out stronger than most women entrepreneurs in society. This study will highlight this group of women entrepreneurs and present a profile of an undisclosed force.

## **OBJECTIVES**

The objectives of this research will focus on five main areas of interest in drawing out a profile of the Tamil women entrepreneurs of the NorthEast.

- i) The characteristics of these women entrepreneurs will be examined. The “entrepreneurial characteristics” as defined by McClelland (1961), Glennon (1966), Hornaday and Aboud (1971), Timmons (1978), Carland (1984), Yoffie and Bergenstein (1985) and Gartner (1989) will serve as a guideline in determining the entrepreneurial characteristics of these women entrepreneurs.
- ii) The factors that spurred these women into entrepreneurship will be examined.
- iii) Challenges, problems, obstacles faced by these women entrepreneurs will be identified.
- iv) The “measures of success” – how these women entrepreneurs interpret their success will be discussed.
- v) Demographic information about these women entrepreneurs will disclose the profile of these women entrepreneurs in the NorthEast of Sri Lanka

## **REVIEW OF LITERATURE**

Extant literature provides numerous studies that have examined characteristics of female entrepreneurs, motivational factors, success measures, access to capital, and comparisons between male and female entrepreneurs. These studies have focused on female entrepreneurs in developed countries, developing countries and the lesser developed countries. However, none of these studies have focused on female entrepreneurs in war-torn zones. The International Labour Organisation has published a series of working papers on women entrepreneurs and these studies have focused on countries where the ILO has established several programmes to promote women

entrepreneurship development and gender equality as in Africa, Vietnam, Bangladesh, Nepal, Mauritius and Sri Lanka, to name a few. However, the ILO's working paper in Sri Lanka focused on the 'Singhalese' women and not on the 'Tamil' women of the NorthEast. Hence, it can be concluded that there has been no past research on women entrepreneurs in the NorthEast of Sri Lanka.

### **Characteristics of Women Entrepreneurs**

Richardson, Howarth and Finnegan (2004) conducted a study on Women's Enterprise Development (WED) in Ethiopia, Tanzania and Zambia throughout 2002. The WED study confirmed the findings of other research and showed that many women entrepreneurs were motivated by factors and desires very similar to men in starting their own micro and small enterprises – the desire to be self-employed, to be their own boss, to generate an income for themselves and their families, and to utilise skills. The groups of women entrepreneurs in the three countries were shown to have proactively decided to be entrepreneurs, and they were formalising and growing their businesses, rather than being driven by the necessity arising from poverty. In terms of a recent report commissioned by the OECD (Hall, 2003), they were closer to being "growth-oriented women entrepreneurs", rather than "lifestyle" entrepreneurs. Whilst the primary research seemed to show that many of the women's motivations for starting their business were typical of both women's and men's desire for business ownership, differences were seen in women's stated "conditions of start-up." Women entrepreneurs in this WED study and others, refer explicitly to their roles as mothers, wives, daughters, and their need to generate income for the family as important "drivers" for business ownership, whereas other research on men in business shows that men tend to give reasons such as, "to generate income."

An ILO report on the findings of a survey conducted in 2000/2001 on a “Start Your Business” training programme in Vietnam by Barwa (2003) revealed interesting findings on the background information of the Vietnamese women entrepreneurs. Forty percent of the women said that their main reason for starting a business was to supplement an existing family income. Twenty-eight percent said that they had a business idea which prompted them to go into business. The women entrepreneurs were engaged in four main business sectors, that is, trade, agricultural production, manufacturing and service. Many of them were engaged in more than one business activity. As most of the women entrepreneurs owned family-run businesses, 49 percent responded that they employed family members, while only 21 percent employed outsiders on wage employment basis. Nearly 97 percent of the entrepreneurs confirmed that their business performance had improved considerably since their participation in the ‘Start Your Business’ training. Most of them indicated increases in profit, customers and sales.

In studying women entrepreneurs in Bangladesh, Karim’s (2001) report based on desk research and analysis of an earlier ILO study in 1995 found that in general female entrepreneurs in Bangladesh were younger than male entrepreneurs, the average age being 33 years for females, and between 36 and 37 years for males. Most of the female and male entrepreneurs (81 percent) were married. On educational levels, it was found that 42 percent of the female entrepreneurs have less than 10 years of schooling (below the secondary school level), while the corresponding figure of their male counterparts is 56 percent. There were more female entrepreneurs (43 percent) than male entrepreneurs (37 percent) with higher education (secondary school onwards). The study found that the family environment influences the creation of entrepreneurial enterprises. Fifty-eight percent of the women entrepreneurs’ spouses were independent workers,

57 percent of them had self-employed fathers and 88 percent of these women entrepreneurs received support and cooperation from their families. Female entrepreneurs start their business at a slightly earlier age than do male entrepreneurs (27 years for females in rural areas and 28 years for those in urban areas). More than half the female respondents had no previous work experience. The age of the majority of female-headed enterprises (61 percent) ranges between 1 and 5 years. For the majority of the respondents (74 percent), the choice of an enterprise idea results from the natural inclination of respondents, irrespective of education or working experience. The majority of the female entrepreneurs (66 percent) rank desire to supplement family income as the primary reason for starting the enterprise. Preference for earning an income and doing family chores simultaneously ranks second, while pursuing a personal interest or hobby comes third.

Hookingsing and Essoo (2003) in studying female entrepreneurs in Mauritius found that these women were strong willed, showed initiative, were eager to look for avenues of assistance/guidance, and were ready to face challenges, including the somewhat daunting task of going through all the permits procedures in Mauritius. On educational status, 40 percent of the women had a GCE 'O' level and 32 percent had a GCE 'A' level or had studied to a higher level. Overall, 92 percent had secondary-level education and 40 percent had vocational qualifications. It was also found that the younger women were better educated with 81 percent of the women in the age group of 30 to 40 having a GCE 'O' level or higher education. The main reasons cited for starting a business were independence, additional income, the need to be one's own boss, to keep oneself occupied and to have the flexibility to cope with family commitments. The barriers faced

by women entrepreneurs were the hassle of getting permits, the lack of market, the ability to raise capital and not being taken as seriously as men.

A study by Maysami et. al (1999) on female business owners in Singapore revealed that the majority of female entrepreneurs in Singapore had an average age of 41, are mostly married and have an average of two children. Teo (1996) as cited in Maysami (1999) found that most of the female Singaporean business owners had at least 10 years of schooling, while 35 percent held first or postgraduate degrees, 15 percent had professional or polytechnic qualifications and 50 percent had completed secondary-level education. Results from previous studies indicated that prior to setting up their ventures, the majority of female business owners had previous work experience. The majority of these female entrepreneurs were in the service and retail industries. The five major factors which best motivate Singaporean female business owners were: i) the perceived presence of a business opportunity; ii) the desire to put their knowledge and skills into use; iii) the need for freedom and flexibility; iv) the desire to achieve personal growth and recognition; and v) the need to make more money for financial independence (Teo, 1996) as cited in Maysami (1999). Moreover, it was the prospective female owners' own personal decision to start a business in fulfilling their sense of self-worth, and not the influence of family and friends, that inspired them. The most common problems faced by female business owners were lack of a start-up capital, lack of confidence in female business owners' abilities on the part of banks, suppliers, and clients alike, as well as family issues. Factors that Singaporean business women cite as having contributed to their success are product and service qualities, quality of personnel, adequate knowledge of products and services, and customer loyalty.

## **Support Agencies for Women Entrepreneurs**

SEED (Small Enterprise Development, ILO), provides a rich source of materials on women entrepreneurs in Mauritius, Bangladesh, Sri Lanka, Africa and Vietnam. The SEED Working Paper No. 58 (2003) on female entrepreneurship in Mauritius revealed several public sector institutions that were active in supporting small enterprises and entrepreneurship in Mauritius. The Ministry of Women's Rights, Child Development and Family Welfare was aimed at increasing the economic empowerment of women, and the National Women Entrepreneur Council was aimed at creating a strong base of women entrepreneurship culture. In the nineties, the Mauritius Employers' Federation introduced a structured entrepreneurship programme with the support of Management Systems International (MSI), based in Washington. The training programme was aimed at developing entrepreneurs in the country and helping participants improve their management skills and achieve greater success in their enterprises.

The SEED Working Paper No. 14 (2001) on "Jobs, Gender and Small Enterprises in Bangladesh" revealed an aggressive government policy of integrating women into the mainstream of economic development. There were various projects being undertaken to alleviate poverty amongst women who were the poorest of the poor in Bangladesh. Most of these projects targeted poor destitute women and promoted self-employment through income generation activities. There were also a number of United Nations Agencies, Donors, INGOs and NGOs that were engaged in poverty alleviation and women's development programmes in Bangladesh. Prominent among the UN agencies involved are the United Nations Development Programme (UNDP), the International Labour Organisation (ILO), United Nations Fund for Population Activities (UNFPA), the Food and Agriculture Organisation of the United Nations (FAO), the

United Nations Capital Development Fund (UNCDF), the United Nations Children's Fund (UNICEF), and the International Fund for Agriculture Development (IFAD). Prominent donors and financing institutions include the Netherlands, German GTZ, Swedish Sida, Norwegian NORAD, the European Union (EU), USAID, and the Asian Development Bank (ADB). Apart from contributions to self-employment programmes and income-generation activities for poor and destitute persons, USAID and the ILO have been involved in entrepreneurship development at a higher level. USAID has funded the women's entrepreneurship development programmes, and the ILO assisted the Productivity Services Wing of the Bangladesh Employers' Association in providing consultancy training and related services to improve the productivity of small and medium-scale enterprises. The Grameen Bank, almost a household word in Bangladesh, is a success story in rural poverty alleviation, especially among the women, admired around the world. Under the Grameen Bank concept, loans are made available to individuals and groups for self-employment and income-generation activities. A similar concept called the Kalanjiam, a micro-credit system, exists in India.

The ILO-SAAT (International Labour Organisation-South Asia Multidisciplinary Advisory Team) has been engaged in a range of activities to assist women's entrepreneurship development in Bangladesh, India, Nepal, Pakistan and Sri Lanka, all of which are in South Asia, and these programmes have been supported by Swedish Sida, UNDP and the ILO's Regional Office for Asia and the Pacific. As examples of the work undertaken by ILO-SAAT in the 1990s, training materials were developed and field-tested to train trainers in entrepreneurship development for women. Regional Training of Trainers (TOT) programmes were held in Bangalore (India), Chiangmai (Thailand), Colombo (Sri Lanka), Manila (the Philippines) and Kathmandu (Nepal)

at which almost 140 trainers were trained on a specially produced ILO-SAAT manual called GET (Gender + Entrepreneurship Together). The training package – GET Ahead for Women in Enterprise – aims to assist ILO partner organisations in promoting enterprise development among women in poverty who want to start or are already engaged in small-scale business.

In Vietnam, ILO in collaboration with the Vietnam Chamber of Commerce and Industry (VCCI) introduced the Start and Improve Your Business (SIYB) training project (ILO Vietnam Working Paper Series No. 1, 2003). The training project was developed to address the needs for basic business management skills in the micro and small enterprise (MSE) sector and to increase income and employment creation in MSEs. Women who participated in SIYB training reported increases in sales, income and additional money for private spending. The SIYB training offered the women an opportunity to network with other women and to build their confidence. Oxfam-Quebec is a project in Vietnam that has exhibited great commitment in training women entrepreneurs operating at the micro-level, especially women who are engaged in household enterprises.

## **METHODOLOGY**

A survey instrument was developed to capture the information relating to the research objectives. A structured questionnaire was prepared in English and translated into Tamil for the purposes of interviewing the Tamil women entrepreneurs. The resulting questionnaire comprised of five sections. The first section examined entrepreneurial characteristics, the second section looked at factors that stimulated entrepreneurship, the third section identified challenges of

entrepreneurship, the fourth section gathered demographic information and the final section identified measures of success.

A total of 200 women entrepreneurs were randomly selected from the eight districts in the NorthEast. They were all micro-enterprises with less than five employees across a range of businesses. The questionnaires were distributed to the women entrepreneurs and collected after a period of one month. Overall, 139 questionnaires were received at a response rate of 69.5%.

## **SURVEY RESULTS**

The data was analysed based on the five research objectives, that is, i) to identify entrepreneurial characteristics of women entrepreneurs in NorthEast Sri Lanka; ii) to identify factors that stimulated entrepreneurship; iii) to examine challenges of these women entrepreneurs; iv) to draw up a profile of these women entrepreneurs; and v) to determine measures of success used by these women entrepreneurs.

### **Entrepreneurial Characteristics**

Entrepreneurial characteristics as defined by Gartner (1989), Yoffie and Bergenstein (1985), Carland, James W. Hoy, Boulton and Carland, Jo Ann C. (1984), Timmons (1978), Liles (1974), Hornaday and Aboud (1971), Glennon (1966), and McClelland (1961) were examined in the study. The means and standard deviations for the 14 constructs based on entrepreneurial characteristics are shown in Table 1. Mean scores of entrepreneurial characteristics of women entrepreneurs are high in 7 characteristics out of 14 characteristics. This indicates that the women entrepreneurs of the NorthEast are entrepreneurial to a certain extent though not fully.

They scored highly in order of the highest mean score of 1.66 to the lowest mean score of 2.15 in the following characteristics: i) high need for achievement; ii) high level of determination and desire to overcome hurdles and solve problems; iii) high level of confidence; iv) set clear goals for business; v) risk-taking behaviour; vi) opportunity-driven; and vii) profit and growth.

### **Factors That Stimulated Entrepreneurship**

The factors that stimulated entrepreneurship were derived based on the writer's observation after conducting a series of consultancy training sessions with the women entrepreneurs. The means and standard deviations for the 9 constructs based on factors that stimulated entrepreneurship are shown in Table 2. Mean scores of factors that stimulated entrepreneurship in women entrepreneurs were high in 5 of the 9 constructs. This indicates that women entrepreneurs in the NorthEast are motivated into entrepreneurship by the following factors: i) to get a better life; ii) to pursue a business idea; iii) to be self-reliant; iv) to support the family; and v) due to lack of opportunities in the employment sector.

### **Challenges of Women Entrepreneurs**

The term 'challenges' in this study would encompass obstacles, problems, hardships, and limitations faced by the women entrepreneurs, basically socio-economic and political factors. The means and standard deviations for the 6 constructs based on challenges of entrepreneurship are shown in Table 3. Mean scores of challenges of entrepreneurship indicated that the women entrepreneurs in the NorthEast were not challenged by the factors identified in the study. The mean scores very strongly indicated that the challenges were neutral to less important for the women entrepreneurs. Lack of financial support, lack of government support, lack of support

from society, lack of support from family and friends, unstable political environment and lack of knowledge and expertise were not seen as obstacles or problems or hindrances to these women entrepreneurs. This indicates that the women entrepreneurs of the NorthEast were strong willed, determined women who were willing to face the challenges in entrepreneurship to achieve their goals. They were focused on achieving the goals they had set for themselves and pursued their goals against all odds. This is because these were goals that could not be compromised; they were about supporting themselves, their children and their family members. This also indicates that these women entrepreneurs were desperate to survive and make some money from their businesses, hence the challenges did not pose a threat or obstacle to them.

## **Demographic Information**

### **Age of women entrepreneurs**

|          |    |
|----------|----|
| Below 29 | 25 |
| 30 - 39  | 40 |
| 40 - 49  | 44 |
| 50 - 60  | 18 |
| Above 60 | 4  |

The study found that the maximum number of the entrepreneurs (64 percent) were in the age group of 30 to 50, indicating that the women entrepreneurs in the NorthEast went into business only after having lost their husbands at war. They were forced into business to take care of themselves and the family, more so if they had children to support.

### **Marital status of women entrepreneurs:**

|                          |    |
|--------------------------|----|
| Married with children    | 58 |
| Married without children | 7  |
| Single                   | 27 |
| Widow with children      | 37 |
| Widow without children   | 7  |

The results indicated that the majority of the women (43 percent) were married with children, and another 27 percent were widows with children. Overall, 80 percent of the women entrepreneurs were married and 20 percent remained single. However, single women too were involved in entrepreneurship either to support their families or due to unemployment. The NorthEast is a war-ravaged area where employment is very limited. Some women remained single after having being maimed at war, and some avoided marriage and turned to social work as caring for the victims of war, and there is a small percentage that remained single due to fear of losing their spouses at war. This indicates that reasons such as having to take care for themselves, their immediate family, and the children, are some of the main reasons why the women entrepreneurs of the NorthEast went into business.

### **Education of women entrepreneurs**

|                     |    |
|---------------------|----|
| University          | 6  |
| A-Levels            | 26 |
| O-Levels            | 33 |
| Secondary Education | 43 |
| Primary Education   | 17 |
| No Formal Education | 14 |

The results found that 78 percent of the women entrepreneurs had a minimum secondary-level education. Only a small percentage (12 percent) had primary education and 10 percent had no formal education.

Hence, it can be concluded that the larger majority of women entrepreneurs in the NorthEast were educated and literate. This indicates that though a war-torn area, the NorthEast has managed to groom a literate society with provision for schools and colleges.

### **Length of time the woman entrepreneur has been in business**

|                    |    |
|--------------------|----|
| more than 20 years | 21 |
| more than 15 years | 15 |
| more than 10 years | 12 |
| more than 5 years  | 30 |
| 1 to 4 years       | 31 |
| less than 1 year   | 20 |

The results indicated that 60 percent of the women entrepreneurs had been in business for more than 5 years. It has been more than 30 years since the war began in the NorthEast. The women of the NorthEast have been involved in small business activities such as cattle and goat rearing, poultry farming, tailoring, production of spices, provision shops and other small business activities to support themselves and their families due to the hardships of war.

### **Type of business**

|                      |    |
|----------------------|----|
| livestock farming    | 34 |
| office services      | 20 |
| craft / textile      | 17 |
| retail trade         | 15 |
| agriculture          | 14 |
| food product         | 12 |
| manufacturing        | 7  |
| education            | 4  |
| consultancy services | 4  |
| Others               | 5  |

The results showed that the largest percentage (26 percent) of women entrepreneurs were involved in livestock farming. Another 15 percent were involved in office services and 13

percent in craft/textile. This indicates that the women entrepreneurs were involved in businesses which did not require high capital and businesses in which they had prior expertise and experience. These businesses were easy to start with minimum capital requirement and did not require technical knowledge or skills to manage.

**Reasons why the woman entrepreneur chose the business she is in**

|   |    |
|---|----|
| flexible hours  | 82 |
| had the idea for the product or service                       | 33 |
| identified a need in the market                               | 25 |
| had special skills and experience necessary for this business | 70 |
| parents' business   | 36 |

Results indicated that the two main reasons why the women entrepreneurs chose the business they were in were flexible hours and the special skills and experience required for the business that they had.

**Number of employees in the business**

|     |    |
|-----|----|
| 1   | 8  |
| 2   | 10 |
| 3   | 4  |
| 4   | 6  |
| 8   | 1  |
| 9   | 1  |
| 10  | 1  |
| 15  | 1  |
| 16  | 1  |
| 22  | 1  |
| 24  | 1  |
| 30  | 1  |
| 120 | 1  |
| 125 | 1  |

26 percent of the women entrepreneurs had more than 5 employees in their businesses. 74 percent had less than 5 employees in their businesses. This indicates that the women entrepreneurs were involved in businesses that did not require many employees, and businesses which the women entrepreneurs could handle on their own or with their children, as in livestock farming, textile, and office services.

**Is this the first business?**

|     |    |
|-----|----|
| Yes | 92 |
| No  | 26 |

The results indicated that the present business was the first business venture for the larger majority (78 percent) of the women entrepreneurs. This indicates that entrepreneurship is still a very new field to the women of the NorthEast and they are still very new to the idea of “women in business.”

**Previous ventures run by the woman entrepreneur**

|     |     |
|-----|-----|
| 0   | 125 |
| 1   | 5   |
| 2   | 3   |
| 3   | 3   |
| 6   | 1   |
| 8   | 1   |
| 180 | 1   |

The results showed that the majority of the women entrepreneurs (90 percent) were in business for the first time, which reinforces the result of the previous question where most of the entrepreneurs said that this was their first venture.

### **Is the business a success?**

|     |     |
|-----|-----|
| Yes | 111 |
| No  | 15  |

The results showed that most of the women entrepreneurs (88 percent) were very optimistic about their business and believed that their business was a success. This is typical of the people of the NorthEast of Sri Lanka. They are people who have very high self confidence, determination and will power and they have demonstrated this extremely well in their struggle for a liberated homeland.

### **Measures of Success**

This section identified the measures of success as interpreted by the women entrepreneurs; their yardstick for entrepreneurial success.

|                                       |    |
|---------------------------------------|----|
| profit/sale                           | 77 |
| achievement of personal goals         | 51 |
| self-fulfilment                       | 91 |
| a balance between family and work     | 85 |
| growth and expansion of business      | 30 |
| making a difference by helping others | 40 |
| employee satisfaction                 | 51 |
| Social contribution                   | 64 |
| contribution to the economic growth   | 45 |

The results showed that most of the entrepreneurs believed the measures for success for them were either self-fulfilment or a balance between family and work. Another factor that was found to be important was profit and sale. These results were found to be consistent with the findings of the marital status of the women entrepreneurs where they started business ventures to support themselves and their families, and the fact that this is their first and only business venture.

## **DISCUSSION**

The women entrepreneurs of the NorthEast were victims of war. They did not become entrepreneurs out of choice; they became entrepreneurs as a result of war. In their pursuit of supporting themselves and their families, they demonstrated entrepreneurial characteristics and capabilities. They demonstrated high need for achievement, high level of confidence, high level of determination and desire to overcome hurdles and solve problems, and set clear business goals for themselves. These were clearly strong entrepreneurial traits that is required in order to succeed in any business venture and these women entrepreneurs had them. Their strong entrepreneurial characteristics is reflected in their response to the challenges posed to them; they were not deterred by the challenges.

They were prompted into entrepreneurship to get a better life after losing their spouses or breadwinners; to be self-reliant and support their family; to pursue a business idea that they only conceptualised due to the circumstances they were in; and due to lack of opportunities in the employment sector. These women entrepreneurs were not deterred by the numerous challenges they faced because they were desperate to survive and support their families. They were victims

of war who had seen greater challenges during war and entrepreneurship challenges were not an issue compared to the hardships they had undergone due to war.

These women were very confident about the success of their business ventures. For them, success was measured by either self-fulfilment or a balance between family and work. This again reflects their main objective of starting a business venture – to support themselves and their families.

Hence, we find a group of strong willed women entrepreneurs in the NorthEast who act and behave entrepreneurially without even knowing that a term called “entrepreneurship” exists in today’s business world. They are oblivious to their entrepreneurial capabilities and manage their business ventures based on their drive and passion to succeed because failure would mean their children may not be fed and their families may have to go into welfare homes.

These women entrepreneurs were educated middle aged women with families to support. For most of them, this was their first business venture. They were small businesses with less than five employees and were mostly engaged in livestock farming and cottage industries. They went into business mainly because of the flexible hours which they needed to balance between work and family, and also because they already had prior skills and experience required of the business. This meant that they need not have to spend time training or acquiring the necessary skills, they could embark on the business immediately. This was important because they were in business as a matter of survival, though some did mention profit and sale.

Ninety percent of these women entrepreneurs had never managed a business before. Hence, they were managing their business ventures based on trial and error, gut feeling, family support and the occasional training that was given to them by the various INGOs and NGOs in the NorthEast. There is only one active women's organisation in the NorthEast of Sri Lanka involved in helping women entrepreneurs and that is the Centre for Women's Development and Rehabilitation (CWDR). This organisation is aimed at rehabilitating women affected by war and enhancing the quality of life for women in the NorthEast by supporting them in income generation activities. The CWDR is involved in setting up small businesses for women affected by war and also gives out micro-credit financing to these women entrepreneurs.

## **CONCLUSION**

The women entrepreneurs of the NorthEast are an undisclosed 'force'; they are a powerful group of women who have experienced war, if not fought at war, and they were determined to succeed at all costs, in business and in war. They were women who had held a gun and business start-ups and challenges were not a problem or obstacle to them. These women, if trained and developed, could be transformed into dynamic women entrepreneurs. As we are well aware, entrepreneurs can be made and these women entrepreneurs of the NorthEast can be developed to become a strong entrepreneurial force contributing to the economic development of the country. These women can play an important role in the socio-economic development of their country. They can be a major driving force in the rehabilitation and reconstruction of their country that has been ravaged by more than three decades of war.

What these women entrepreneurs need is a structured developmental plan to take them from the basics of entrepreneurship to become skilled and expert entrepreneurs. A structured training and development package such as the ones introduced by the International Labour Organisation in Bangladesh, Vietnam and Mauritius can be introduced to the women entrepreneurs of the NorthEast. These women entrepreneurs who have the confidence and desire to succeed will be very receptive to an entrepreneurial development programme. However, the training programme has to be strategic and structured. In this respect, the International Non-Governmental Organisations (INGOs) can play a more aggressive and participative role in the development of women entrepreneurship in the NorthEast of Sri Lanka. Though it cannot be denied that there is a strong presence of INGOs in the NorthEast, their contribution towards the development of women entrepreneurship is minimal and limited. UN agencies, Donors, INGOs and NGOs can play a more active role in the development of women entrepreneurship in the NorthEast.

The government of the NorthEast can also play a more active role in promoting women entrepreneurship by supporting them in the form of loans, subsidies, overdrafts, micro-credit financing, skills training and entrepreneurship consultancy training. The government can introduce policies which encourage and support women entrepreneurship in the NorthEast. Support agencies to help and assist women entrepreneurs can be set up to ensure the success of women entrepreneurial ventures. The government can include in its strategic plans development plans for women as in vocational training, rural development programmes, establishment of cottage industries production and the creation of facilities for working women and children.

Finally, the society has to be 'educated' to start thinking entrepreneurially. The entrepreneurial mindset must be inculcated at various levels of the social makeup. Entrepreneurship must be seen as a means of enhancing women's life in a holistic way, at a personal level, at the family level, and in the context of the community and society in general.

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Table 1: Entrepreneurial Characteristics

|   | Mean | Std.<br>Deviation |
|---|------|-------------------|
| High need for achievement   | 1.66 | 1.107             |
| Locus of control: believes in personal control and influence                  | 2.55 | 1.660             |
| Risk-taking behaviour   | 2.04 | 1.160             |
| Have created on organization/new venture                                      | 3.12 | 2.050             |
| Principal Purpose is profit & growth  | 2.15 | 1.655             |
| Innovative behaviour  | 2.45 | 1.547             |
| Opportunity-driven (exploit opportunities in rapidly changing environment)    | 2.13 | 1.527             |
| Flexible decision-making system: acting in revolutionary ways                 | 3.04 | 1.767             |
| Hires outside help / expertise / resources of others to help in the business  | 3.00 | 1.615             |
| have a tremendous amount of energy and drive                                  | 2.99 | 1.489             |
| high level of confidence  | 1.99 | 1.590             |
| high level of determination and desire to overcome hurdles and solve problems | 1.92 | 1.136             |
| set clear goals for the business  | 1.99 | 1.620             |
| have a special tolerance for ambiguous situations and uncertainty             | 2.47 | 1.374             |

Note: mean scores based on a five-point scale ranging from 1= most important to 5 = least important.

Table 2: Factors that stimulated Entrepreneurship

|  | Mean | Std. Deviation |
|--|------|----------------|
| Political environment                      | 2.98 | 1.639          |
| Economic conditions                        | 3.46 | 1.481          |
| Encouragement from the government          | 2.82 | 1.656          |
| Encouragement from NGOs                    | 2.87 | 1.760          |
| To get a better life                       | 4.04 | 1.626          |
| To pursue a business idea                  | 3.91 | 1.876          |
| To be self-reliant                         | 3.91 | 1.427          |
| To support the family                      | 4.14 | 1.395          |
| Lack of opportunities in employment sector | 3.79 | 2.069          |

Note: mean scores based on a five-point scale ranging from 1= strongly disagree to 5 = strongly agree.

Table 3: Challenges of Entrepreneurship

|   | Mean | Std. Deviation |
|---|------|----------------|
| Lack of financial support               | 3.22 | 1.789          |
| Lack of government support              | 3.58 | 1.769          |
| Lack of support from society            | 3.25 | 1.703          |
| Lack of support from family and friends | 3.28 | 1.774          |
| Unstable political environment          | 3.37 | 2.005          |
| Lack of knowledge & expertise           | 3.49 | 1.943          |

Note: mean scores based on a five-point scale ranging from 1= most important to 5 = least important.

## **Is the entrepreneurship rate in Germany negatively affected by labor market regulations?**

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### **Abstract**

Many studies provide convincing evidence that highly educated individuals, particularly academics, most successfully start up businesses. Survival rates are higher, growth is faster, and innovation more widespread. However, many talented people do not even consider starting a business, but rather restrict their occupational choice on being an employee. We argue that this reluctance is due to a systematically distorted occupational choice decision. We develop a model of becoming an entrepreneur based on prospect theory, and test its implications with a rich data set covering 5,000 students in and around Cologne, Germany. We regress the willingness to become an entrepreneur on an individual's entrepreneurial competence, institutional knowledge (particularly about labor market flexibility or restrictions), and risk aversion. Our empirical results confirm firstly that individual perception can be explained by institutional knowledge and secondly individual perception determines the affinity to become an entrepreneur. Thereby, a lower probability to become an entrepreneur is determined by a low level of institutional knowledge rather than unfavorable facts within the institutional environment. Thus, academic education aiming to increase entrepreneurship should not only concentrate on analytical tools but have a strong emphasis on institutional details, too. At the same time, less skeptical media coverage on institutional constraints and hurdles might as well boost entrepreneurship because it fosters positive perception.

JEL Classification: M13, J24, M59

*Keywords: academic start-ups, occupational choice, prospect theory.*

## 1 INTRODUCTION

Birch (1987: 1979) and many follow-up studies (Zacharakis/Neck/Bygrave/Cox 2002; Reynolds/Miller/Maki 1995) provide convincing evidence that newly founded companies create more jobs and economic growth than established and big companies. Among the most successful are highly educated entrepreneurs, particularly academics. Survival rates are higher, growth is faster and innovation more widespread (Davidsson/Honig 2003; Moog/Backes-Gellner 2003). However, many talented people do not even consider starting a business, but rather restrict their occupational choice on being an employee. Explanations based on traditional microeconomic theory argue that regulations in general hinder a market efficient solution for start-ups (for market entry) (OECD 1999) because they reduce entrepreneurial flexibility. For Germany, particularly labor market regulations concerning hiring and firing, overtime and short time work, etc. are supposed to have this effect. Academic start-ups as growing companies and often with personnel intensive production are supposedly hindered to grow due to excessive costs of employing and laying off new employees due to a lack of flexibility. Since there are many restrictions to layoffs in Germany it is argued that it is too difficult and expensive for a start-up company to layoff employees in case of economic downturns. Therefore, they not even consider hiring new employees. Furthermore, if new labor market entrants like academics know about such problems with labor market regulations, they are not willing to start a business. In contrast, it is argued that labor market regulations may help to diminish the effects of market failures and externalities and may therefore be a valuable asset for human resources management (Backes-Gellner/Frick/Sadowski 1995), even for or particularly for start-up companies. The consequences of labor market regulations on start-ups are not determined yet (Freeman/Kleiner 1999).

With our study we go even beyond this rather old discussion and argue that the reluctance of academics to start a business is due to a systematically distorted occupational choice decision. We assume that the individual perception of the relevant regulations for a start-up – irrespective whether this perception matches with real regulations – will have its own, direct impact on the individual's occupational choice decision. We argue that especially the gap between perceived and real regulations concerning institutional flexibility has a strong impact on occupational choice. Therefore, a perception of limited freedom of action for human resources decisions has a significant influence on the willingness to become self-employed.

We assume that the effect is particularly strong for one-men (sole proprietors) and small businesses, because this is most likely the situation when subjective evaluations of the owner are decisive. The owner or potential owner use their subjective evaluation of labor market regulations to calculate potential personnel costs resulting from labor market regulations and its perceived inflexibility. An anticipation of inflexibility leads to an anticipation of lower profits and personal income for the potential founder, which in turn affects his occupational choice in a very early stage. So, in accordance with standard economic theory we assume that expected income plays an important role in occupational choice, but in deviation to standard reasoning we argue the alternative to become self-employed is not only determined by factual labor market regulations but is severely distorted by the *perception* of labor market regulations.

A second deviation from standard economic reasoning is that we do not assume risk neutrality for entrepreneurs. Traditionally, an entrepreneur is seen as risk neutral, which means he is indifferent to income volatility. In our second model, entrepreneurs may as well be risk averse. So, we analyze the impact of different degrees on risk aversion on the probability to become an entrepreneur.

In a third model, we challenge a second assumption of traditional economic entrepreneurship theory, i.e. we no longer assume fully rational decision making in occupational choice. So far, traditional economic entrepreneurship research uses expected utility theory (EUT) with fully rational decision makers<sup>1</sup>. However, there is a vast amount of literature with increasingly convincing evidence for bounded rationality in decision making (e.g.: Goette/Huffman/Fehr 2004; Felten 2002; Shleifer 2000; Gigerenzer/Todd 1999; Selten 1990). The traditional EUT ignores limited knowledge, time restrictions and emotions in decision making. We argue, that taking into account individual perceptions of risk and reference points as a means to evaluate the outcome of a decision, is an important development to explain occupational choice of potential employees/entrepreneurs. Therefore, we use prospect theory to explain the probability to become an entrepreneur (see originally Kahneman/Tversky 1979). According to Kahnemann/Tversky we consider firstly, subjective probability weighting depending on individual knowledge and secondly, that individuals evaluate gains and losses subject to a reference point.<sup>2</sup> Based on these assumptions we will analyze the effect of entrepreneurial competence and the effect of individual income reference points on the probability to become an entrepreneur.

The paper is structured as follows. In chapter 2.1 we present a basic decision tree of the occupational choice decision of a labor market entrant. In the following three chapters we present firstly, a simple rational choice model with a risk neutral potential entrepreneur, secondly with a risk avers decision maker, and thirdly, a prospect theoretical model with decision-makers with bounded rationality. In chapter 3 we specify three alternative empirical models to test the theoretical implications with a rich data set covering more than 5,000 students in and around Cologne, Germany. Finally, we summarize our results and draw first conclusions for entrepreneurship theory and policy.

## 2 OCCUPATIONAL CHOICE AND THE PERCEPTION OF LABOR MARKET FLEXIBILITY

### 2.1 The model - basic assumptions

In the next section we assume that every individual has the choice to become self-employed or not  $\{s,e\}$ , with  $s$  determining the occupational status of being self-employed and  $e$  working as an employee (cf. figure 1). There are two types of decision maker  $j$ : one who perceives labor market regulations to be flexible (*type f*) and the other who perceives them to be inflexible (*type i*). So, *type f* assumes that labor market regulations are not hindering efficient employment adjustments, whereas *type i* anticipates restrictions to employment adjustments. Entrepreneurs of the latter type expect limited flexibility when running their business employees of *type i* expect lower fluctuation and thus stable employment relations. Expected incomes of both decision makers as either entrepreneur or employee are given in figure 1.

Figure 1 about here

When labor market entrants decide on their occupational choice, wages of future employees are assumed to be known and fixed at a certain level. In contrast, entrepreneurial income is assumed

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<sup>1</sup> Following von Neumann/Morgenstern (1947) or Savage (1954).

<sup>2</sup> People tend to evaluate outcomes as gains and losses relative to a reference point (Moore/Cain 2004).

to vary substantially. The distribution of entrepreneurial income  $S$  is assumed to be known. Standard deviation or range may reach quite high levels. However, to keep matters simple, we assume a symmetric distribution.<sup>3</sup> Entrepreneurial income is determined by developments in the respective market. Here we distinguish between three situations:

a) Steady state. In this scenario the market develops steadily along a stable trend. An entrepreneur can easily foresee the labor volume at any given time he or she will recruit the number of employees that is needed for an efficient production and there will be no need to adjust staffing plans. Entrepreneurial income that is generated under this scenario is  $s_j^b$ .

b) Market underperformance due to not predictable future events. Those events lead to a diminishing demand and the need to downsize. This market situation will lead to a lower entrepreneurial income  $s_j^a$ , which is assumed to be even lower than employee income  $w$ .

c) Market overperformance. Demand booms far more than expectable and labor volume is much higher than planned. An entrepreneur can either hire additional personnel or have people work overtime, but very likely at additional cost. Overperforming markets are in general assumed to lead to higher entrepreneurial income  $s_j^c$ , although profit might not increase as much as sales due to excessive expansion costs resulting from inflexible institutional arrangements. However, we assume entrepreneurial income in overperforming markets always to be higher than in stable or underperforming markets. So,  $s_j^a < w_j < s_j^c$ .

Entrepreneurial profit or income is sales minus cost. So, depending on labor intensity of production, entrepreneurial income is more or less influenced by employment costs. Producing at suboptimal employment levels diminishes entrepreneurial income.

If markets perform worse than expected (case a), it is in the entrepreneurs' interest to reduce their employment level instantly. If this is not possible or at high adjustment costs only, profits are negatively affected. Therefore, *type i* entrepreneurs expect lower flexibility and higher adjustment costs than *type f* entrepreneurs. Accordingly, *type i* entrepreneurs anticipate lower entrepreneurial income than *type f* entrepreneurs due to suboptimal employment levels or high adjustment costs, so  $s_f^a > s_i^a$ .

In contrast, in a stable market situation (case b), the entrepreneur has no need to deviate from his planned employment levels. So both kinds of decision makers, *type f* and *type i*, expect similar costs because there are no unforeseeable adjustment costs. Therefore, entrepreneurial income is assumed to be identical: so  $s_f^b = s_i^b$ .

If markets perform better than expected (case c), entrepreneurs need to increase their employment level more than planned. In such a situation *type i* entrepreneurs will hire employees more carefully or more slowly than *type f* entrepreneurs because of their perception of inflexible labor market regulations: *Type i* entrepreneurs fear the costs of having to lay off those employees in case markets adjust downwards again. Therefore, *type i* may temporarily produce below the optimal employment level, for example by using overtime with overtime premia in order to produce on a higher level. In contrast, *type f* entrepreneurs will adjust their employment level instantly to any market situation. Therefore, they always work at an optimal employment level

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<sup>3</sup> We thereby ignore studies that give reasons to assume that entrepreneurial income is not symmetric. Lazear (2004) e.g. concludes that entrepreneurial income should be skewed.

and thereby expect to generate higher profits (and entrepreneurial income) than *type i* entrepreneurs. So  $s_f^c > s_i^c$ .

On top of the aforementioned effects, the perception of labor market regulations and particularly the flexibility to adjust employment levels also exerts an effect on the expected income of the different types of employees  $w_f$  and  $w_i$ . On one side, *Type i* assumes a stable employer-employee relation due to his perception of strong labor market regulations and low flexibility. Therefore, employee income  $w_i$  is considered to be riskless. On the other side, *type f* anticipates frequent layoffs and fluctuation. Therefore, *type f* employees do not consider income to be fully downward rigid, which leads to lower expected incomes for *type f* than for *type i*. So:  $w_f < w_i$ . Now we analyze how these assumptions on income etc. affect a risk neutral decision maker.

## 2.2 Risk neutral decision makers: perceptions of labor regulations and their impact on occupational choice

A risk neutral individual decides on his occupational choice based on expected income  $E(s_j)$ . Expected entrepreneurial income is  $E(s_j) = qs_j^a + ps_j^b + qs_j^c$ . Expected employee income is  $w_j$ . So the decision to become entrepreneur or employee is taken according to the following rule:

If  $qs_j^a + ps_j^b + qs_j^c < w_j$  with  $j \in \{i, f\}$  the individual decides to become employee.

If  $qs_j^a + ps_j^b + qs_j^c \geq w_j$  with  $j \in \{i, f\}$  the individual decides to become entrepreneur.

If expected entrepreneurial income is higher than expected employee income, an individual prefers to be self-employed. If we apply this decision rule to the two different types of individuals *i* and *f*, we obtain the following results for occupational choice.

If we compare decisions of *type f* and *type i*, we see that a decision maker of *type f* who perceives labor market regulations to be more flexible, is more likely to become self-employed for two reasons: Firstly, in case of an under- or outperforming market, anticipated entrepreneurial income of *type f* is higher, i.e.  $E(s_f) > E(s_i)$ . Secondly, *type f* as an employee anticipates higher fluctuations than *type i*, so expected employee income of *type f* is lower wage than expected income of *type i*, i.e.  $w_f < w_i$ . Both effects result in a higher probability of *f type* decision makers to become entrepreneurs. So we obtain a first hypothesis.

*Hypothesis 1:*

*Individuals who perceive labor market regulations to be restrictive have a lower probability to become self-employed than individuals who perceive labor market regulations to be flexible.*

So, whenever costs of obtaining full information on labor regulations are high (e.g. due to a large number of a vast variety of regulations) entrepreneurship rates are low independent of de jure and de facto flexibility. It's perceptions that matter.

## 2.3 Risk avers decision makers: entrepreneurs as innovators rather than risk takers

In a second step, differences of the decision maker in the attitude towards risk are integrated in our model. In standard economic theory employees are assumed to be risk avers and entrepreneurs to be risk neutral. We assume that even entrepreneurs may be risk averse. From Knight's point of view the constitutional characteristic of an entrepreneur is to take and to deal with risk generated by capital restrictions. So the entrepreneur is assumed to be risk neutral.

However, Schumpeter separates the entrepreneur (identifying opportunities to barter, trade, or innovate) from the individual(s) supplying capital; the first is generating innovation etc, the latter is taking the financial risk. Accordingly, the entrepreneur may as well be risk averse and can still run a business.

To analyze the effect of risk aversion on occupational choice, we have to deal with the expected utility of an individual. We compare the decision situation of a risk neutral and a risk averse individual. The general rule of occupational choice can then be modeled as follows:

$$EU(s_j) = qu_r(s_j^a) + pu_r(s_j^b) + qu_r(s_j^c) \geq u_r(w_j) \implies \text{entrepreneur}$$

$$EU(s_j) = qu_r(s_j^a) + pu_r(s_j^b) + qu_r(s_j^c) < u_r(w_j) \implies \text{employee} \quad \text{with } j \in \{i, f\}$$

$u_r$  is a Bernoulli utility function with a constant, absolute degree of risk aversion with  $u_r' > 0, u_r'' < 0$ . Since being self-employed is associated with substantial risk (associated with situations a to c), a risk averse decision maker expects a positive risk premium if he is to become an entrepreneur. The risk premium increases the more risk averse the individual is.

*Hypothesis 2: The higher is the degree of risk aversion, the lower is the probability of becoming an entrepreneur.*

At the same time it can be shown that the general pattern of hypothesis 1 does not change. *Type f* individuals are more likely to become entrepreneurs than *type i* individuals. But the decision of *type i* individuals is more heavily influenced by the degree of risk aversion than decisions of *type f*. This results out of two aspects: a) *Type i* expects a lower entrepreneurial income and a higher wage than *type f*. b) The variance of the expected entrepreneurial income is higher for *type i*.

## 2.4 Decision-makers and bounded rationality: occupational choice and prospect theory

Based on prospect theory developed by Kahneman/Tversky (1979) we analyze the influence of systematic deviations from rational decision making on occupational choice. First, Kahneman/Tversky (1979) have provided extensive evidence of departures from the prediction of expected utility theory. Unlike EUT assumes, individuals' estimates of probabilities are systematically biased, i.e. they use an individual decision weight function. Second, individual's perceptions are attuned to the evaluation of changes rather than to the evaluation of absolute magnitudes. Previous experiences define a reference point. Decision outcomes are evaluated in relation to this reference point and decision-makers appear to be more adverse to losses, relative to their reference point, than attracted by gains of the same size (Kahneman/Tversky 1979).<sup>4</sup>

The *decision-weight function*  $g_\gamma$  is a transformation of the objective probabilities  $p$  and  $q$ . The function is monotonically increasing, with discontinuities at 0 and 1. It systematically overweighs small probabilities and underweighs large probabilities (Moore/Cain 2004). The extent to which objective probabilities are over- or underestimated is assumed to depend on the level of competence of the decision maker, which is specified with the following function.

$$g_\gamma(p) = \frac{p^\gamma}{(p^\gamma + (1-p)^\gamma)^{1/\gamma}} \quad \text{with } \gamma = f(\text{competence}), 0 < \gamma \leq 1.$$

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<sup>4</sup> The idea that the carriers of utility are changes of wealth rather than asset positions is a cornerstone of prospect theory (Kahneman/Tversky 1979).

The more competent a person is, the less distorted is the decision-weight function and the higher the level of *incompetence*, the higher is the bias in this function. Thereby, an individual's occupational choice decision is systematically distorted depending on his or her competence level. So, based on prospect theory we expect that the decision to become an entrepreneur is systematically distorted depending on the competence level  $\gamma$  of the decision maker. Occupational choice can thus be modelled as follows:

$$P(s_j) = g_\gamma(q)u(s_j^a) + g_\gamma(p)u(s_j^b) + g_\gamma(q)u_r(s_j^c) \geq (g_\gamma(q) + g_\gamma(p) + g_\gamma(q))u(w_j)$$

⟹ entrepreneur

$$P(s_j) = g_\gamma(q)u(s_j^a) + g_\gamma(p)u(s_j^b) + g_\gamma(q)u_r(s_j^c) < (g_\gamma(q) + g_\gamma(p) + g_\gamma(q))u(w_j)$$

⟹ employee

How does this affect the probability to become an entrepreneur given the above mentioned decision tree? According to our assumptions entrepreneurs are faced with a symmetric function of market situation. Steady market trends are most likely and over- or underperforming markets are less likely. So, the mass of the probability function is concentrated around a steady market development ( $s_j^b$ ) which has a probability of  $p_b$ , which is higher than that of ( $s_j^a$ ) and ( $s_j^c$ ), so  $p_b > p_a, p_c$ . If individual competence is high, the individual's subjective probability distribution ( $g_\gamma$ ) hardly differs from this objective probability distribution. In contrast, if an individual's competence is low, the subjective probability distribution is heavily distorted. According to the assumptions of prospect theory, small probabilities are overweighted, so the probability of ( $s_j^a$ ) and ( $s_j^c$ ) is overweighted. At the same time the remaining probability of a stable market development ( $s_j^b$ ) is underweighted. An incompetent decision maker will weigh the smaller probabilities ( $q$ ) of over- or underperforming markets higher than a competent decision maker. In contrast, he will underweigh the high probability ( $p$ ) of stable market developments. The incompetent decision maker redistributes probability mass from the stable market situation to the over- or underperforming market situation. Thus, the incompetent decision maker "gains" by overweighting excess profits ( $dc$ ), but at the same time he "loses" more by overweighting unexpected losses ( $da$ ). As long as the utility function is concave, the "loss" due to incompetence  $da$  exceeds the "gain" due to incompetence  $dc$ .

To illustrate the effect on occupational choice we distinguish between two kinds of decision makers (cf. table 1): a perfectly competent decision maker who uses the objective probabilities to calculate his prospects, and an incompetent decision maker who weighs the probabilities with the function ( $g_\gamma$ ).

Table 1 about here

Thus, an incompetent decision maker will always get lower prospects from being an entrepreneur than a competent one. This leads us to a third hypothesis regarding the probability to become an entrepreneur:

*Hypothesis 3a: All else being equal, incompetent decision makers are less likely to become entrepreneurs than competent decision makers. The more competent a decision maker is, the higher is the probability to become an entrepreneur.*

Secondly, the assumption that individuals evaluate risky prospects on the basis of changes relative to some reference point, they become risk averse towards gains and risk loving towards losses. They value large gains less than proportional and large losses less than proportional, which is in line with (experimental) evidence (Kahneman/Tversky 1979). So we introduce a reference point into our occupational choice model, assuming that previous income may be the reference point for occupational choice.

*Hypothesis 3b: All else being equal, decision makers having higher previous income should be more likely to become an entrepreneur than decision makers with lower previous income (because the first ones value losses less severe).*

### **3 DATA, MEASUREMENT ISSUES, METHOD AND EMPIRICAL RESULTS**

We test our hypotheses with our own database (Cologne Founder Study<sup>5</sup>). It is a very rich data set, which was gathered to analyze the potential of academic start-ups. The dataset is a sample of students from five universities in the metropolitan area of Cologne. It contains of 3,806 students. The data were collected with a standardized questionnaire sent out by mail in 1998/99. The questionnaire includes more than 300 variables. For every student we have data about their perception of different labor market regulations and expected market conditions. Moreover, we have information on formal education and work experience (employed and self-employed), which partly determines their competence level. We have information on their willingness to become entrepreneur as opposed to becoming an employee. Furthermore, we have a big number of objective and subjective indicators concerning personal attitudes, like importance of job characteristics, valuation of entrepreneurs in society, or intention of studying.

*Measurement of the dependent variable: probability of becoming an entrepreneur*

The dependent variable we use is the “willingness of a student to become self-employed”. Since students usually have not finally taken their occupational decision while still studying, and therefore neither entrepreneur nor employee, we can only take their “willingness to become an entrepreneur”. However, as many empirical studies have shown, actual entrepreneurs are a subsample of the so called nascent entrepreneurs. So someone who never thought about becoming an entrepreneur is almost certain to become an employee, and someone who considers becoming an entrepreneur in an early stage of his occupational choice will become an entrepreneur with a positive non trivial probability (z.B. Franke/Lüthje 2002; König/Meder/Schulz 1999; Hinz 1999; Welter/von Rosenblatt 1998). So our results can be interpreted like an upper bound of the probability to become an entrepreneur.

Our dependent variable “willingness to become entrepreneur” is a discrete variable ranging from -4 (low willingness to become entrepreneur) to +4 (high willingness to become entrepreneur). It is calculated based on several likert scaled occupational preference items and therefore treated as

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<sup>5</sup> The students database is, next to another company database, part of a project supported by the German Research Foundation (DFG) in the context of “interdisciplinary start-up research”. We express our thanks to the Deutsche Ausgleichsbank (DtA), the Sparkasse Köln and the City of Cologne for their financial support. For more information about the project and the survey see Backes-Gellner/Demirer/Moog (2000).

quasi-metric (Peel/Goode/Moutinho 1998). As the distribution of the variable is also close to a normal distribution (table 2), we use OLS to test our empirical implications.

|                    |
|--------------------|
| Table 2 about here |
|--------------------|

35 % of all students in all five universities have a strong interest in becoming an employee (-4 to -2). Only 17 % of the students have a strong willingness to become an entrepreneur (+2 to +4). Most of the students (46 %) are still more or less indifferent.

#### *Measurement of independent variables*

In the next section we specify three empirical models to analyze the willingness to become an entrepreneur. The three empirical models follow the three alternative theoretical assumptions and models given in chapter 2. The independent variables we use are driven by the variables discussed in the respective chapters and are summarized in table 3. In addition to the explanatory variables derived from our theoretical models, we use a number of standard control variables, such as gender, numbers of semester studied, faculty enrolled in, importance of ideas, importance of fame/reputation or the actual financial status.

This leads us to the following three empirical models.

|                    |
|--------------------|
| Table 3 about here |
|--------------------|

#### *Model 1:*

$$\text{Willingness to become an entrepreneur} = \beta_0 + \beta_1 \text{flexlaw} + \beta_2 \text{flexreg} + \text{control variables} + \varepsilon$$

First, we test the influence of the perception of labor market regulations. We differentiate between the perceived (in)flexibility due to labor law ( $\beta_1$ ) and the perceived (in)flexibility due to collective bargained regulations ( $\beta_2$ ). The higher the coefficient is, the higher is perceived flexibility. So, according to hypothesis 1 we expect  $\beta_1$  and  $\beta_2$  to be positive, because a higher labor market flexibility should lead to a higher willingness to become an entrepreneur.

#### *Model 2:*

$$\text{Willingness to become an entrepreneur} =$$

$$\beta_0 + \beta_1 \text{flexlaw} + \beta_2 \text{flexreg} + \beta_3 \text{riskavers} + \beta_4 \text{promotion} + \text{control variables} + \varepsilon$$

Model 2 is an extension of model 1 and adds variables covering the degree of risk aversion of the decision maker. A first variable we use, is the importance of a foreseeable future income ( $\beta_3$ ). We assume that a student is more risk averse, the more important it is for him or her, that his future income is foreseeable (not subject to irregular changes). So, we expect  $\beta_3$  to be negative because the more risk averse a person is, the less likely he or she is to become an entrepreneur. A second variable we use is the importance of foreseeable promotions ( $\beta_4$ ). Here we also expect a negative coefficient because again, the more important it is that the career is foreseeable, the higher is risk aversion and the lower is the probability to become an entrepreneur.

#### *Model 3:*

$$\text{Willingness to become an entrepreneur} = \beta_0 + \beta_1 \text{flexlaw} + \beta_2 \text{flexreg} + \beta_3 \text{riskavers} + \beta_4 \text{promotion} + \beta_5 \text{friend} + \beta_6 \text{parents} + \beta_7 \text{self-employed} + \beta_8 \text{freelancer} + \beta_9 \text{apprentice} + \beta_{10} \text{internship} + \beta_{11} \text{employee} + \beta_{12} \text{infointens} + \beta_{13} \text{actfinstat} + \text{control variables} + \varepsilon$$

In the third model, we include a set of variables to operationalize the competence level. In general we assume that people who have a broader information base have a higher competence level when forecasting potential market developments. Firstly, we use a set of variables about the *entrepreneurial spirit in the social surrounding* of a student, because we assume that students who are in contact with people who are entrepreneurs implicitly learn from them how to evaluate their market. We ask whether the student has a friend who started a business or whether their parents work as entrepreneurs. Secondly, we use variables representing a student's *work experience in an entrepreneurial context*. We ask whether they have any experience as an entrepreneur or whether they have been working as a freelancer, which is quite similar to being an entrepreneur. Thirdly, we use general work experience as an indicator for the level of *general business related competence*. Here we asked whether they ever went through an apprenticeship, worked as an intern or as an employee. We assume, if students have more experience in practical work and real business experience they have a higher competence level to assess potential opportunities as well as problems and market conditions in general. So, the more general the students work experience is, the higher is their willingness to become self-employed. A fourth variable to measure the competence level, is the intensity of economic information intake. We assume, the higher is the number of news-media students use for economic information, the higher their competence and thereby, the higher their willingness to become an entrepreneur. *Control variables*: In addition to the explanatory variables, we use a number of control variables which are common in occupational choice studies. These are e.g. the importance of realizing ones own ideas, dummy variables for field of study and sex, or number of years studied.

Table 4 summarizes the results of OLS regressions. Results for model 1 clearly indicate that entrepreneurship is determined by individual perception of labor market flexibility (labor law and collective agreements). Both variables are significantly positive, i.e. the higher is perceived flexibility, the higher is the willingness to become an entrepreneur. The perception of the (in)flexibility due to collective agreements has a stronger influence than that of labor law. The second model shows that the willingness to become entrepreneur is affected by an individual's degree of risk aversion. The higher the risk aversion the less pronounced is the willingness. The impact of foreseeable income is stronger than the importance of promotion. The two additional variables in the regression model do not lower the significance of the flexibility variables. So, the perception of labor market regulations remains significant. The fit of model 2 is better. This indicates that the degree of risk aversion is important for the entrepreneurial choice.

Table 4 about here

Model 3 provides mixed results. Firstly, entrepreneurial experience, general knowledge, work experience, and entrepreneurial competence in the social surrounding are positively correlated with the willingness to become an entrepreneur. Surprisingly, entrepreneurial parents have no significant effect. The intensity of economic information intake has a significant positive influence on start-up willingness. Students who use more news media to stay informed have a higher willingness to become entrepreneurs than students who are less well informed. Having

personally experienced being an entrepreneur in the past significantly increases the willingness in the future. Working as a freelancer has no effect, as well as having finished an apprenticeship. Looking at working experience as an employee, we find a significant negative effect on becoming an entrepreneur. However, the competence gained by participating in an internship significantly increases the willingness. This might be caused by the fact that internships are generally located in higher hierarchical level than students working as regular employees. The actual financial status as a reference point has the expected positive effect. The variables from model 1 and 2 remain important. The influence of the perception of flexibility of collective agreements becomes stronger, the perception of labor law becomes insignificant. The degree of risk aversion measured by importance of foreseeable income remains significantly negative. Overall, the use of our competence variables in the regression increases the fit of our model. It explains 32 % of the variance in the willingness to become an entrepreneur.

#### 4 CONCLUSION

The aim of this paper was to analyze theoretically and empirically the decision to become an entrepreneur, and particularly to see whether prospect theory helps to better explain this occupational decision. We start with a traditional decision model of occupational choice, we then introduce varying degrees of risk aversion into our model, and finally we use the concept of weight probability distribution from prospect theory to explain occupational choice. Based on these models we expected the willingness to become entrepreneur to be higher if labor market regulations are perceived to be more flexible, if individual risk aversion is lower and if general entrepreneurial competence is higher and the reference income is higher. All implications are borne out in the data. Particularly, we find positive effects of a more positive perception of labor market flexibility (independent of real facts) and of a higher business and entrepreneurial competence level. Therefore, we firstly conclude that not only de jure or de facto regulations matter, but even more so media coverage of labor market flexibility. Public opinions driven by media affect individual perception of flexibility and thereby the willingness to think of becoming an entrepreneur. Due to bad news many students may be withheld from considering becoming an entrepreneur in a very early stage. Since individual perception of flexibility concerning regulations has one of the strongest impacts on occupational choice, media coverage on this subject is probably very important for the entrepreneurship rate in a country. Secondly, since we find that higher competence levels have a positive effect on the willingness to become entrepreneur, the amount at which real facts on labor market regulations and market developments is taught, might be important for the entrepreneurship rate. Higher competence of students to evaluate market opportunities and risks realistically is also a major factor increasing the willingness to start a business. So if a university wants to increase its entrepreneurship potential, teaching market competences by case studies, guest lecturers and business plan competitions are likely to increase the willingness to consider entrepreneurship as a realistic occupation alternative. As regards the explanatory strength of different theories, we find prospect theory to be very powerful since it introduces the degree of competence about a subject or decision area as an important variable. Competence determines the deviation of the individual decision-weight function from the objective probabilities and thereby the prospect of being self-employed strongly.



**Table 4: Results of the OLS regressions**

| Dependent Variable: Willingness to become entrepreneur | Model 1            | Model 2            | Model 3           |
|--|--------------------|--------------------|-------------------|
| Perception of flexibility (labour law)                 | .065**             | .055*              | -.01              |
| Perception of flexibility (collect. agreements)        | .081**             | .065**             | .215***           |
| Importance of foreseeable income                       |                    | -.18***            | -.19*             |
| Importance of foreseeable promotion                    |                    | -.09**             | -.110             |
| Entrepreneur among friends                             |                    |                    | .192**            |
| Entrepreneur among parents                             |                    |                    | .101              |
| Experience as entrepreneur                             |                    |                    | .134*             |
| Experience as freelancer                               |                    |                    | -.035             |
| Experience from apprenticeship                         |                    |                    | .127              |
| Experience as intern                                   |                    |                    | .156**            |
| Experience as employee                                 |                    |                    | -.160**           |
| Intensity of economic information intake               |                    |                    | .14*              |
| Actual financial status                                | -.085**            | -.08**             | .181**            |
| Expected salary-difference (income-wage)               | .078**             | .086**             | .036              |
| Importance of ideas                                    | .35***             | .33***             | .207**            |
| Importance of fame                                     | .02                | .06*               | .042              |
| Dummy 1 : Humanities                                   | .052               | .045               | .276***           |
| Dummy 2: Social and political studies                  | -.06*              | -.06*              | -.027             |
| Dummy 3: Mathematics and natural sciences              | .05                | .051               | .245***           |
| Dummy 4: Art and music                                 | .06*               | .047               | -.120*            |
| Dummy 5: Technical sciences                            | -.05               | -.025              | -.024             |
| Dummy 6: Sports  | -.006              | .001               | -.056             |
| Male dummy   | .079**             | .074**             | .190**            |
| Number of semesters studied                            | .038               | .019               | -.067             |
| Intention of studys                                    | .051               | .056*              | .057              |
| Corrected R <sup>2</sup><br>(F-Statistics)             | .170<br>(11.63***) | .212<br>(13.31***) | .321<br>(3.94***) |

\*, \*\*, \*\*\*significant on a 10 % , 5 % or 1 % level.

Source: Own data.

**The impact on growth from public seed-financing to  
new technology projects in small enterprises**

Lars Bager-Sjögren\*

Hans Lööf\*\*

**Abstract**

In Sweden, NUTEK (the national board for technical and business development at that time) being one of the main actors, supplied conditional loans between 1994 and 2004 to new technical project mainly pursued in small business. In this study we analyze the development of the firms supported 1994 to 1997. We compare the population of supported firms with a population of firms not funded by NUTEK but with the same age, size and business sector affiliation.

This study differs from other studies in having longitudinal annual report data for both populations of supported and not supported enterprises between 1990 and 2003. The main result from the analysis of survivors is that the support to new technical project has had no effect when considering all supported firms. Also in sub-populations as only independent firms and independent firms within the manufacturing sector, no positive additionality emerged.

For new and independent firms, established between the years 1994-1997 there are increases in sales, increases in employment, increases in productivity and increases in solidity were all larger for the supported firms than the comparison group of non-supported firms. There is thus evidence that public support for technical projects may have societal positive effects but only for a limited population of firms, the newly started and independent ones.

## **Introduction**

One common policy tool stimulating innovation is the supply of public seed financing support to new technology projects. In for example the USA the SBIR program is targeted to this (Wessner 2000, Lerner 1999, Wallsten 2000) In Sweden authorities like National Board for Technology Development (STU) in the 1970ties and 1980ties and its later incarnation The National Board for Economic and Technologic Development (NUTEK) has supplied a similar type of support. The reason for this is the alleged importance of new technology in economic growth and that new technology seems to be more likely to be introduced in new enterprises mainly because these are not affected by sunk costs from earlier technology investments (Oakey 199?). The "valley of death" debate (Wessner ibid) has underlined the need for seed financing support to especially new technical small firms which is the character of the programs mentioned above. This paper is written with the background that in Sweden no comprehensive quantitative evaluation of such programs has taken place. Process evaluations and surveys on participators have been made but no scrutinization of the alleged growth contributions of the seed financing programs has actually been performed. This paper is a start of such an endeavor by making an analyze using only administrative data on annual report. The papers outline is as follows: first we briefly present the NUTEK seed financing program. Secondly we define main variables of interests and discuss the dilemma of evaluation and how we in this study try to coop with that. In the third section we present the results and make some conclusions about the limitations of the results and paths for further research.

### **The NUTEK program for seed financing of new technical projects**

The National Board for Economic and Technologic Development (NUTEK) in Sweden and its predecessor National Board for Technology Development (STU) has since the end of 1960ties supplied conditional loans for product development projects.

The general aim with this support was to finance development of products and processes based on the application of new technology with large commercial growth potentials.

It is to be noted that the support is supplied not to firms but to projects or ideas which can equally be hosted in an already established enterprise as in a newly started one. The support has mainly been in the kind of conditional loans but also grants has been supplied but in a lesser degree and amount (Table 1). A conditional loan in the NUTEK form is a loan which must be paid back if the project generates a commercial application which in turn generates sales. In order to receive support the enterprise must finance at least half of the estimated project budget. The loan might be distributed in sequences in order to insure that the project progress according to plan. The amortization payment of the loan starts if the project generates incomes. The payment of interest can be capitalized and postponed up to five years. According to the Swedish venture capital Association these kinds of loans among venture capitalist are considered more like equity increase than debts. However it must be noted that in contrast to equity which earn its rate of return conditional on performance i.e. profits generated the conditional loans of NUTEK must be reimbursed on positive sales although break even is not reached. In this respect the conditional loans put a harder pressure on the company to enforce the commercialization process.

There is a backdoor for enterprises not having enough means to amortize if according to plan and that is to change the loan to a royalty agreement.

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*Table 1 about here*

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Table 1 depicts number of loans distributed in the period of 1994 to 2003. In total 498 conditional loans amounting to almost SEK 400 million (approx \$50 million) was supplied to technical projects. In table two the distribution on supplied seed money exhibits that on average this amounted to SEK 340 000 (\$50 000).

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*(Table 2 about here)*

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In this paper we will focus on conditional loans supplied between the years 1994-1997. The reason for this is to have a reasonable time for success to emerge. In public programs notorious references are frequent about success in a distant future. A relevant question posed is: What is the distribution for projects with both new technology relevance and high commercialization potential? In this paper we are inspired by two sources to set a success time frame. The first is the experience of venture capital investments which on average has a time frame between three to seven years. However considering that these projects are in the very early phase where venture capitalists in lesser degree do investments we also consider the results from an earlier evaluation of the repayment of conditional loans. Reitberger (1982) analyzing such repayment in form supplied conditional loans in the 1970 concludes that if a project has not generated income after five years it must be considered a failure. Another interesting factual from Reitberger (1982) as the estimation of success ratio as the proportion project actually realized a reimbursement of loan. For small enterprises this proportion was 5 percent or one company out of twenty.

The general problem to analyze effect of project success is economic data on project level. In Sweden there is no such database, so one has to resort to assumptions regarding the influence the project have on the total of enterprise performance. For small firms it might be a reasonable assumption and especially for new, small firms the assumption that the project dominates the enterprises economy and performance seems realistic.

### **Variables of interest, data and method of analysis**

Commercial success is undoubtedly to generate profits. However in order to generate profits you have to generate sales. Thus a relevant success criterion must be data on sales.

Considering that we actually study project in a early stage sales might not be the first "success". The project success actually lies in pushing the concept to commercialize forward

in order to make more reliable for private equity investment. A success indicator in the short perspective might be the change in the solidity measured as the ratio of equity to total capital.

Besides these economic measures we also focus on employment and productivity, two concepts referred to indicate societal utility besides private enterprise utility.

In previous research which utilizes sample survey methods it is common to try to collect data on other variables than just economic ones. Table 3 lists some of these. However these studies put forward other questions than we are interested in here. Mainly the investigates if there are certain structural factors which correlates with enterprise success. Storey (1994) concludes that these factors might be appealing but seldom explains much of the observed variance in enterprise economic performance.

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*(Table 3 about here)*

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In this study we will focus only on economic performance and have collected annual report data in order to have well defined and well measured variables. These variables have been checked by professional accountants and tax authorities and are probably the best kind of measures available today. The population of enterprises is incorporated companies. The NUTEK supported enterprises industrial code classification and age of establishment has been governing the construction of the relevant control group. Thus all enterprises with the same age and industry classification at the most detailed level are included in the database. For both groups supported (treatment group) and not supported (non-treated) we have annual report data from 1990 to 2003 in the case the enterprise has existed for the full period. In this paper we only utilize part of the material.

### **Hypotheses in this investigation**

The main issue for this study was to whether NTSBF, defined as participators in the NUTEK seed financing program in a seven years perspective exhibits increased growth in four

traditional measures as: sales, productivity, employment and solidity. The general hypothesis is that the “treated firms” are expected to exhibit higher growth than the comparison group. In estimating these measures it must be underlined the importance to consider extreme values. In ordinary measurement of central tendencies the recommendation is to down weight the effect of outliers and extreme values especially if the distributions measured are not symmetric. However albeit that the general case is skewed distributions in almost all economic phenomena dealing with effects of innovative behaviour one has to change focus and explicit observe and include the extreme values into the analysis. Considering that successful innovations are an infrequent event the advantage of population analyses that is considering the full total population of firms is if not a necessity a distinct advantage. Thus the estimated growth in the selected economic measures is the population averages. In brief this analysis differs from others in the same area in the following respects:

- Only administrative data or register data
- Whole population both for the treated group of firms and non-treated included in analyses. No sampling errors and full coverage.

We also have information if firms also been treated in two other similar public financial support schemes

### **The evaluation dilemma**

The evaluation dilemma consists of not having information about the same unit of analysis in two different statuses at the same time. An enterprise can not be supported with public means at the same time as not having been supported. Thus a before-after analysis might be a relevant approach on the individual level if one can make reliable that the surrounding and co-founding factors will be the same before and after or that these can be controlled for. In dynamic processes like technical development a before-after analysis can meet the objections of not being realistic.

The statistical solution to the evaluation dilemma resides in moving from the individual to the level of population (Holland 1986). This consists of the estimation of a characteristic in a population receiving support and then comparing this estimate with an the same characteristic estimated in a relevant group of controls not having support. However, solving one problem turns often into another. Now the problem lies in how to create the relevant control group and convince others about this relevance.

The main problem analyzing program effects is thus the problem of creating a relevant counterfactual. In part we solve this by instead of using a random sample strategy have population data in this respect we do not exclude relevant observations. However the problem of possible self selection bias influencing the estimates of additionality must be addressed. According to Heckman et al (1997) there are four sources of biases in estimation of program effects. First, bias can stem from the use of different definitions in the objectives of interest between treated firm and non-treated firms. Second, bias can emanate from differences in economic environment between the two groups of firms. Third, bias might occur due to different distribution in confounding variables, differences in observables. Finally and fourth, bias can be generated as self-selection bias which is differences in distribution of un-observable characteristics (for an outside observer) in the two groups of firms. Building upon annual report data regulated by both international standards and legislation and having population coverage on these we find it reasonable to assume that that the first and second sources of bias are reduced to a minimum. Our general strategy in order to minimize bias from the other two sources of bias is to focus on changes in the objective variables. The so called difference in difference estimator (DiD) has been considered as one of the most robust estimators in the literature on matching estimators (Todd & Smith (2001), Meuser, P., R., Troske, K., R., & Gorislavsky, A. (2004)). This estimator compares differences between supported firms and the identified comparison group. Bias generated by static properties in

supported firms not present in non-supported firms is differenced away and will thus not influence our estimates of growth. In this paper however we will only report estimates of simple differences in a future more elaborated paper we will also make conditional DID-estimation for matched observations.

## **Results**

In Table 4 for we start the analyses with investigating if there are differences in the survival rate of the enterprises. We only report results for independent enterprises. In our data we also have information if the enterprise has been acquired by another enterprise in the time period of interest; however the incidence of such mergers or acquisitions is very rare and not included in this analysis. We see that there are indication of higher survival rate at the year 1997 for the firms which received support between 1994 and 1997 in comparison to the comparison group of non-supported firms. For the sub-group of only new firms which are defined as being established between the year 1994 and 1997, the survival ratio for 2003 for supported firms are much lower than for the comparison group. This might indicate a problem with relevance of the comparison group in the respect that these in to large extent are dominated by firms without pursuing risky technical projects.

Although these are population means in order to make conclusions one has to relate these two groups to some kind of super population. One reasonable suggestion to such a super population is future enterprises entering the market in these industries. We thus might consider our data as sample from the population of both present and future enterprises. In this case the conventional statistical test becomes relevant. The t-tests for differences in survival rates are not statistically significant neither 1997 nor 2003.

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Table 4 about here

Turning to the main results in this paper still focusing on independent enterprises table 5 presents difference-in-difference estimates for the time period of 1997 up to 2003. The

principal result is that considering all enterprises and only enterprises in manufacturing sector actually the comparison perform better than the NUTEK supported firms. However for new established firms (bottom panel) there are positive "effects" while evaluating the differences. However comparing the levels of 2003 for the measured variables we find that the comparison group lies ahead. This might also be an indication of that the sub comparison group is as stated above dominated by firms not pursuing risky technical projects with innovative implications.

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Table 5 about here

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Now an indication of risk might be that only few enterprises succeed and most of them fail albeit generate some income. In the distributions of Sales this could be indicated by highly skewed distribution in the non-treated group with high kurtosis. In table 6 we present the full statistical distribution for the levels of Sales 1997 and 2003. These indicate that the comparison group characterized by larger skewness and kurtosis.

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Table 6 about here

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One speculative conclusion is that administrative selection process at NUTEK might not have been that adventurous as daring to select the project prone to be most innovative and contiguous, this might be a support for the argument put forward by Wallsten (1997).

## **Conclusions**

The preceding analysis strength lies primarily in the availability of population data. The main weaknesses are two. The alleged control group might not consist of enterprises pursuing technical projects similar to the group of supported firms. Only more expensive surveys will have an opportunity to handle this problem succinctly. A possible way to go is to merge patent data records on our data. Thus patents as an indicator of on-going project would probably

single out a more relevant control group. The second problem lies in the small number in the treatment group. Although the treatment group is the grand total of firms supported in the time period the must be considered as a sample of a super population of future supported firms. Such a small sample considered here can only be looked upon as a first indicator on problems in the analysis however this sample grows for each year and in another year or so we will have at least twice the number permitting to more elaborated analysis and perhaps conclusions.

Making conclusions on such indicators might be premature, however the indicators seems to align to other empirical results showing that new ideas in new firms is a more sensible approach for a innovation policy than spreading out public means to all “new” project. Established firms do have a record of performance and should attract the necessary means by this merit without the need for public finance. A final comment deserves the time for evaluation. To evaluate a program at a certain time like 2003 as in this paper is most certainly not adequate as the sole judgment of the program. Contingencies typical for economic development might play a role. A program should at least be evaluated for different time frames. For example one could consider 3-years moving averages in order to sort contingencies out.

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Table 1 NUTEK Seed financing program 1994-2003

|                            | 94-96 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | Total |
|----------------------------|-------|------|------|------|------|------|------|------|-------|
| Applications               | 197   | 216  | 152  | 187  | 185  | 180  | 104  | 81   | 1302  |
| Approvals                  | 92    | 142  | 91   | 118  | 114  | 95   | 50   | 46   | 748   |
| "Denials"                  | 105   | 74   | 61   | 69   | 71   | 85   | 54   | 35   | 554   |
| Acc loan number            |       |      |      |      |      |      |      |      |       |
| 95-03                      | 92    | 234  | 325  | 443  | 557  | 402  | 452  | 498  | 498   |
| Amount of conditional loan |       |      |      |      |      |      |      |      |       |
| SEK million                | 48.9  | 45.9 | 58.3 | 85.2 | 51.9 | 73   | 13.5 | 19.8 | 396.5 |
| Grants, SEK million        | 3.4   | 4.6  | 2.5  | 5.1  | 13.7 | 3.6  | 9.3  | 3.5  | 45.7  |
| Total                      | 52.3  | 50.5 | 60.8 | 90.3 | 65.6 | 76.6 | 22.8 | 23.3 | 442.2 |

Source NUTEK Annual reports

Table 2 Distribution of support as conditional loans, current values

| Min percentiles, max mean & std | Total per project |
|---------------------------------|-------------------|
| Minimum                         | 8000              |
| 10%                             | 50 000            |
| 25% (1:a quartile)              | 131 031           |
| 50% (median)                    | 340 000           |
| 75% (3:e quartile)              | 821 650           |
| Maximum                         | 15 000 000        |
| Mean                            | 689 417           |
| Standard deviation              | 1 090 273         |
| Total number of cases           | 749               |

Source ITPS

Table 3 Other common factors used to explain success

| Factors   | Referens                      |
|---|-------------------------------|
| Motivation, eagerness to pursue an idea   | Utterback & Reitberger (1982) |
| Education   | Storey (1994)                 |
| More than one founder, a proxy for the possible representation of larger network and broader skills in top management | Storey (1994)                 |
| Middleage entrepreneur (35-55)  | Utterback&Reitberger (1982)   |
| Newly established enterprise  | Storey (1994)                 |
| New products  | Storey (1994)                 |
| Experience from earlier employment in MNC (spin-off)  | Storey (1994)                 |
| Family business background  | Lindholm Dahlstrand (2004)    |
| Management willing to let in external capital   | Storey (1994)                 |
| Limited corporation   | Storey (1994)                 |
| The ability to explain (sell) the product versatility   | Storey (1994)                 |
|   | Utterback & Reiberger (1995)  |

Table 4 Survivors 1997 and 2003, proportions

|                 | All independent enterprises |       | Independent and new enterprises |       |
|-----------------|-----------------------------|-------|---------------------------------|-------|
|                 | mean                        | std   | mean                            | std   |
| <b>1997</b>     |                             |       |                                 |       |
| Non treated     | 0.791                       | 0.002 | 0.774                           | 0.004 |
| Treated         | 0.813                       | 0.027 | 0.754                           | 0.054 |
| p>t H(0)diff~=0 | 0.422                       |       | 0.703                           |       |
| <b>2003</b>     |                             |       |                                 |       |
| Non treated     | 0.570                       | 0.003 | 0.526                           | 0.005 |
| Treated         | 0.547                       | 0.038 | 0.429                           | 0.071 |
| p>t H(0)diff~=0 | 0.555                       |       | 0.174                           |       |

Source: ITPS

Table 5 Results Population means Did estimation (values in SEK \$1=SEK7)

| <i>All independent enterprises</i>                        | NUTEK firm | Comparison group | DID-estimate |
|---|------------|------------------|--------------|
| <i>Differences</i>  |            |                  |              |
| Sales   | 2 465 613  | 3 446 162        | -980 549     |
| Employees   | 2          | 1                | 1            |
| Productivity  | 192 823    | 152 444          | 40 379       |
| Solidity  | 14         | 10               | 3            |
| <i>Levels 2003</i>  |            |                  |              |
| Sales   | 6 059 379  | 7 719 665        | -1 660 286   |
| Number of employees                                       | 6          | 5                | 1            |
| Productivity  | 521 613    | 551 129          | -29 516      |
| Solidity  | 38         | 50               | -12          |
| N   | 100        | 21 700           |              |
| <i>Independent manufacturing firms</i>                    |            |                  |              |
| <i>Differences</i>  |            |                  |              |
| Sales   | 3 485 791  | 7 104 164        | -3 618 373   |
| Employees   | 3          | 3                | 0            |
| Productivity  | 62 403     | 90 488           | -28 085      |
| Solidity  | 3          | 10               | -7           |
| <i>Levels 2003</i>  |            |                  |              |
| Sales   | 5 644 464  | 12 300 000       | -6 655 536   |
| Number of employees                                       | 6          | 9                | 0            |
| Productivity  | 394 892    | 470 397          | -3           |
| Solidity  | 29         | 47               | -75 505      |
| N   | 23         | 3000             |              |
| <i>Independent older firms (more than 3 years of age)</i> |            |                  |              |
| <i>Differences</i>  |            |                  |              |
| Sales   | 983 248    | 2 997 920        | -2 014 672   |
| Employees   | 1          | 1                | 0            |
| Productivity  | 169 528    | 152 357          | 17 171       |
| Solidity  | 11         | 11               | 0            |
| <i>Levels 2003</i>  |            |                  |              |
| Sales   | 5 713 040  | 7 468 802        | -1 755 762   |
| Number of employees                                       | 6          | 5                | 1            |
| Productivity  | 547 642    | 542 320          | 5 322        |
| Solidity  | 36         | 50               | -14          |
| N   | 75         | 16 700           |              |
| <i>New firms (up to three years of age)</i>               |            |                  |              |
| <i>Differences</i>  |            |                  |              |
| Sales   | 6 912 708  | 5 045 938        | 1 866 770    |
| Employees   | 6          | 2                | 4            |
| Productivity  | 259 214    | 152 773          | 106 441      |
| Solidity  | 23         | 10               | 13           |
| <i>Levels 2003</i>  |            |                  |              |
| Sales   | 7 554 547  | 8 537 776        | -983 229     |
| Number of employees                                       | 7          | 5                | 2            |
| Productivity  | 447 431    | 580 073          | -132 642     |
| Solidity  | 43         | 49               | -6           |
| N   | 25         | 5 000            |              |

Table 6 Character of the Distribution of sales estimates (values in SEK)

| <i>All independent</i> | <i>non-treated</i> |          | <i>treated</i> |          |
|------------------------|--------------------|----------|----------------|----------|
|                        | 1997               | 2003     | 1997           | 2003     |
| min                    | 0                  | 1000     | 0              | 6000     |
| 1%                     | 0                  | 5000     | 0              | 6000     |
| 5%                     | 49960              | 36000    | 37171          | 28000    |
| 10%                    | 159138             | 101000   | 245631         | 80000    |
| 25%                    | 512721             | 418000   | 758000         | 562000   |
| 50%                    | 1229611            | 1257000  | 2311422        | 2187000  |
| 75%                    | 3466263            | 4197000  | 7040000        | 8091000  |
| 90%                    | 9726324            | 13400000 | 15300000       | 17900000 |
| 95%                    | 18700000           | 26700000 | 24000000       | 25800000 |
| 99%                    | 59700000           | 92700000 | 44400000       | 34300000 |
| max                    | 9.61E+08           | 1.86E+09 | 4.44E+07       | 3.43E+07 |
| n                      | 17100              |          | 75             |          |
| mean                   | 5161754            | 7586492  | 5544631        | 5713040  |
| std                    | 2.38E+07           | 4.30E+07 | 8411816        | 7961854  |
| skewness               | 22.78              | 24.23    | 2.74           | 1.97     |
| kurtosis               | 719.58             | 783.12   | 11.35          | 6.43     |

| <i>New and independent</i> | <i>non-treated</i> |           | <i>treated</i> |          |
|----------------------------|--------------------|-----------|----------------|----------|
|                            | 1997               | 2003      | 1997           | 2003     |
| min                        | 0                  | 1000      | 19000          | 2000     |
| 1%                         | 0                  | 4000      | 19000          | 2000     |
| 5%                         | 41250              | 28000     | 33471          | 8000     |
| 10%                        | 129653             | 91000     | 159341         | 11000    |
| 25%                        | 427026             | 411000    | 226785         | 432000   |
| 50%                        | 1025628            | 1290000   | 845000         | 1735000  |
| 75%                        | 2584603            | 4645000   | 2802960        | 5660000  |
| 90%                        | 7515906            | 14800000  | 4359929        | 18500000 |
| 95%                        | 14500000           | 31900000  | 4874460        | 28000000 |
| 99%                        | 61300000           | 108000000 | 5072000        | 81900000 |
| max                        | 3.89E+08           | 1.89E+09  | 5.07E+06       | 8.19E+07 |
| n                          | 5285               |           | 25             |          |
| mean                       | 4124465            | 8621975   | 1627211        | 7554547  |
| std                        | 1.58E+07           | 4.68E+07  | 1.68E+06       | 1.69E+07 |
| skewness                   | 13.35              | 22.67     | 0.83           | 3.68     |
| kurtosis                   | 242.68             | 705.52    | 2.36           | 16.46    |

Note \$1=SEK7

Source: ITPS

# **TRANSNATIONAL FAMILY NETWORKS AND ETHNIC MINORITY BUSINESS DEVELOPMENT: THE CASE OF THE UK VIETNAMESE NAIL SHOP**

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## **ABSTRACT**

It is generally acknowledged that social and family networks have an important influence on business development, particularly in the context of ethnic minority entrepreneurship. However the networks of refugee entrepreneurs have received scant attention in the literature. This study explores the role that transnational networks play in the start-up and operation of UK Vietnamese nail shops in London. The research involved in-depth, face-to-face interviews with 10 owner-managers, and 4 key informants. The analysis draws on concepts of “strong” and “weak” network ties (Granovetter, 1973) and “mixed embeddedness” to explain why the Vietnamese continue to enter such a competitive sector. The results highlight the importance of transnational family networks within all aspects of the business and suggest that in general an over-reliance on these “strong-ties” inhibits “break-out”. Networks, which include better educated, and/or innovative family members, could however, be important in encouraging diversification. This suggests that there is a need to support Vietnamese entrepreneurs in developing more diverse networks as a means of encouraging business diversification. Trusted community members with links to the wider community are essential for brokering these links.

Keywords: entrepreneurship; Vietnamese; networks; “break-out”

## **INTRODUCTION**

Social and business networks are generally thought to be good for the economy and policy has frequently sought to “implant a culture of competitiveness through co-operation (Huggins 1998:814). Networks are seen as a ‘resource’ through which small business managers gain access to important social and cultural resources, information and capital (Birley 1985, Aldrich and Zimmer 1986, Curran and Blackburn 1991) and research has confirmed the importance of personal networks for company performance (Ostgaard and Birley 1996). So vital is networking thought to be that Business Link, the UK’s nationwide agency for business support has recently been promoting ‘Speed Networking’ events, in which businesses can “meet a new business contact every three minutes allowing you to really explore the diverse nature of the many businesses present and make the right business connections”. Whilst a recent study for the UK government’s Small Business Service has further emphasised the importance of networks and recommended that business advisers would benefit from a greater understanding of them. (Blundel and Smith 2002)

In the case of ethnic minority firms Ram (1993) notes that it is the ‘family and the ‘community’ which lie at the heart of ethnic firms social networks. Family and community resources have been shown to be important to the establishment, development and ‘competitive advantage’ of ethnic minority businesses (EMBs). With globalisation there is an increasing tendency for families to be widely dispersed, and this has led to an increasing number of EMBs with a transnational economic organisation and networks. However, research in this area has tended to focus on larger and more established communities such as the Chinese, and those who have migrated out of choice or chosen to operate as transnationals (Li 1998, Tseung 2002). The role transnational networks play in the development of micro businesses run by smaller, ethnic groups, and in particular refugee entrepreneurs, has been largely neglected in the literature. Similarly, few researchers have explored the role of the family in the networks of those starting a business (Greve and Salaff 2003).

A particular concern with respect to ethnic minority enterprises in the UK is their continuing concentration in a few, generally lower order sectors (Ram and Jones 1998). The concern of policy makers and enterprise support programmes has been to encourage such businesses and new entrepreneurs from these communities to “break-out” of traditional sectors and diversify or move into higher order areas where markets are not so competitive. This paper is concerned with the role that networks play in this process.

The paper focuses on the UK Vietnamese business community, a relatively new group of ethnic minority entrepreneurs who have only been establishing businesses in significant numbers during the last 5 years. The nail shop sector is chosen to provide a case study of a new type of ethnic minority business that is emerging in the UK, which unlike traditional EMBs is not based on serving the local ethnic niche market, and which has developed as a result of economic restructuring, and with the support of transnational family networks. The Vietnamese have owned nail shops in the US for over 10 years, having taken over businesses from the Koreans, but it is only during the last 3-4 years that a sizeable number have been established in the UK. As the fastest growing UK Vietnamese business sector it now accounts for over half of all Vietnamese businesses in London (Bagwell et al 2003). The paper explores how family networks, both within the UK and abroad, influence business ideas, and the start-up, operation and development of the business. It draws on theories of social capital and mixed embeddedness to explain why the Vietnamese continue to enter such a competitive market. The paper focuses on two key issues:

- How do Vietnamese businesses in the nailshop sector make use of their networks?
- What role might these networks play in facilitating or hindering break-out?

It argues that by developing a better understanding of the role networks play in ethnic minority business development policy makers and enterprise support agencies will be better able to develop interventions which are more likely to encourage ‘break-out’, and it concludes by making some suggestions regarding the shape these interventions should take.

## **SOCIAL NETWORKS AND SOCIAL CAPITAL**

Networks can be described as referring to the relationship between the firm or the individual and the myriad of links with organisations and other individuals in the wider environment. Networks have been studied at the firm level, for example, business clusters and industrial districts, and the level of the individual entrepreneur. Networks may also be formal, defined as intentionally formed groups of companies, generally operating in close proximity to each other (Kingsley and Malecki, 2004) or consist of an informal collection of organisations and individuals who have an interest in or links with the firm and/or its owner.

The network approach to entrepreneurship is based on the hypothesis that founders use their personal network of private and business contacts to acquire resources and information they would not (or not as cheaply) be able to acquire on markets (Witt 2004). Several studies have highlighted the importance of networks to business development (Witt 2004). For example Davidsson and Honig (2003) found that nascent entrepreneurs who were members of a business network such as a Chamber of Commerce were more likely to have more rapid start-up.

Social or personal networks, defined as being made up of the family, friends and personal contacts of the entrepreneur have also been found to have an important influence on the business by providing access to resources not available internally. (Ostgaard and Birley 1996). These personal networks are important not only for providing information and access to important physical and financial resources, but also for accessing human and social capital. (Johannisson (2000). The central proposition in the social capital literature is that networks of relationships constitute, or lead to resources that can be used for the good of the individual or the collective. (Dakhli and de Clercq 2004).

However not all network ties will be of equal value to the entrepreneur. Granovetter (1973) developed a model of strong and weak ties within the network. Family and friends are defined as strong ties, which were seen as being reliable, but not able to offer such reliable information as weak ties. Ultimately friends and family are likely to hold similar views, beliefs and problems solving techniques. In contrast Granovetter (1973:1367) claims that weak ties act as “bridges” to information sources not necessarily contained within an entrepreneur’s immediate (strong-tie) network. Thus dependence on family members may restrict the network from which the entrepreneur seeks a wide range of complementary resources when planning or establishing a business (Greve and Salaff 2003). Whilst a network of loosely coupled acquaintance offering skills, knowledge and insights will reduce the importance of family members (Renzulli et al 2000)

## **FAMILY NETWORKS AND ETHNIC MINORITY ENTERPRISE**

Social and family networks have been found to be particularly important to ethnic minority enterprises. (Light et al, 1993; Waldinger, 1995). These networks enable the ethnic minority entrepreneur to draw on unique cultural resources or social capital not generally available to the mainstream, including cheap family labour, pooled savings and access to trusted networks which facilitate trade and provide access to information, thus providing a particular competitive

advantage (Coleman, 1988). These informal networks have also been found to be important as a means of mobilising resources and generating sales (Fadahunsi et al 2000)

However research has also suggested that an over-reliance on the family and co-ethnic community can be a constraint on business development (Flap et al 2000). In a study of a number of different BME groups in north London (Bieler, 2000) found that whilst social capital provided some advantages, it could also be limiting as the co-ethnic group is not necessarily the best source of information, and the social constraints of the community could inhibit break-out. Groups with the strongest co-ethnic ties tend to be weakly connected with outside agencies thus missing out on the information and support such agencies could provide.

Similarly cross cultural-studies suggest that certain cultures tend to be characterised by networks with stronger ties than others. In nations with a highly collectivist perspective strong tie networks are likely to be based exclusively on kinship and friendship ties (Drakopoulou and Patra 2002:12). Whilst these tight knit networks offer benefits of resource leverage and strong levels of support and trust their lack of diversity limits access to information and advice and can inhibit innovation (Tiessen, 1977). Differences in the networking behaviour of entrepreneurs from different countries have also been found, with entrepreneurs from more collectivist family orientated cultures such as Greece tending to spend longer on maintaining their strong-tie network (Drakopoulou and Patra, 2002)

## **TRANSNATIONAL NETWORKS AND ENTERPRISES**

Most network studies have assumed that networks are based on relationships with those in close proximity, but as Light and Gold (2000) note the transnational social ties of migrant families can play an important role in shaping ethnic economic arrangements. Links to family members overseas provide resources for importing or exporting goods and/or capital, and networks bring in workers with needed skills as well as those willing to accept low-level jobs. "Transnationals can be very innovative, introducing new products and ways of doing business in countries of origin and settlement" (Light and Gold 2000:152). Globalisation, and in particular the availability of cheaper air travel, long-distance telephone, fax and electronic mail has led to an increasing number of EMBs with a transnational economic organisation and networks. Transnational businesses have been defined as those with locations in more than one country and the transmigration of the owner in order to operate it (Wong and Ng (2002).

The Chinese are frequently cited as an example of an ethnic group with strong global networks in which shared ethnic, linguistic and cultural ties underpin the development of transnational economic links (Douw and Huang 2000, Tseng 2002). For example Wong and Nga (2002) describe the transnational actors of small Chinese firms in Canada who rely on the extended family networks of Chinese families straddling different societies. Sometimes one member of the family runs the operation of the business in Canada whilst another spends several months of the year overseeing operations in China. However, research in this area has tended to focus on larger and more established communities such as the Chinese, and on economic migrants rather than refugees.

## **BREAK-OUT AND MIXED EMBEDDEDNESS**

Whilst family networks have been shown to play an important role in the operation of EMBs others have argued that an over emphasis on ethnic resources can mask the influence of the external political and economic environment (Barrett et al 2001, Ram 1993). Racism and lack of alternative sources of employment it is argued account for the greater propensity for many ethnic groups to enter self-employment and their concentration in a few key sectors of the economy. Recent theories have advocated a more interactive framework of “mixed embeddedness” in which the internal ethnic resources and cultural milieu of the ethnic entrepreneur interact with the external influences of the wider economic and institutional environment (Kloosterman, 1999). In the case of the UK Vietnamese, their history of migration as refugees, their skills and experience, and the economic context in the UK determined the job and business opportunities that were available to them. Whilst cultural influences such as strong collectivist and family values interact with the former to influence business practice. Thus whilst the focus of this paper is on the role family networks play in business start-up and development an attempt is also made to understand the wider context which also contributes to the business entry decision.

## **METHODOLOGY**

The methodology involved a mixture of qualitative methods, including in-depth, face-to-face interviews with 8 nail shops owner managers, a former nail shop owner now running a Japanese restaurant, and the main Vietnamese nail shop supplier in London. Interviews were also held with a Vietnamese business advisor and three key informants from the Vietnamese community in order to obtain an overview of the Vietnamese business community as a whole and the key issues (cultural and structural) facing it. The interviews with the owner managers took place in the nail shops, enabling observations of the business to be made.

There is no general database of Vietnamese businesses in the UK, however an earlier mapping study of Vietnamese businesses in London conducted by the author (Bagwell et al, 2003) provided the population from which the individual business interviews were selected. The sample was designed to be broadly representative of the geographical distribution of nail shops in London.

Two Vietnamese-speaking research assistants helped with the recruitment of business participants and enabled the interviews to be conducted in Vietnamese where necessary or preferred by the owner manager. They and their contacts in the community provided vital access to the businesses, which would have otherwise been difficult to secure. The interviews concentrated on the key stages of business development: start-up, operation and development of the business, and who had provided support and information at each stage. The interviews were taped and transcripts were analysed for emergent themes.

## RESEARCH FINDINGS

### Networks and Support for Start-up

It is important to place the business entry decision within the context of the wider economic environment in which the Vietnamese community were operating. Many of the older nail shop owners arrived as refugees in the 1980s, with few skills or qualifications relevant to the UK job market. Most came from rural areas in North Vietnam and had little prior experience of business, in contrast to the US Vietnamese who tended to be from the more business orientated South. They eventually found work in the clothing sector, a major source of employment for the Vietnamese community in London until its demise in the mid 1990s. As work in this sector diminished alternative sources of employment were sought. The success of the Vietnamese in the nail care sector in the United States, where the fashion for manicures and false nails was already well established, provided the inspiration. The willingness of the Vietnamese to work long hours for low wages, and the use of a faster more automated process, enabled them to provide the service quicker and cheaper than traditional beauty parlours, thereby making it affordable to a much larger customer base. A further attraction of the nail sector was its low entry costs. Basic equipment and supplies can be brought for about £7,000, an amount that is relatively easy to raise from within the extended family. A special 'start-up kit' for new nail shop owners, together with advice on licensing requirements, which was available from the supplier, also facilitated start-up. It is not surprising therefore that so many Vietnamese perceived nail shops as being an attractive business proposition.

Three of the businesses interviewed – the supplier, one nail shop owner and the former nail shop owner had learnt the trade working in the US, and had run businesses there for some time before spotting the market opportunity in the UK and bringing the business idea over. As the niece of the nail shop owners explained,

“My aunt and uncle used to live in California and it was them that set up this business. They had two over there but she got homesick and they came back and set up here. ... I manage it. They are back and forth all the time.”

These two businesses were the early pioneers who displayed many of the characteristics of transnational businesses. They maintained strong family and economic ties in more than one country, which they relied on for running various aspects of the business. They travelled regularly during the course of their business and tended to be more open to new ideas.

The other businesses interviewed, having observed the success of these early pioneers decided to copy them. The availability of relatives already running nail shops in the US meant that they could learn the trade in salons there before returning to start-up their own business in the UK. The following scenario was fairly typical.

“Nearly 5 years ago I went there to see my family over there. I've got a cousin there and I heard about nails over there and I stayed there for a year and went to college, I was there for about a month. After that I worked in a salon over there to get experience.”

With this group the presence of relatives in the US provided a useful source of training at the start-up phase, and one or two went back to learn new techniques once their business was established, but the family networks of these businesses tended not to incorporate economic arrangements in the same way as those operating on a more transnational basis.

With the increasing number of nail shops being set up in London later entrants to the market were able to learn the trade from friends and family running nail shops in the capital rather than travelling to the US.

As research with other ethnic groups has found (Fadahunsi, 2000; Ram and Smallborne, 2003), the Vietnamese tend to rely on their own social and trusted community networks for business advice in preference to mainstream business advice agencies. With a couple of notable exceptions, which are discussed later, advice for start-up was mainly obtained from family or friends working in the sector or the Vietnamese nail shop supplier. The latter played a pivotal role providing advice on licensing arrangements, new designs, and brokering on the job training arrangements with existing businesses for those wanting to enter the industry. He claimed to have 900 Vietnamese customers who had all found him through word of mouth – demonstrating the strength of the community network. The interviews confirmed the importance of informal networks based on tight-knit family and community ties. There are no Vietnamese business associations, and none of the businesses belonged to Chambers of Commerce or other business associations. The long hours worked by the businesses, often 10-12 hours a day, 7 days a week, coupled with a lack of trust of outsiders, meant that there was little spare time or inclination for developing new contacts outside their existing network.

### **Employing Staff**

Family networks tended to be used initially for staffing the business and a number of nail shops had sponsored various members of their family to come over from Vietnam to work for them. One owner explained that his staff were:

“All family members, cousins, nieces, nephews. .. I want to offer the opportunities to members of the family first. If there is still vacancies I would offer it to other people. ..There is an obligation to do it. I have a responsibility to find them work” (male nail shop owner).

This sense of responsibility towards the family is deeply embedded within Vietnamese culture and has been shown to still have a strong influence on the business practice of younger, UK educated business managers (Bagwell 2004). Thus a reciprocal arrangement operated within the family network in which businesses could obtain cheap loyal labour, and employees obtain work that they might have found difficult to secure elsewhere. However the strength of these network ties sometimes prevented the family members involved in the business from entering more profitable business or employment areas. It was often easier and less risky to stay employed in the family business than start up on your own. The manager of one business, a 29 year old woman, who was the owner’s niece, and who had grown up and been educated in the UK, explained the dilemma she was in.

“... people have asked me to go and work for them or set up on my own...European as well. But because it’s family I have to be quite loyal to them. They’d probably feel

betrayed if I left them. Because it's family you are inclined to put 110% into what you are doing. If everything comes down to you, you sort out all the problems and sort out all the paperwork, but I'm quite lucky in that I have a stable job where I know the people, you are quite flexible if you need time off."

Where family members were not available or had moved on to establish other nail shops, local community networks provided a source of employees. As one nail shop owner explained:

Interviewee: It's all Vietnamese people, they get together in one place and they know each other

Interviewer: Where do they get together?

Interviewee: In a restaurant or in a bar or a pub. There is one famous pub in Mare St, full of Vietnamese people

Interviewer: So that's how word of mouth gets around?

Interviewee: Yes and you get employees from that

Most employees worked on a part-time self-employed basis handing over a commission from their earnings to the nail shop owner. This highly flexible employment arrangement was ideally suited to the growing pool of informal Vietnamese labour entering the UK as students or by other means.

### **Diversification and Development**

Five of the businesses interviewed had expanded by opening up new branches in other areas with different family members taking responsibility for their management. For example one business owned three nail shops and the owners' friends and family had a further seven trading under the same name. For these businesses the ability to expand depended partly on the availability of members within the close-knit network who could be trusted to run the new branch.

Two of the businesses interviewed had however diversified into new business areas. The female owner of two nailshops, who was of Chinese Vietnamese ethnic origin, had branched out into Chinese medicine, a trade that she had learnt from her grandfather and uncles in Vietnam. The former nail shop owner, had tried unsuccessfully to run a nail shop before nail treatments became popular, and having learnt to cook Japanese food from his siblings in the US and cousins in Germany had decided to open his own Japanese restaurant in London, in partnership with two Vietnamese friends. The daughter of his 'adopted mother' provided a lot of business advice as she was, "a professional – she has been working in England for 10 years – a lot of the big companies – so she knows about the finances, the council and everything". He had also enlisted the help of specialist market research consultants in locating a suitable area for his latest venture. Significantly, none of his nuclear family was directly involved in the operation of the restaurant, perhaps leaving him freer to pursue his personal ambitions than some of the other business owners who may have been more constrained by family loyalties. Thus these two entrepreneurs, whilst still relying on their family for business ideas and training, appeared to have a more diverse range of more innovative and better educated family members within their network than the others. They were also more likely to seek advice and information from sources outside the family and community network, and were less dependent on family members for the operation of their businesses.

The role of education in providing the entrepreneur with a wider range of resources to call on was also apparent in the case of some of the younger nail shop owners. For example, two of these had studied Health and Beauty at college in the UK and as a result were planning to offer beauty treatments in their salon. One regularly attended beauty shows as a means of seeking out new ideas and had tried a range of suppliers, whilst the other was actively researching the market and had a number of contacts – both English and Vietnamese working in this field. Both showed a greater tendency to rely on the human capital acquired as a result of their training, and, having been educated in the UK had a wider range of weak-ties in their networks.

## **CONCLUSIONS AND IMPLICATIONS FOR POLICY**

This small scale exploratory study has attempted to provide some insight into how Vietnamese nail shop owners in London use their informal networks to support the development of their business. The findings emphasize the heavy reliance on strong family network ties for almost everything related to the business; including the business idea, training and finance for start-up, and employees. In this respect the Vietnamese share a lot in common with many other ethnic minority businesses in the UK. In the case of the Vietnamese nail sector however, it is the international family links with relatives in America, which have played a key role in providing the initial business idea and training. Some of these transnational network ties also have an economic basis, in a similar way to transnational enterprises run by the Chinese community. Unlike the Chinese, who have been found to make use of much larger trusted networks or *guanxi*, the networks of the Vietnamese tend to be more tightly confined to a smaller group of family and friends.

The heavy concentration of the Vietnamese in the nail sector can be attributed to both economic and cultural influences. Economic restructuring has provided the push, whilst a growing market for nail care, and co-ethnic ties with the know-how provided the “pull”. Cultural values, which encourage family needs to be considered before individual desires, and even sometimes the best interests of the business, place an obligation on the individual to help the rest of his or her family. This tends to encourage family members to enter similar business sectors, as information about the business can easily be provided, training given and start-up costs are affordable. The result is the current situation in which the marketplace, in London at least, is saturated and characterised by ruthless competition. The growing number of Vietnamese nail technicians working informally from unlicensed premises is creating additional friction within the sector.

The more innovative businesses in this study tended to have a more diverse range of strong family ties than others, or were younger and better educated and more integrated into mainstream society. The presence of well-educated and more innovative members within the family network appeared to be particularly important for encouraging business diversity. With the younger UK educated businesses, greater exposure to a wider network of loose ties, including sources of information such as the internet, is as one might expect, encouraging them to consider entering other business areas, but there remains a tendency to fall back on traditional sectors in which family support is more readily available.

Previous research has suggested that human capital is positively related to innovation (Dakhli and de Clercq, 2004), and that migrants with greater levels of human capital are less reliant on co-ethnic networks or social capital (Marger 2001). The findings of this study indicate that in the case of refugee enterprises, the human capital of family members within the international diasporic network also need to be considered. Thus the findings provide some support for previous research, which has highlighted the benefits of a more diversified mix of strong and weak-ties for business start-up and development (Davidsson and Honig, 2003 ). However, this study also emphasises that it is the nature of these strong ties which are important, and that those that provide the entrepreneur with innovative ideas and additional human capital are more likely to encourage “break-out”.

These conclusions suggest that policy and enterprise support programmes designed to assist groups such as the Vietnamese need to be more aware of the influence that the transnational diaspora can have on business development. Strong transnational network ties can provide a fertile source of new business ideas and could be further exploited. However a diverse network of local advisors with the necessary human capital, is needed to help translate ideas into viable businesses back home. Thus new and existing entrepreneurs need to be encouraged to develop networks with a wider range of “weak-ties”/individuals outside the family network. Given the Vietnamese community’s lack of trust of outsiders it is suggested that trusted individuals from the community who can act as a “bridge” to mainstream sources of support are vital to this process.

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**FOUNDER/CEO TURNOVER: A SOCIAL CAPITAL APPROACH TOWARD  
REDUCING THE PERFORMANCE IMPACTS IN ENTREPRENEURIAL  
STARTUPS**

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# **FOUNDER/CEO TURNOVER: A SOCIAL CAPITAL APPROACH TOWARD REDUCING THE PERFORMANCE IMPACTS IN ENTREPRENEURIAL STARTUPS**

## **ABSTRACT**

CEO succession is a significant event for all business organizations. However, such activities can be more disruptive for entrepreneurial startups due to the critical role Founder/CEOs play in the organization and the relatively fragile state of a new venture. A social capital perspective suggests that the ability of the firm to perform might be conditional upon the efforts made at increasing the social capital within the organization. This study examines the impact upon performance of Founder/CEO turnover and the offsetting social capital developed within the firm.

There has been a wide variety of research that has examined the impact of the departure of a CEO on firm performance (Begley, 1995, Daily & Dalton, 1992, Jayaraman, Khorana, Nelling & Covin, 2000, Wilard, Krueger & Feeser, 1992). Unfortunately, the evidence from these various streams of research has not provided a consistent set of findings (Jayaraman, e. al., 2000). Entrepreneurial startups present the opportunity to examine a setting where the performance impact of CEO turnover may be particularly dramatic. New ventures offer such insights as these organizations would appear to be more dependent on the Founder. The role of a Founder/CEO in a new venture setting is critical not only for their leadership but also for the web of relationships which they build. It is this ability to develop relationships that help a new firm overcome a liability of newness (Freeman, Carroll, & Hannan, 1983; Li & Guisinger, 1991). Therefore as a setting, the examination of entrepreneurial startups offers the potential to provide fresh clarity on the overall impact of CEO turnover.

The potential loss of a Founder/CEO would suggest that a priori there could be actions that would protect the new firm. The actual loss of a Founder/CEO has organizational impacts that should cause an entrepreneurial firm to address the loss of social capital associated with that individual. We would expect, *ceteris paribus*, that those organizations that can overcome the loss of social capital will outperform those firms that are unable to recover that social capital. However, we might also expect that those firms who are able to retain their Founder/CEO would outperform, at least in the short run, those firms that are forced to deal with a CEO transition easily in their company's life.

This study examines the means available to the organization to offset the loss of social capital associated with the loss of the Founder/CEO. While it has been implied

that organizations can replace social capital, the loss of the Founder/CEO appears to be a unique blow to the organization. This manuscript will examine the actions available (both a priori and ex post) to offset the loss of social capital. Potential mitigating factors might include: 1) efforts to keep the Founder/CEO in place for the first three years of the company's life; 2) efforts to prevent multiple CEO changes during the early years of existence; 3) increasing the size of the management team; and 4) ensuring the presence of founding teams that extend beyond the Founder/CEO. These individuals can provide the organization additional social capital connections and may be able to offset the social capital loss when the Founder/CEO leaves.

We hope that this study will make three contributions to the literature. First, the manuscript extends the application of social capital by examining the means to replace social capital. The manuscript also provides fresh insight to the understanding of how organizations overcome the loss of a CEO by examining the topic from a social capital perspective, a perspective not previously employed. Finally, we hope that this manuscript provides fresh insight into entrepreneurial organizations and how they survive their initial years of newness (Stinchcombe, 1965).

## **THEORY**

### **Social Capital and New Ventures**

Although multiple definitions exist, we suggest that social capital is the degree to which an organization has relationships that allow it to collaborate and cooperate (through such mechanisms as networks, shared trust, norms and values) to achieve

mutual benefits (Putnam, 2000). Social capital can be a unique resource for the new venture.

That resources such as social capital are critical to the firm has gained increasing prominence in recent years (Florian, Lubatkin, & Schulze, 2003; Tsai & Ghoshal, 1998; Yli-Renko, Autio, & Sapienza, 2001). Specifically, an argument suggests that if the firm can develop resources (be they tangible or intangible) that are immobile, valuable, rare, inimitable, and non-substitutable they could lead to a rent-generating competitive advantage (Barney, 1991, Conner, 1991). Social capital would appear to have the potential to be a particularly powerful means to develop competitive advantage for the firm. Social capital is considered an intangible asset, in other words it does not have a physical presence. Other intangible assets would include the firm's brand image, culture, knowledge, as well as expertise held by the firm. Such assets are much more difficult to observe, replicate or substitute and thus have a greater potential to provide a competitive advantage.

Contrast intangible assets to the tangible resources such financial assets, capital assets, and land. Such resources have some physical presence and are acquired in the marketplace generally at or above market prices and in the full view of the competition. It is possible that tangible assets such as a unique location or a previously unknown source of capital could provide the new venture with the potential for economic rents, however, due to the nature of their acquisition, tangible assets do not commonly provide this type of opportunity to the new venture.

Therefore, intangible assets such as social capital would appear to have a greater potential to create a competitive advantage for the firm. This advantage is particularly

important for the pre-startup and initial founding period of the firm (Kogut and Zander, 1988; Nahapiet and Ghoshal, 1998; Schendel, 1996; Spender, 1996; Liebeskind, 1996). These assets include the social capital possessed by the firm (Nahapiet & Ghoshal, 1998). The social capital of an entrepreneurial venture may be either from the relationships and connections internal to the firm (Bolino, Turnley, & Bloodgood, 2002) or the relationships and connections external to the firm (Koka & Prescott, 2002). These relationships and connections can be developed by individuals prior to coming to the entrepreneurial startup or developed during the existence of the entrepreneurial venture (Hansen, 1995).

New ventures have a greater propensity to fail than do mature firms, in part, since they do not have well-established relationships and connections nor standardized efficient routines (Stinchcombe, 1965). Relationships and connections of individuals in the entrepreneurial startup are critical to helping to create and support these routines. The absence of relationships and routines has been recognized as resulting in a “liability of newness” for startup firms (Freeman, Carroll, & Hannan, 1983; Li & Guisinger, 1991). Thus, we believe that the social capital of the firm is an important part of the survival of the new entrepreneurial venture.

### **Development of Social Capital in the Entrepreneurial Ventures**

One of the key sources of social capital for the firm is the Founder/CEO. This individual embodies the visible relationships and connections that form the basis of the new venture. Studies have suggested that investors bet on these individuals as often as they bet on an idea (Douglas & Shepherd, 2002). Additionally, in their role as CEO they will develop other relationships and connections as the spokesperson for the company.

However, the founder/CEO typically does not begin the firm by themselves; rather that person is part of a team (Ensley, Carland & Carland, 2000). The founding team is recognized for bringing resources to entrepreneurial startups (Bruton & Rubanik, 2002). These resources are critical to the firm and its' survival and there is some evidence that larger teams have the ability mitigate the liability of newness (Eisenhardt & Bourgeois, 1988; Eisenhardt & Schoonhoven, 1990). Although not specifically examined, the value of larger teams may lie in the fact that the larger team brings the individual team members' specific relationships and connections to the startup (Bruton & Rubanik, 2002). The impact upon the organization is potentially amplified with new ventures as their knowledge, planning and ability to evaluate the environment is more concentrated in fewer people in the organization (Baysinger & Hoskisson, 1990).

Therefore, in visualizing the range of individuals critical to the startup, researchers should not restrict their investigation to the Founder/CEO. It would seem quite logical that it would also include the top management team. Each unique member of the top management team brings their unique social capital to the new venture aiding not only the new venture's potential legitimacy but also providing additional communication channels within the organization (Florin, Lubatkin & Schulze, 2003; Sparrowe, Liden, Wayne, & Kraimer, 2001).

### **Social Capital and the Top Management Team**

The loss of a CEO leaves an organization with a hole to fill in its internal and external organizational relationships (Kesner & Sebor, 1994). The loss of social capital would appear to be compounded when the CEO is also a founder of the firm and the firm

is in its formative years. Social capital theory would argue that this loss of social capital would have a negative impact on the firm and there has been some strong evidence of the negative impacts to performance of CEO turnover in older organizations (Dahya, McConnell, & Travlos, 2002). Florin, et.al. (2003:375) suggest that “superior human resources enhance a venture’s ability to attain, sustain, and even enhance its competitive advantage...” Therefore, it is hypothesized that:

*Hypothesis 1: Turnover in the Founder/CEO has a negative impact upon the Performance of the firm.*

We would go on to suggest that firms that suffer repeated replacement of the CEO in their formative years are continuously prevented from developing an effective base of social capital. A punctuated-equilibrium approach would suggest that such rapid changes would prevent the firm from developing structures that were essential to success. Furthermore, strategic change researchers have warned about the negative impact of repeated strategic change (Bamford, Rogers & Miller, 1999; Ginsberg, 1988; Hannan & Freeman, 1984). The new venture would never have the opportunity to establish the social capital necessary for sustained success. Therefore, we suggest:

*Hypothesis 2: Firms in which the Founder/CEO remains for at least the first three years will outperform those that lose their Founder/CEO during the first three years.*

*Hypothesis 3: Repeated Turnover in the CEO position has a negative impact upon the performance of the firm.*

Social capital theory suggests that firms might have the ability to recognize the potential for the loss of significant human capital and respond by actively seeking to fill the void (Florin, Lubatkin & Schulze, 2003; Sparrowe, Liden, Wayne, & Kraimer,

2001). For example, a Founder/CEO may have had relationships with key external constituents such as a key customer group. Those key relationships will be lost when the CEO leaves unless the startup has established individuals within the top management team as credible contacts with this connection. The new CEO will likely replace some of that lost social capital but social capital is not determined strictly by time. It is both possible and practical to hire individuals in other positions that have key relationships with the same constituent group contact lost when the CEO left or have relationships with another individual or group that will fill the same function. Therefore, we might expect that the startup firm will look for an individual or individuals who bring relationships with key constituent groups. The firm in fact may have to hire multiple individuals in the top management team to equate to all of the social capital possessed by a CEO that leaves the organization. The resulting social capital should moderate the negative performance effect of the loss of the Founder/CEO on the entrepreneurial firm's performance. Therefore, in terms of the top management team we suggest:

*Hypothesis 4: The presence of at least one additional individual (beyond the CEO) in the TMT at founding will positively moderate the relationship between CEO turnover and the performance of the firm.*

*Hypothesis 5: The TMT size will positively moderate the relationship between CEO turnover and the performance of the firm.*

## **METHODOLOGY**

### **Data**

The above hypotheses are examined using a database of all new banks formed in the United States (U.S.) between 1996 and 2000. This industry was chosen since bank formations provide researchers an opportunity to obtain high-quality secondary data at

the point of firm formation as well as the large number of new firms formed each year in a single industry. Banks, while regulated at the most basic operational level (checking/savings account), are given wide strategic latitude within the context of their industry. It is often difficult to establish the specific date in which a startup firm begins operations. However, the date of inception for banks is clear as regulations require that all banks be chartered prior to beginning operations. Additionally, limiting the investigation to a single industry also helps to increase the reliability of the investigation by limiting the impact of extraneous variables.

The prior research in this area has typically relied on evidence from older firms where the impacts of founding may no longer be of importance (Bamford, Dean & Douglas, 2004; Cooper & Gimeno-Gascon, 1992; Low & MacMillan, 1988). Indeed, empirical entrepreneurship research efforts have typically regarded firms up to eight years old as “new” ventures (Biggadike, 1979; McDougall, Covin, Robinson, & Herron, 1994). Research evidence (Jayaraman, Khorana, and Covin, 2000) has suggested that as the distance from founding increases, the impact on the organization of changes in top management decreases. Thus, this study sought to examine startup firms from the point of founding.

Data on new bank formations was gathered from the Sheshunoff BankSearch Database. Using data provided by Sheshunoff we identified the population of bank formations in the period from 1996 to 2000. Of these, we excluded subsidiaries of other banks or bank holding companies since they were not independent ventures. Also excluded were trust banks and credit card banks as these are established with unique missions and are not generally comparable to commercial banks. This yielded a sample

of 901 firms, of which we had full data on the CEO, top management team and performance for 798 firms.

## **Measures**

**CEO/Founder Change.** The founding CEO is identified in the data provided by the Sheshunoff BankSearch Database and the CEO is further reported each year that the business remains in operation. A change was recorded as 0 for no change and a 1 if there was a change when the CEO left the organization. Multiple changes in subsequent CEO's were recorded as a separate data item

**TMT.** The number of unique members of the top management team were recorded for each year. The average number of TMT during the study period was recorded. The CEO was removed from this calculation.

**TMT at Founding.** The presence of at one unique member of top management in addition to the Founder/CEO was recorded as a dichotomous variable.

**Controls.** To control for the size of the firm we included: Average Assets at the time of Founding and a set of dummy variables for the year of formation (1996- 2000).

**Performance.** The average Net Interest Margin (NIM) was used as a standard performance measure of effective management in banking (Lindley, Verbrugge, McNulty, & Gup, 1992). Following extant research, we assumed a lag impact to performance and measured NIM two years after a Founder/CEO exit event or in Year 7 if no Founder/CEO exit occurred for that firm. There were no significant differences found in a year to year analysis of NIM.

## RESULTS

Summary statistics and the correlation matrix for all variables are presented in Table 1. All variables were within the bounds of normal distribution.

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Insert Table 1 about here  
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Hypothesis 1 suggested that having the Founder/CEO leave the firm would negatively impact the performance of the firm. Table 2 shows that this hypothesis was supported.

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Insert Table 2 about here  
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Hypothesis 2 suggested that retaining the Founder/CEO for at least the first three years of the firm's existence would improve the performance of the venture relative to other firms that suffered a Founder/CEO turnover event. That hypothesis was supported.

Hypothesis 3 stated that repeated turnover in the CEO position would have a negative impact upon performance in the new firm. Table 2 shows that this was supported as well.

Hypothesis 4 suggested that the presence of at least one additional member of the Top Management Team in addition to the Founder/CEO would moderate the relationship between a Founder/CEO exit event and performance. This was not supported.

Finally, hypothesis 5 suggested that as the average size of the TMT rose, that this would also moderate the relationship between Founder/CEO turnover and the performance of the firm. This hypothesis was supported.

## **DISCUSSION**

Prior research, while somewhat inconsistent, has not found a significant performance impact with CEO turnover. This has been especially true as firms' age. This is not as surprising a result from a social capital perspective as the theory would suggest that as firms age that the social capital of the organization would embed and disperse within the organization. The social capital loss of a Founder/CEO can be offset by the stability of other members in the TMT, legitimacy in the market, administrative history in the industry, and accumulated goodwill. Thus, beyond some impact from industry effects and/or small personal ability differences in a sufficiently sized sample there would be virtually no impact from the loss of a Founder/CEO or subsequent CEO exit event. This situation is quite different when we examine new ventures from the point of founding. Embedded within the Founder/CEO *is* much of the social capital of the organization. Indeed we found in this study that the loss of the Founder/CEO is strongly related with a performance loss for the firm. This situation appears to be effectively moderated with the addition of individuals in the top management team. As the number of individuals increases the ability of the new venture to maintain its performance also increases. Although we also expected that presence of at least one member of the top management team would also moderate the performance loss in the event of a Founder/CEO exit event, we found no significant findings.

Furthermore, we felt that the social capital of the new firm would be negatively impacted by repeated turnover in the CEO position. Indeed we find this situation to be true within our sample. This examination finds support for the observation that the social capital perspective is potentially valuable in explaining performance results from changes

in the Founder/CEO and TMT of a new firm. There is also evidence that the social capital perspective will provide an effective framework that might shed light on the question of the impact of the changes in CEO or Founder/CEOs of firms in new ventures.

We would suggest that the next step would be an examination of how firms react to the loss of social capital. Thus, richer examinations that employ qualitative methodologies that allow for the classification of the social capital of the Founder/CEO and the top management team would be valuable. This type of rich in-depth analysis will require a longitudinal investigation.

Anecdotal evidence suggests that entrepreneurial startups are clearly aware of their intangible assets including their social capital and seek to manage that intangible asset. Thus, as research on entrepreneurial startups progress, an area of potential insight appears to be in the management of intangible assets such as reputation and culture of the firm. It is these factors that may ultimately lead to the most defensible strategic advantage and the entrepreneurial startups seem keenly aware of this fact.

The evidence presented here suggests that social capital has the potential to provide insight into the analysis of entrepreneurial settings. Future research should continue to build on these findings and employ this theoretical lens to a greater extent. Particularly, it is hoped that this exploratory research can lay the ground work for the in-depth rich investigation of social capital and how it is impacted by the change in the CEO of the entrepreneurial startup.

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TABLE 1  
Summary Statistics and Correlations

| Variable                          | Mean     | S.D.      | 1       | 2       | 3       | 4       | 5      | 6     | 7       | 8       | 9       | 10      | 11    |
|-----------------------------------|----------|-----------|---------|---------|---------|---------|--------|-------|---------|---------|---------|---------|-------|
| 1 Net Interest Margin             | 3.69     | 1.73      | 1.000   |         |         |         |        |       |         |         |         |         |       |
| 2 CEO Change                      | 0.31     | 0.46      | -.135** | 1.000   |         |         |        |       |         |         |         |         |       |
| 3 Multiple CEO Changes            | 0.38     | 0.64      | -.094** | .894    | 1.000   |         |        |       |         |         |         |         |       |
| 4 # of Officers - Average         | 1.88     | 0.99      | .058    | .065    | .074*   | 1.000   |        |       |         |         |         |         |       |
| 5 Presence of Officers - At Found | 0.54     | 0.51      | -.044   | .088*   | .080*   | .481*** | 1.000  |       |         |         |         |         |       |
| 6 Assets at Founding              | \$55,357 | \$407,413 | .002    | -.001   | -.003   | -.069*  | -.061  | 1.000 |         |         |         |         |       |
| 7 Year of Formation - 1996        | 0.14     | 0.35      | -.017   | .157**  | .221**  | -.053   | .142** | -.017 | 1.000   |         |         |         |       |
| 8 Year of Formation - 1997        | 0.17     | 0.37      | -.046   | .179**  | .141**  | .028    | -.067* | .014  | -.183** | 1.000   |         |         |       |
| 9 Year of Formation - 1998        | 0.2      | 0.41      | .086*   | -.006   | -.015   | .088**  | -.019  | -.013 | -.205** | -.228** | 1.000   |         |       |
| 10 Year of Formation - 1999       | 0.26     | 0.44      | -.028   | -.126** | -.121** | .006    | -.023  | -.010 | -.244** | -.270** | -.303** | 1.000   |       |
| 11 Year of Formation - 2000       | 0.22     | 0.41      | .002    | -.127** | -.138** | -.073*  | -.006  | .025  | -.217** | -.240** | -.269** | -.320** | 1.000 |

t p < .10  
 \* p < .05  
 \*\* p < .01  
 \*\*\* p < .001

**TABLE 2**  
**Results of Regression Analyses**

|                            |                | Model 1  |      | Model 2  |      | Model 3  |      | Model 4  |      | Model 5  |      |
|----------------------------|----------------|----------|------|----------|------|----------|------|----------|------|----------|------|
|                            |                | <i>B</i> | s.e. |
| Founder/CEO Leaves         |                |          |      |          |      |          |      |          |      |          |      |
| Organiz.                   |                | -.129    | ***  | .13      |      |          |      |          |      |          |      |
| Assets at Founding         |                | .006     |      | .00      |      |          |      |          |      |          |      |
| Formation Year - 1996      |                | .008     |      | .22      |      |          |      |          |      |          |      |
| Formation Year - 1997      |                | -.002    |      | .19      |      |          |      |          |      |          |      |
| Formation Year - 1998      |                | .105     | **   | .17      |      |          |      |          |      |          |      |
| Formation Year - 2000      |                | .019     |      | .17      |      |          |      |          |      |          |      |
| CEO Leaves After 3 Years   |                |          |      | .046     |      | .39      |      |          |      |          |      |
| Assets at Founding         |                |          |      | .006     |      | .00      |      |          |      |          |      |
| Formation Year - 1996      |                |          |      | -.005    |      | .51      |      |          |      |          |      |
| Formation Year - 1997      |                |          |      | .162     |      | .49      |      |          |      |          |      |
| Formation Year - 1998      |                |          |      | .046     | *    | .5       |      |          |      |          |      |
| Formation Year - 2000      |                |          |      | .125     |      | .62      |      |          |      |          |      |
| Multiple CEO Changes       |                |          |      |          |      | -0.087   | **   | 0.10     |      |          |      |
| Assets at Founding         |                |          |      |          |      | 0.005    |      | 0.00     |      |          |      |
| Formation Year - 1996      |                |          |      |          |      | 0.007    |      | 0.22     |      |          |      |
| Formation Year - 1997      |                |          |      |          |      | -0.015   |      | 0.19     |      |          |      |
| Formation Year - 1998      |                |          |      |          |      | 0.101    | **   | 0.17     |      |          |      |
| Formation Year - 2000      |                |          |      |          |      | 0.019    |      | 0.17     |      |          |      |
| Founder/CEO Exit           |                |          |      |          |      |          |      | -0.126   | ***  | 0.13     |      |
| Additional Officer at      |                |          |      |          |      |          |      |          |      |          |      |
| Founding                   |                |          |      |          |      |          |      | -0.028   |      | 0.12     |      |
| Assets at Founding         |                |          |      |          |      |          |      | 0.005    |      | 0.00     |      |
| Formation Year - 1996      |                |          |      |          |      |          |      | 0.009    |      | 0.22     |      |
| Formation Year - 1997      |                |          |      |          |      |          |      | -0.003   |      | 0.19     |      |
| Formation Year - 1998      |                |          |      |          |      |          |      | 0.105    | **   | 0.17     |      |
| Formation Year - 2000      |                |          |      |          |      |          |      | 0.021    |      | 0.17     |      |
| Founder/CEO Exit           |                |          |      |          |      |          |      |          |      | -0.13    | ***  |
| Average Number of Officers |                |          |      |          |      |          |      |          |      | 0.072    | *    |
| Assets at Founding         |                |          |      |          |      |          |      |          |      | 0.009    |      |
| Formation Year - 1996      |                |          |      |          |      |          |      |          |      | -0       |      |
| Formation Year - 1997      |                |          |      |          |      |          |      |          |      | -0.01    |      |
| Formation Year - 1998      |                |          |      |          |      |          |      |          |      | 0.098    | **   |
| Formation Year - 2000      |                |          |      |          |      |          |      |          |      | 0.023    |      |
| Overall                    | F              | 3.726    | ***  | 1.158    |      | 2.519    | **   | 3.272    | ***  | 3.789    | ***  |
|                            | N              | 800      |      | 251      |      | 801      |      | 798      |      | 800      |      |
| Adjusted                   | R <sup>2</sup> | .02      |      | .004     |      | 0.011    |      | 0.02     |      | 0.024    |      |

Standardized regression coefficients are reported

\*P<.05

\*\*P< .01

\*\*\*P< .001

**COMPARATIVE ENTREPRENURSHIP: THE CASE OF FATHER-TO DAUGHTER  
FAMILY BUSINESS TRANSMISSION IN FRANCE AND TUNISIA**

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**ABSTRACT**

The object of this paper is to point out the importance of the cultural variable in the process of family business transmission. Using a qualitative method, the research focuses on father-to-daughter business transmissions in two countries: Tunisia and France.

**COMPARATIVE ENTREPRENURSHIP/ THE CASE OF FATHER-TO DAUGHTER  
FAMILY BUSINESS TRANSMISSION IN FRANCE AND TUNISIA**

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## **INTRODUCTION**

Although a certain lack of consensus exists as to the very definition of family businesses, points of convergence arise as to the greatest difficulties they are confronted with. The management of continuity (Cadieux, Lorrain and Hugron, 2000; Chua, Chrisman and Sharma, 1999; Churchill and Hatten, 1987; Davis and Taguiri, 1989; Dumas, 1989; Dyer, 1988; Handler, 1989; Hugron, 1985; Perrault, 1994; St-Cyr and Inoussa, 2000) and the intertwining of the subsystems which make up this type of firm (Benckard and Dyer, 1983; Hugron, 1998; Lansberg, 1998) are the stakes most frequently cited for this type of business. An in depth examination of the succession process discloses this series of stakes (Solomon, King, Tarabishy and Winslow, 2000).

The integration of the socio-cultural dimension in the study of small businesses, offers new insights into the factors likely to come into play during the different stages of the succession process. With respect to studies on cultural differences (Hofstede, 1997 ; Kirby, 2003 ; Tompenaars and Hampden-Turner, 2003) that demonstrate, at the same time, the diversity of the genre, close consideration of this dimension seems particularly necessary for understanding the case of father -daughter (choice of successor) handing over. Indeed, as Hayton, George and Zhara (2002, p.1) observe “Conceptual arguments for the association between cultural characteristics and entrepreneurship have existed for decades but only in the last 10 years has this relationship been the focus of empirical scrutiny” .

From this point of view, the present research belongs to the field of comparative entrepreneurship applied to the process of entrepreneurial succession, thereby extending the 2002 study (Barbot and Bayad) based on a set of French cases, the results of which were later applied to a set of Tunisian cases (Barbot, Bayad and Bourguiba, 2004). After conducting a state of the art of the literature on the succession process of heirs of family businesses, while integrating the role of the cultural variable, we will present the methodology adopted and the results obtained from the Tunisian and French cases. The methodology is based on five case studies using the method of narrative accounts of heiresses in order to collect their experiences and pinpoint cultural incidents which arise during the succession process. The main interest of our contribution lies in illustrating the importance of the cultural dimension in the process of handing over family businesses. The cultural approach chosen seeks to better understand the systems of representation, the internal reasoning of each firm (the ways of being together) so as to adapt management practices to national particularities.

### **WHAT RESEARCH HAS BEEN CARRIED OUT ON THE SUCCESSION PROCESS?**

A large number of authors are interested in the phenomenon of family business transmission. Research carried out since the seventies in this field has given way to several perspectives and various attempts at modeling. Certain authors describe the main stages in the process of succession, others focus on the key factors of success and the phenomena coming into play during the process of succession planning. Likewise, some research focuses on the study of difficulties encountered during the stages of succession. The first investigations were based on the life cycle approach (Barnes and Hershon, 1976; Gersick, Davis, McCollom, Hampton and Lansberg, 1997; Holland and Boulton, 1984; Holland and Olivier, 1992) giving way to the elaboration models centered on the roles of actors (Handler, 1989). Their contributions include the identification of two main components in the succession process, the entrepreneurship and the family component and, on the other

hand, two types of transfers involved in the succession phenomenon: the transfer of management and property (Handler, 1990; Hugron and Dumas, 1993).

Authors who have focused on identifying the key success factors and the phenomena contributing to the process of succession (Ambrose, 1983 ; Barrach, Gantisky, Carson and Doochin, 1988; Haddaj and Andria, 2001; Handler, 1994; Morris, Williams, Allen and Avila, 1997) have pointed out the effect of the quality of the interpersonal relationship between the predecessor, the successor and the members of the family (Cadieux et al., 2000; Davis and Harveston, 1998; Lansberg and Astrachan, 1994; Saint-Cyr and Inoussa, 2000), as well as the role of the competencies of the successor (Haddaj and Andria, 2001) in the planning and in the successful completion of the transfer. Furthermore, the vast amount of research aimed at understanding why successors are interested in taking over the family business (Barrach et al., 1988; Birley, 1986; Handler, 1989; Sharma, Chrisman and Chua, 1998; Stravou, 1999) has led to various notions such as accessibility, credibility of the successor and the « need to prove his or her capacities » to predecessors, members of the family, and employees, as well as legitimate development and leadership.

Certain difficulties observed during the succession process (Handler<sup>1</sup>, 1989 by Cadieux, 2002), notably mutual adjustment between the predecessor and the successor, stimulate further research on the identification of challenges to succession and the key success factors of the process.

Moreover, certain authors observe that managerial transmission is considered to be more delicate and complex than patrimonial transmission (Cadieux, Lorrain, Hugron, 2002; Hugron and Dumas, 1993; Zahra and Sharma, 2004). Indeed, this dimension of the transfer process is strongly linked to the individual characteristics of the actors and underlines the importance of the quality of the predecessor-successor relationship. Intrinsic analysis of the transfer of responsibilities and authority allow schematizing the two-way dialogue between the owner-manager and the successor.

In general, recent studies take into account the dynamic dimension of the succession process, during which the roles of the two main types of actors, predecessor and successor, evolve in an intertwined way (Handler, 1990; Hugron and Dumas, 1993). Intertwining enables the transmission of power (Chrisman, Chua, Sharma, 1998; Churchill and Hatten, 1987; Handler, 1990; Hugron, 1993; Morris et al., 1997) and property in the firm (Ambrose, 1983 ; Churchill and Hatten, 1987 ; Dunn, 1999 ; Morris et al., 1997). As managerial and patrimonial transfer are closely linked, the process of succession is not described in a linear way (Handler, 1990; Hershon, 1976; Hugron, 1991; Longenecker and Schoen, 1978; Mc Givern, 1989)<sup>2</sup> but rather in a dialectical manner (Barbot and Bayad, 2002).

More specifically, certain researchers have focused on the difficulties encountered during the stages of succession as witnessed through the influence of psychological and family factors on the choice of the successor and the nature of the difficulties encountered by the latter (Davis and Harveston, 1998; Dumas, 1989; Dunn, 1999; Gilding, 2000; Kets De Vries 1990, 2002; Pailot, 2003). These authors have pinpointed the effects on equity, patterns, the grieving process (...) and their impact on the preparation and the development of the succession. Moreover, the difference between daughters and sons in terms of involvement in

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<sup>1</sup> Handler (1989, 1994) demonstrates, beyond the two dimensions of transfers which are inherent to succession (the transfer of management and property as well as their evolution in time), the necessity for mutual adjustment between predecessor and successor. According to Handler, obstacles commonly arise to mutual adjustment during the second or the third phase of the evolution of the succession process. He identifies four types of obstacles: individual, interpersonal, organizational and environmental.

<sup>2</sup> Nevertheless, certain authors express their own conceptions of the interactions within models of this type. Examples include the combination of five external variables for McGivern (1978, 1989), the socialisation of the successor for Longenecker and Schoen (1978), the double approach of the transfer of management and the transfer of property for Hugron (1991).

the succession process and their access to positions of responsibility within the family firm has been frequently underlined (Barbot and Bayad, 2002; Cadieux et al., 2000; Dumas, 1989; Hugron, 1998; St-Cyr et al., 1998).

Finally, the majority of the previously mentioned models of the succession process neglect to consider the gender variable and most often emit the implicit hypothesis that the successor is male. Indeed, the studies which deal with the experience of daughters as successors are much more rare. Nevertheless since the seventies, a rich body of literature has developed on the managerial and entrepreneurial specificities of women (Chaganti, 1982; Duchénaut and Orhan, 2000; Dumas, 1989; Dumas, 1992; Dumas et al., 1996; Helgesen, 1990; Henning et al., 1977; Josephowitz, 1987; Lauffer, 1979; Mione, 2002; Rosener, 1995; St-Cyr and Inoussa, 2000; Vier Macahdo and Rouleau, 2002).

What is more, with regards to the fore mentioned main works, rare is research on the succession process which takes into account the cultural variable. Out of 190 articles published between 1996 and 2003, Chrisman, Chua and Sharma (2003) notes the predominance of studies on the succession of family businesses (22% of all articles focused on this issue) and one relative exception (only 5% of all articles focused on this issue) on problems dealing with the cultural aspect. Zahra and Sharma (2004, p.335) add that “The focus of the literature on succession mirrors the primary concern of family business managers” (Chua, Chrisman & Sharma, 2003). Paradoxically, key issues related to effective management of family firms, such as strategy formulation, (...), culture (...), are routinely ignored or remain understudied”.

#### **THE ROLE OF CULTURE IN THE PROCESS OF FAMILY BUSINESS SUCCESSION**

The particular nature of family firms lies in the interaction between family and firm life (Dunemann and Barrett, 2004; Feltham, Feltham and Barnett, 2005; Gervais, 1978). Within these firms, family values enable to build a strong system of cohesion (Cady and Buff, 1996; Trompenaars and Hampden-Turner, 2003). In addition to considering the intertwining between the family culture and that of the firm, the analysis of family and socio-cultural values seems necessary to study the planning process of succession, as noted by Dunemann and Barrett (2004, p. 24): “Family values and other social considerations have a demonstrable influence over the conduct of family business. Examining all of these factors should form an integral part of the succession planning process”.

If entrepreneurship can be considered as an event induced by socio-cultural factors (Shapiro and Sokol, 1982), the cultural variable gains greater meaning when applied to the quality of the relationship between actors of the succession process and the choice of successor and specifically, in the present paper, for the father to daughter case. National culture generates behavioral changes through family, training, education, traditions, lifestyles (Duchénaut, 1996), politics, religion (Kirby, 2003) and degrees of masculinity -femininity, individualism -collectivism (Hofstede, 1997; Trompenaars and Hampden-Turner, 2003). In this respect, Hugron (1998, p. 37) points out that « Chinese, Jewish, Italian (...) families educate their children according to their own cultural codes ; these factors are not insignificant to understanding business styles in family firms ». Within family firms, the cultural context can affect behaviors and, in the same way, management styles, be they an individual's, the family's or the firm's. In these companies, culture has an influence on the individual's way of being, thinking, and doing and can influence the role of each member of

the family, as well as how the patrimony is passed on from one generation to another, the choice of the successor and the predecessor –successor relationship.

Moreover, through Freud's work, we know that parental models contribute to « orienting the existence » of children, notably when they are of the age to make occupational choices (Belle, 1991). From this respect, the social learning stream of theoretical thinking (Bandura, 1997, p. 85) considers that learning and motivation stem from observing the behavior of others who act as models; which underlines the influence of the family and lifestyles on social and entrepreneurial behavior of children. Duchénaut and Orhan (2000), following the path of Stanworth, Granger and Blythe (1989), remarks an existing pre-eminence of the social context on the psychological model of the entrepreneur. Dunemann and Baret (2004, p.25) states that “From the earliest basic childhood experiences to those that flow with more specific connection to the family business, successors, for good or ill, are shaped by culture and formative influences surrounding them”. In other words, the family environment, especially that of the close family, constitutes an « entrepreneurial model » and a « favorable field for fostering company spirit» notably for women entrepreneurs (Duchénaut, 2000, p. 114). In line with this, Haftendon (2003, p.1) adds “one has to find out how the national cultural attitude influences the entrepreneurial activities of the population of a country or region”.

From this same optic, in line with the implicit hypothesis found in the majority of succession process models, according to which only the sons are considered to be potential successors; researchers are interested in the specificity of the father-daughter transfer. These last authors (Barbot and Bayad, 2002; Chrisman et al., 1998; Dumas, 1989; Dumas et al., 1995; St-Cyr et al., 1998; St-Cyr and Inoussa, 2000) who find that the daughter is considered to be a better successor than the sons (Ward, 1987) and others with a specific interest in the family business (Duchénaut and Orhan, 2000), observe that the daughter encounters particular barriers when taking over the family business.

With respect to the insufficient amount of research integrating culture on one hand and the specificity of female taking over of family businesses, the present research aims at exploring the incidence of national cultures on the process of father-daughter succession of family businesses. From this perspective, we are most particularly interested in family businesses in two countries seldom considered in Anglo-Saxon literature: Tunisia and France.

With due respect for the important contribution of this last body of research, we nevertheless explored the particularities of North African<sup>3</sup> culture, because, as pointed out by Russell (1997, p.3), « The social and cultural histories of most less developed countries and the industrialized West (...) are very different ». These investigations allowed us to identify factors which influence the succession process, according to different cultural contexts. From this respect, beyond the sexual diversity (female/male), the stages of the succession process could change within the same gender of successors (females). We consider that within the frame of female taking over, differences can be stated and explained through the predominance of the influence of national culture.

On the basis of these observations and adopting a comparative point of view, we investigated differences and/or similarities between how father to daughter successions occur in Tunisian and French family businesses. In doing so, we opted for a dynamic vision of the succession process.

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<sup>3</sup> In this respect, note that no African country has, according to our knowledge, conducted a study on the specificity of father-daughter succession. Likewise, more generally speaking, the transmission of family businesses remains a seldom studied domain for African-based research.

## **PROPOSAL OF A MODEL TO TAKE INTO ACCOUNT THE CULTURAL DIMENSION OF THE FATHER-DAUGHTER TRANSFER**

In order to address the question of the specificity of father-daughter transfer, while considering the impact of the cultural variable, we adopted a dialectic model thus stressing the dialogique<sup>4</sup> character of the two types of transmission (managerial and patrimonial) and the psychological characteristics of the key actors. By depicting the succession process as based on two principal actors, the retained model integrates both the psychology of the actors and their intertwining (which constitutes one of the essential characteristics of the family business). Equally demonstrated is the impact of culture on relationships between the different actors of the process.

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Figure 1 about here

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The proposed approach, as shown by the previous figure, points out the influence of the leader's personality on the preparation, the setting up and the successful completion of the transfer. Moreover, the successor's attitude toward the firm and the predecessor is believed to influence his credibility (Barach et al., 1988) and capacity to take on the role of the leader within the family firm as well as his success during the transfer process. The integration of three components (firm, predecessor and successor) attests to the complexity of the issue of choosing a successor within the family, putting into play several factors including the assignor's psychology (Kets De Vries, 1990) and the potential successor's technical competencies (expertise) and relational competencies (confidence) (Haddadj and Andria, 2001) as well as the various dimensions of the different stages of each one of the two types of transfers (managerial and patrimonial).

Moreover, the family relationships change from one cultural context to another (Hugron, 1998). This difference will eventually give way to modifications in the predecessor-successor relationship and most notably with respect to confidence and criteria such as acceptability, credibility and legitimacy. On the basis of this hypothesis and in line with the comparative framework, we inquired into the differences and/or similarities between how Tunisian and French family businesses are passed on to the daughter.

### **METHODOLOGY**

The choice of the method and selection of criteria for the cases and data collected will be gradually detailed. While the choice of a qualitative research method is certainly uncommon when undertaking this type of research, our aim is not to measure a phenomenon but rather to characterize it. With this in mind, the different cases we studied allowed us to penetrate the culture of the two countries in question.

For the case of field studies, as Bertaux (1997) points out, the notion of a « statistically representative sample » makes little sense. Rather it is replaced by that of a « progressively constructed sample ». It is thus necessary to delve further and include phenomena we suggest referring to as « differentiality ». What counts, above all, is to promote the researcher's possibilities in exploring reality by way of a variety of accounts. The stake at hand is not only

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<sup>4</sup> Dialogique, according to Morin, allows « maintaining duality within the unit. It associates two terms which are both complimentary and antagonistic ». Source : Morin, 1990, p. 99.

descriptive; it lies in the validity of the model. From a methodological point of view, this work merits further development using a more quantitative approach.

The studies that are interested in the specificities of father-to-daughter transfers demonstrate that the heiresses are the «invisible» successors (Dumas, 1989) and rarely perceived as «natural» heirs (St-Cyr and Inoussa, 2000). Acknowledging, on the one hand, the limited number of studies integrating the influence of gender differences on the succession process and, on the other hand, the almost inexistent comparative research on father-to-daughter transfers; we deem necessary the adoption of a qualitative method, both exploratory and descriptive (Robson, 1997). Such a research approach allows us to contribute to the body of knowledge on the difficulties faced by heiresses. Indeed, the purpose of qualitative research is to understand social processes by showing how individuals and groups experience them (Deslauries, 1991), thus allowing a more systematic and global vision of reality (Deslauries, 1991; Rubin and Rubin, 1995; Russman and Rallis, 1998 as cited by Bertaux 1997). Understanding the diversity of intra-family relationships is essential to the study of difficulties encountered by daughters during this process.

As Pailot (1999, p. 28) remarks, « the narrative accounts method, with regards to its epistemological orientation, is an interdisciplinary perspective which presents an interesting framework for understanding how the past lives of leaders allow us to make sense of the reasoning behind certain actions ». Without advocating a mechanical vision of man trapped in a narrow psychological and sociological determinism, this method recognizes the overlapping areas between family and firm concerns, which can hardly be neglected when analyzing family businesses. Narrative accounts can contribute to the knowledge of modes of transmission of family capital or, in broader terms, societal change and historical evolution of social relationships interactions. Investigation by way of narrative accounts, through the exploratory, analytical and expressive approach, allows us « to capture the reality of mechanisms and social processes related to the object under study » (Bertaux, 1997).

### **Criteria for constituting the case studies and the data collection**

In response to the research objectives, six criteria were retained for the selection of the study sample: firm of French or Tunisian origin, firm owner and manager belong to the same family, first to second generation father-daughter succession, completed or initiated succession, daughter already engaged in the succession process through actual participation in the patrimony and through active management responsibilities within the firm.

The semi-guided interviews<sup>5</sup> were carried out on the French and Tunisian fields with the daughters of business founders using an interview guide inspired by the literature review<sup>6</sup>. The research was aimed at uncovering certain fundamental points leading to the identification of father-daughter specificities, differences in the modes of communication and management in the firm and within the family in each cultural context. The non inclusion of the perception and opinions of other individuals in the succession process is justified by the choice of our research question.

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<sup>5</sup> The semi-guided interview is based on predetermined questions and themes concerning subjects which must be covered during the interview. The quality of the collected information is strongly influenced by the researcher's capacity to establish a climate of confidence.

<sup>6</sup> The interview guide used was elaborated, in collaboration with Canadian researchers, and applied in the study conducted in France by Barbot. M.C. and Bayad. M., CIFPME 2002.

(<http://www.hec.ca/airepme/pdf/2002/183FA%20-%20Marie-Christine%20Barbot.pdf>).

The main themes covered are summarised in table 1.

To our knowledge, a French and Tunisian data base centered on female transfers does not exist. With the realization that this type of information would be difficult to obtain, we were able to make contacts with three Tunisian heiresses through information supplied by organizations such as the *Center of Research, Studies, Documentation and Information on Women* (CREDIF) and the World Association of Women Entrepreneurs (FCEM) in Tunisia. The French cases also stemmed from professional contacts.

Although the five firms were of comparable size, they belonged to different sectors of activity. Nevertheless, we argue that this diversity offers fresh insights on differences in the development of the succession process.

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Table 1 about here

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Firstly, the individual interviews were recorded and then transcribed immediately after in a literal way. Secondly, a thematic and comparative analysis was conducted in line with the chosen model with the aim of identifying the differences in perception between the participants. This analysis allowed us to integrate significant information on the succession process.

## **RESULTS AND ANALYSES**

Using the components of the proposed model, the determining factors of the transfer process are summarized in the following table.

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Table 2 about here

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These different cases allow pinpointing distinctive data concerning the links between the actors of the family business, the development of the succession process (managerial and patrimonial transfer) and the expressed difficulties of the heiresses. Could these differences be due to contingent reasoning?

In all five cases, the founders were strongly attached to their companies and this link seemed to reinforce their desire to implicate the heiresses in the succession process albeit, at the same time, it made the withdrawal of the founder more difficult.

In the Tunisian firms, confidence and complicity are common characteristics of the father-daughter relationship and appear to be catalysts for initiating the transfer. These characteristics are less obvious in the French cases and are progressively acquired through learning and training. The understanding of the leader-successor-firm relationship is necessary to study the succession process. The nature of the links between these three components determines the course of the transmission.

For the Tunisian heiresses, the transfer stems from the desire to maintain family relationships. The first task, which is to insure continuity, is proof of love and consideration towards the father's work efforts. In this respect, the daughters play the role of relays, linking

the members of the family within the firm. For the daughters, the continuity of the family depends on the continuity of the family firm. It is not the business of the family but a family business. The desire to take on the family activity is also present in the French cases; these women invested heavily in a mission: insuring the continuity of the family enterprise in respect of the founder's toil. Meanwhile, for the French successors, the quest for self-actualization achieved by taking over the business is greater than that of family cohesion and commitment to the family.

The characteristics of the Arabic-Moslem environment and culture steep the conceptions of the fathers as well as the daughters. The cultural variable can be source of certain conceptions which facilitate/constrain the unrolling of the succession process.

Although Arabic-Moslem traditions have not always allowed women to take on an active role in economic life beyond family obligations, the Tunisian conception of this culture integrates more on a complementary perspective. Indeed, the Tunisian context was already familiar with working women since 1956 and supportive of a more formal recognition of daughters in the process of succession planning. The three heiresses were familiarized with the family business from a very young age. Contrary to certain assumptions about the Arabic-Moslem context, the rational aspects of competencies and aptitudes can override emotional factors of preference for sons. Although the daughters must prove to their fathers and to other members of the family that they are competent, the legitimacy dimension seems, for the Tunisian cases, more accessible than for the French cases. The French daughters encountered an identity problem and attempted to affirm their independence toward the father, a characteristic typical of Western culture (Dumas, 1990).

Furthermore, for all the successors, degrees, education and training, offers solutions in confronting problems of legitimacy and credibility (Barrach et al. 1988, Duchénaut and Orhan, 2000) in the family, as well as in the firm. Training and the social level of the predecessor and the successor, education and society's degree of tolerance appear to be variables meriting consideration in the succession process of family businesses.

Taking into account the cultural context in which the transmission takes place is even more significant when it concerns the development of these two types of transfer. In the Tunisian context, the problem of patrimonial transmission does not exist given that it is carried out in respect of religious laws in place (1/3 for the daughter, 2/3s for the son). The succession process for the Tunisian case, hence, focuses most especially on the managerial transmission. In addition, the particularity of how the Tunisian daughter has been educated dotes her with the capacity to adapt and to communicate well with a founding father that is often authoritarian and very attached to his company which thereby increases the likelihood of a smooth transfer of management. On the contrary, these two dimensions of the transmission (managerial and patrimonial) are complimentary in the French case. These women are truly considered as the successor only when the other two dimensions have been satisfied. (I'm unsure here –which other 2 dimensions are you referring to?)

The cultural specificities of these two countries, as previously discussed, are found in the differences in the relationships between the main actors of the process and the development of the process itself.

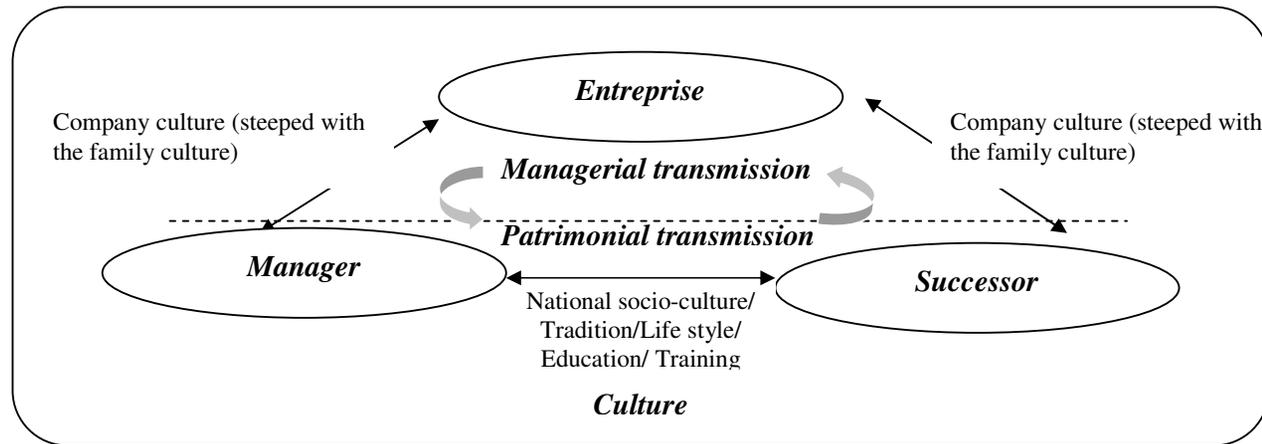
## CONCLUSION

The study provides a basis for continued research for researchers in the field of family business dealing with succession issues, in addition to new insights for consultants and educators. This work must be put in perspective with respect to other research in the field which compares first and foremost the case of succession in countries with similar characteristics (Furio and Desai, 2000).

With respect to entrepreneurship in general and transmission in particular, project leaders must take into account the cultural context, which is not to say that they are passively subjected to it. The effect of these traditions is not mechanical and depends largely on initiatives. The recognition of the importance of tradition leads us, by no means, to consider societies as motionless, mere reflections of folkloric caricatures.

Finally, we may conclude that best practice research cannot be undertaken as an end to itself. Indeed, instead of imitating other countries, it is necessary to identify the value of one's own traditions as well as possible departures from the norm. Each country is characterized by "*fundamental traits which pass the test of time*" (D'Iribarne, 1989). Entrepreneurship is truly a phenomenon which is above all cultural. With this in mind, the successful transmission of a firm involves respecting the national culture in which it is found. With regards to this last observation, firm transfer assistance programs do not always offer the perfect solution.

**Figure 1: A multidimensional model of succession in family businesses**



Source: Barbot, Bayad and Bourguiba, 2004

**Table 1: Descriptive Presentation of Cases**

| CASE   | case 1                         | case 2           | Case 3           | case 4                                     | case 5                  |
|--|--------------------------------|------------------|------------------|--|-------------------------|
| Country  | France                         | France           | Tunisia          | Tunisia                                    | Tunisia                 |
| Stage of process                                   | Completed                      | Initiated        | Completed        | Completed                                  | Completed               |
| Characteristics of the firm :                      |                                |                  |                  |  |                         |
| Activity   | Fruit and vegetable wholesaler | Printshop        | Fez manufacturer | Metal fittings, facades and office layouts | Press company           |
| Founding date                                      | 1953                           | 1987             | 1945             | 1978                                       | 1951                    |
| Turnover   | 7 millions euros               | 3 millions euros | 50 000 euros     | 700 000 euros                              | 5 millions euros        |
| Payroll  | 22 employees                   | 30 employees     | 6 employees      | 54 employees                               | 120 employees           |
| Number of children                                 | 3 daughters – 1 son            | 2 daughters      | 3 daughters      | 1 daughter – 2 sons                        | 4 daughters – 3 sons    |
| Reasons for succession                             | Retirement                     | Retirement       | Death of founder | Health reasons                             | Death of founder        |
| Conflict between children over who is to take over | No                             | No               | No               | No   | Yes (only with one son) |

**Table 2 : Results**

| <b>CASE</b>                               | <b>case 1</b>  | <b>case 2</b>  | <b>case 3</b>  | <b>case 4</b>   | <b>case 5</b>   |
|---|--|--|--|---|---|
| <b>LINKS</b>                              |  |  |  |   |   |
| Manager-firm link<br>Father-daughter link | Strong<br>Autonomy /<br>Employer-employee<br>relationship<br>favoured  | Very strong<br>Confidence / Father-<br>daughter relationship<br>favoured | Very strong<br>Closeness / Father-<br>daughter relationship<br>favoured        | Very strong<br>Very close/<br>resemblance   | Very strong<br>Closeness / father-<br>daughter relationship<br>favoured   |
| Successor-firm link and<br>motivations    | Capacities, interest<br>for the company,<br>training, experience.<br>Self-realisation,<br>continuity of the<br>family firm, desire<br>to take over | Capacities, interest<br>for the company,<br>training.                    | Great willingness to<br>guarantee the<br>continuity of the<br>family heritage. | Capacities, training<br>experience, interest<br>for the company and<br>for work with father.<br>Willingness to insure<br>the continuity of the<br>firm and maintaining<br>control and<br>management within<br>the family. | Interest for the firm and<br>for work with father<br>travail, capacities,<br>formation, experience<br>within the firm.<br>Willingness to insure<br>the continuity of the<br>company<br>Attachment to work<br>within the company and<br>with father. |
| <b>STAGES</b>                             |  |  |  |   |   |
| Planning                                  | Patrimonial<br>transmission<br>precedes managerial<br>transmission.<br>Planning only of<br>patrimonial transfer.                                   | Patrimonial<br>transmission easier to<br>put into place.                 | Some managerial<br>transmission without<br>planning of<br>patrimonial transfer | Managerial transfer<br>without planning of<br>patrimonial transfer  | Planning of managerial<br>transfer without taking<br>into account the<br>patrimonial transfer   |
| Choice of successor                       | Refusal of the<br>prospective  | Natural successor as<br>sister disinterested in                          | Successor by default.<br>There is no son to                                    | Prospective successor<br>as older brother not   | Successor potential but<br>not natural as the two   |

|  |   |   |  |   |   |
|--|---|---|--|---|---|
|  | successor. Successor by default.  | firm  | carry on the business which caters to men.                     | interested in the firm.   | brothers are interested in the firm.  |
| Education of successor                           | <i>Baccalauréat</i> (high school degree) then continuing education, training within the firm.                         | Higher education in management. Completely familiar with how the family firm is run.          | Higher education in computer engineering.                      | <i>Baccalauréat</i> then management degree accompanied by training within the firm. | Higher education in history and geography. Education in journalism alongside part-time training within the company.       |
| Strategy to guarantee the passing on of the firm | Proactive, initiator of the succession process.   | Commitment to a strategy of high visibility « so that the idea comes to her quite naturally». | Passive: only one capable of taking over after fathers' death. | Proactive: undertaking of a credibility strategy.                                   | Proactive: initiated by the father-founder. Undertaking of a credibility strategy.  |
| Entry of successor                               | Progressive   | Progressive   | Progressive and partial  | Progressive   | Progressive   |
| Disengagement of founder                         | Progressive and total   | Absence   | Total  | Progressive and partial   | Progressive and partial   |
| Managerial transfer                              | Difficult   | Underway  | Through training   | Relatively easy through training  | Progressive   |
| Patrimonial transfer                             | Transmission of capital in equal parts. Buying of shares by the successor 4 years after « to clarify the situation ». | Underway  | Transmission of capital according to current laws              | Transmission of capital according to current laws                                   | Transmission of capital according to current laws. Buying of shares by the successor following disinterest of the sister. |

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## **The Relationship between Family Firms and Corporate Governance**

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## **Abstract**

Contributing to the agency theory literature, this identifies relations between family control and corporate governance structure. Although the sub-set of theory that specifically relates to family control is in its infancy, emerging literature supports the notion that family control creates a number of strong incentives that have potentially competing influences on the manner in, and extent to, which internal corporate governance mechanisms are utilised. A sample of 100 listed companies (evenly divided between family and non-family firms) is used to test the hypotheses that corporate governance structures are different between family and non-family firms; and that family firms adopt optimal corporate governance structures. This paper finds evidence suggesting that family firms do utilise substantially different corporate governance structures from non-family firms. Some further evidence is provided to support the notion that these differences do lead to performance differentials. Indeed, the results suggest that family control creates, rather than negates, agency costs. Future research may be well rewarded by pursuing this latter notion further.

## **Introduction**

New research on family controlled firms provides a novel method for re-examining a maturing economic paradigm: agency theory. The progeny of Jensen and Mecklings' (1976) ambitious attempt to expose the inner machinery of the black box called the firm, agency theory has been used by myriad theorists to explain how the misalignment of interests between the firm's participants is brought into equilibrium throughout a diverse range of contexts. One context that has been represented in the literature with relative paucity is family control. The purpose of this paper is to contribute to the small but emerging body of literature that seeks to resolve the dearth of family firm literature; providing a new and powerful perspective on the agency theoretic.

While prior research has focused on the manner in which the different incentives faced by family members impact on outcomes such as performance, a purpose of this paper is to examine the relation between family control and other potentially substitute or reinforcing internal control mechanisms (i.e. corporate governance). The combined effect of any interaction will then be regressed on performance within a simultaneous equations framework to establish if family firms adopt a wealth-maximising set of corporate governance mechanisms.

It has been posited in previous papers (e.g., James, 1999) that family blockholders in family controlled companies have different incentives to atomised shareholders in widely-held companies. However, the question of whether family ownership provides incentives to reduce agency costs (through a better alignment of shareholder and managerial interests) or create agency costs (by providing opportunities for family members to expropriate the wealth of outside shareholders) remains a reasonably open empirical issue. The strongest evidence in emerging literature would tend to corroborate the former (Anderson & Reeb, 2003; Anderson, Mansi &

Reeb, 2002), however, research by Schulze et. al. (2001), conducted in the context of proprietary companies, would support the alternative. The manner in which family members respond to alternative incentives will be reflected in the extent to which other internal corporate governance mechanisms are utilised. In this sense, research that extends the family firm literature to include a discussion of corporate governance will be both an end in itself (in that relationships will either be evidenced or remain uncorroborated) and a means to other ends by further illuminating the nature of the incentives faced by the firm's participants.

The first purpose of this paper is to examine the nature of the relationship between family control and individual corporate governance variables using a similar set of variables to that used by Anderson, Bates, Bizjak and Lemmon (1998), a study of corporate governance in the context of firm diversification, rather than family control. Agency theory suggests that family owners experience different incentives to diversified, atomised shareholders; these differences should manifest themselves through differences in the utilisation of other control mechanisms; this paper produces evidence to support this notion. As the focus of the agency argument relates to the incentives of the firm's internal participants, it follows that it is reasonable to restrict the discussion to internally set controls (i.e. corporate governance mechanisms). The influence of external control mechanisms (eg. the takeover market, the labour market, etc.) is assumed to be fairly uniform across all observations in the sample.

The second purpose of this paper is to examine the degree to which family firms adopt wealth-maximising internal controls. The shift in focus between the first purpose and the second is an attempt to go beyond developing isolated relationships - to identify the extent to which the

matrix of control mechanisms operate in unison in resolving competing incentives (the incentive to reduce agency costs as opposed to the incentive to expropriate wealth and create agency costs). The second hypothesis is tested on a reduced sample (excluding non-family firms) within a simultaneous equations framework (analogous to the methodology used by Agrawal and Knoeber (1996). Evidence of significant results on individual coefficients indicates the use of sub-optimal corporate governance structures.

The remainder of this paper is partitioned as follows: section 2 is a review of the literature motivating the subject; section 3 amalgamates the various themes within the literature with a view to developing several testable hypotheses; section 4 reviews the data collection procedures; section 5 explains the empirical methods; section 6 details the results of the empirical tests; section 7 briefly considers other robustness and diagnostic issues; section 8 summarises the paper;

### **Literature Review: Motivation and Significance**

***Family Firms and Agency Theory*** - It was Adam Smith (1776) who first foresaw, with unprecedented prescience and insight, that managers of widely-held companies, being the managers of other people's money, cannot well be expected to watch over it with the same anxious vigilance as, say, the managers of a partnership. Smith's sentiments were developed in the pioneering work of Berle and Means (1932) and formalised by Jensen and Meckling (1976), creating the catalyst for a fruitful area of financial research: agency theory. Jensen and Meckling argued that traditional conceptions of firms as control structures are flawed. 'Firms', as such, are

merely legal fictions. Rather, a firm is actually a nexus between a series of complex contractual relationships between various stakeholders.

An important contractual relation is the relation between the owner and the manager. This relationship takes on the special character of being an agency relationship, a relationship that involves delegation of decisions. If both parties are rational utility maximisers, it follows that the contract may leave scope for the manager to make decisions that are not in the owner's interests. The costs of this divergence of interests, in combination with the costs of monitoring and bonding the manager to limit this divergence, are termed agency costs.

A great deal of the literature has been devoted to applying agency theory to the diffusely held corporation; that is, those firms where professional managers pursue the control function on behalf of a variety of diversified, atomised shareholders. However, the effect of agency costs in other ownership structures, in particular, the family founded, owned and controlled firm is covered by the academic literature with relative paucity. While important work has been directed towards developing an understanding of this unique ownership structure, when it is considered that family firms account for around 20% of the listed companies in Australia (Mroczkowski & Tanewski, 2004; Harijono, Tanewski & Ariff, 2004), and are represented similarly in the S&P 500 in the U.S. (Anderson, Mansi & Reeb, 2002), it would seem that the economic significance of family firms has been underrepresented by the academic literature.

Research on family firms provides an avenue for developing agency theory in a new and fundamentally different context. This is largely the result of the entirely different incentives that

motivate family shareholders in contrast to diversified shareholders. Consistent with Demsetz and Lehn (1985), Anderson and Reeb (2003) acknowledge two reasons why family firms have several incentives to reduce agency costs. Firstly, as family firms have concentrated shareholdings, they have an increased incentive to reduce agency costs because “the more concentrated is ownership, the greater the degree to which the benefits and costs are borne by the same owner” (Demsetz & Lehn, 1985, p 1156). However family ownership extends beyond concentration. As the wellbeing of the family is tied directly to the welfare of the company, families have further incentives to reduce agency costs that might impede performance. Additionally, a family’s special technical knowledge concerning a firm’s operations may put it in a better position to monitor the firm more effectively. Essentially, the special relationship between a family and a family firm provides incentives for the family to counteract the free rider problem that prevents atomised shareholders from bearing the costs of monitoring, ultimately reducing agency costs.

Secondly, it is maintained that family firms make decisions on much longer time horizons than non-family firms. It is suggested that family owners view the firm as an asset to be passed on to subsequent generations (Chami, 1999) leading to strict adherence to maximising the value of the firm (James, 1999). Contemplate the mindset of a new CEO who knows the average CEO tenure in Australia to be 4.4 years (Booz Allen, 2003), accepts that it is unlikely that he or she will outperform the average and therefore decides to manage the company over a short time frame with strict adherence to his or her own utility maximisation. Contrast that outlook against the mindset of a founding family CEO who intends to maximise the long term wealth of a family company that bears the family’s name, and with it carries the family’s reputation. Indeed,

Schulze, Lubatkin, Dino and Buchholtz (2001), as well as echoing the benefits of personal involvement, and special relationships, also acknowledge the altruistic benefits unique to family ownership. Altruism, the notion that self-interest is pursued through the welfare of others, promotes loyalty, facilitates communication and increases time horizons, ultimately reducing agency costs.

However, it has also been posited that family ownership leads to an increase in agency costs. Anderson and Reeb (2003) identify the possibility that family firms might use their concentrated blockholding to expropriate wealth from other shareholders through excessive compensation, related party transactions and special dividends. Anderson, Mansi and Reeb (2002) add the possibility of risk avoidance, that is, because of their undiversified exposure, family firms may use their control of a firm to avoid risks acceptable to the other, diversified, shareholders. Morck and Yeung (2003) note the potential for family business groups to organise into pyramidal control structures that facilitate the expropriation of wealth from non-family shareholders in family subsidiaries to family holding companies. It is asserted that agency costs in family business groups stem from either management not acting for the shareholders, or rather, acting only in the interests of family shareholders. Schulze, Lubatkin, Dino and Buchholtz (2001) elaborate on the potential for non-family shareholders to be held ransom to the mercy of family owners. While Jensen and Meckling (1976) acknowledge the potential for conflict to arise between owner's interests, these would be resolved efficiently by one of the owners selling their shares. However, this assertion is predicated on the assumption that capital markets are efficient, allowing the conceding owner to sell their stake in the firm at its full value. Schulze, Lubatkin, Dino and Buchholtz point to inefficiencies in the capital market that may put pressure on the

conceding owner to acquiesce. While the focus of their research is directed at proprietary companies (with illiquid capital markets), similar problems could affect public companies. In the spirit of Coase (1937), who acknowledged that activities will be included within the bounds of the firm when it is less expensive to do so than to go through external markets, Demsetz and Lehn (1985) were the first to directly acknowledge that, while concentrated ownership generally serves the interests of diffuse shareholders well, if the concentrated owner can achieve their consumption goals more effectively through the firm than privately, the welfare of the diffuse owners may be threatened.

***Corporate Governance and Economic Significance*** - While new research on family firms would further develop a fledgling body of literature that provides a new perspective on an established academic paradigm, incorporating other aspects of corporate governance into the discussion would give original research an economic significance that would be valuable to a range of the market's participants. Research addressing the relationship between family firms and corporate governance would be of nontrivial value to professionals, policy makers, regulators and anyone else concerned with either sphere of interest.

While the concepts encompassed by corporate governance are as old as Adam Smith, the term itself has only really gained mainstream prominence since the corporate collapses of the 1980's. The Cadbury Commission report (1992, p 12) "... based on compliance with a voluntary code coupled with disclosure ..." was the progenitor of corporate governance discussion within the U.K.; the response to a number of high-profile collapses. Recommendations of the report related to non-executive directors, audit committees, disclosure of director's compensation, disclosure of accounting statements, internal control systems and the role of the auditor. The Commission's

sentiments were echoed locally by the Australian Investment Managers' Association (1999) in the 'Blue Book.' It is interesting that some ten years later, after the latest round of corporate collapses, the tenor of the arguments remains principally the same despite the lapse of time.

Corporate governance has become increasingly topical since the adoption of the Sarbanes-Oxley Act (2002) in the US, a legislative response to the excesses encompassed by the spectacular collapse of the 'dot-com' and 'telco' speculative bubbles of the late 1990's. Provoked by the collapse of Enron and Worldcom (Enron had used complex off-balance sheet vehicles to hide extraordinary losses leading to a write-down in shareholder funds of US\$1.2 billion; Worldcom had used accounting improprieties to inflate reported earnings and cash flows by US\$3.9 billion (Bartholomeusz, 2002), the SEC's response, while similar in theme to earlier reforms, differs fundamentally in that the requirements are mandatory. The implications for other regulators are unambiguous, for Australian regulators no less so: if Australian companies are to compete in international markets, their standards of corporate governance must be no less effective than those imposed in the largest capital market in the world. Even so, the attitudes of Australian as well as UK regulators have maintained their voluntary tone. The mandatory components of the Australian response involve those requirements proposed under the 9<sup>th</sup> redevelopment of CLERP, (Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill, 2003; Corporate Disclosure, 2002), relating to the role of the auditor, accounting standards, continuous disclosure, and enforcement issues. The voluntary component relates to changes in the ASX's listing rules in line with the ASX Corporate Governance Council Implementation Review Groups's (2004) principles on corporate governance. While the principles maintain the same character as those outlined in Sarbanes-Oxley; compliance with the listing rules is

voluntary; either companies comply or they don't but explain why. Motivated by the Higgs report (2003) and the Smith Report (2003), the approach in the UK has developed in a similar vein. While policy on corporate governance continues to be generated, it is unclear exactly how much is grounded upon firm empirical evidence rather than anecdotal accounts, or perhaps, politics. For example, the response in the US, the UK and Australia has largely focused on the role of independent directors. However, extant research has shown no compelling relationship between the proportion of outsider directors on the board and performance (Hermalin & Weisbach, 2003; Klein 1998). It would seem that normative policy is being advocated without the grounding of a firm positive understanding of how the misalignment of interests between various participants is actually brought into equilibrium. Convincing research on the role of corporate governance in family firms would allow policy makers to develop a regulatory framework that recognised the contingencies inherent in different ownership structures. Market efficiency would also be improved by information that allowed market participants to correctly value different ownership structures after taking into account the differences in value attributed to different corporate governance structures. Research relating to corporate governance and family firms would be of practical value to a myriad of interested parties, providing a positive basis for a consistent set of normative assertions.

***Corporate Governance and Family Firms*** - While there are compelling reasons for pursuing research on family firms and corporate governance independently, there are further incentives to develop the relationship between the two. One incentive, in particular, is motivated by the emerging body of financial literature that focuses on rights as a determinant of corporate value. On a macro level, recent research by La Porta et. al (1998, 1999) has identified the relationship between variation in property rights and corporate value between different property rights

regimes. While the focus of La Porta and his colleagues' paper is directed across different firms in different nations, the essence of the argument operates at the firm level: the rights attached to a security affect the ability of the security holder to procure the security's value and hence, the value of the security itself. While, in a macro sense, the greatest source of variation in the rights of a security will relate to differences in legal regimes, within the same legal regime, the greatest source of variation in shareholder rights will relate to firm-specific corporate governance (that is to say, the Corporations Act (2002) operates fairly uniformly across all Australian firms). As corporate governance mechanisms are largely set by the internal participants within the firm, they should be consistent with wealth maximisation. That is, according to the 'optimal governance hypothesis' (Anderson et. al., 2003), firm participants will voluntarily adopt corporate governance mechanisms to the point where the marginal benefit of adopting further mechanisms (the reduction in agency costs) is just offset by the extra cost of implementation.

A purpose of this paper is to determine whether the optimal governance hypothesis holds true in the presence of family control. One stream of extant literature would suggest that family control is, potentially, an agency cost reducing mechanism in itself. Family firms are concentrated blockholders with a unique incentive to overcome the free rider problem that prevents atomised shareholders and, indeed, some other blockholders from effectively monitoring management (Tufano, 1996; Anderson & Reeb, 2003). Furthermore, as the wealth of the family is directly tied to the future of the company - and decision making in family firms is predicated on much longer time horizons than in non-family firms - family firms more strictly adhere to wealth maximisation than their counterparts (Chami, 1999; James 1999). These reasons, in combination with the ancillary benefits of altruism (Schulze et. al., 2001), would suggest that family control is

an agency cost reducing mechanism. When it is considered that family control is one of several potentially substitute or reinforcing mechanisms, it follows that the combination of corporate governance structures adopted by family firms will be different to the combination of structures used by non-family firms but no less consistent with wealth maximisation.

However, there is also a line of argument within the agency theoretic that would suggest that family control creates (rather than negates) agency costs. It has been suggested that family control provides family members with a unique opportunity (not available to other shareholders) to use their concentrated blockholding to expropriate the wealth of outside shareholders through excessive compensation, related party transactions, special dividends and risk avoidance (Anderson & Reeb, 2003; Anderson, Mansi & Reeb, 2002; Morck & Yeung, 2003). If family members use their control of the firm to expropriate the wealth of outside shareholders, it would be expected that corporate governance structures would be different between family and non-family firms and inconsistent with wealth maximisation. Furthermore, any differences in corporate governance variables between family firms and non-family firms are, ex ante, predictable: if the wealth of outside shareholders is being expropriated, managerial compensation should be higher in family than in non-family firms, the sensitivity of compensation to performance should be lower, board characteristics should portray inefficiencies and the CEO's personal characteristics should be consistent with entrenchment. The effects of inside ownership are more complex when it is considered that low levels of inside ownership facilitate the reduction of agency costs whereas high levels of inside ownership may create further entrenchment effects.

The following hypotheses (stated in the alternative) naturally follow:

**H1:** Family firms adopt different corporate governance structures to non-family firms.

**H1A:** Managerial compensation is different between family and non-family firms.

**H1B:** Managerial compensation differs in sensitivity to performance between family and non-family firms.

**H1C:** Board characteristics are different between family and non-family firms.

**H1D:** Ownership structure (excluding the family) is different between family and non-family firms.

**H1E:** The CEO's age and tenure are different between family and non-family firms.

**H2:** Family firms adopt optimal (wealth maximising) corporate governance structures.

## **Method**

**Sample Selection** - The sample includes a cross-section of 100 firms, listed on the Australian Stock Exchange in 2002, with each having a common CEO (who is a board member) over 2001-2002 and a common reporting period (June 30). The constraint of a common CEO diminishes the effects of confounding noise on the compensation variables. It also increases the likelihood that randomly chosen non-family firms will have similar ownership characteristics to family firms (as family control, by definition, includes a CEO with a large shareholding). However, it does have the potential to introduce a survivorship bias (ie. more successful companies are less likely to have CEO turnover). Sampling proceeded on the basis that all family firms that met the above constraint were included in the sample (assuming data was available). After eliminating outliers, 50 family firms were present in the sample. A further 50 matched firms were chosen on the basis

of size (total assets) and ASX industry classification. Unfortunately, thin coverage over the ASX industry codes meant that companion firms could not be identified for about 10 companies. As a consequence, a further 10 companies were chosen at random to provide symmetry to the sample.

Firm-level data on corporate governance and accounting variables were collected for each firm as reported in corporate reports (available from Datastream). Share price information and some further accounting information were collected from Datastream. Data were collected solely for 2002 for all variables except those required in the compensation analysis (where data covering 2 years was collected). Corporate governance variables are reasonably static over time such that the absence of a time-series dimension to the analysis remains a limitation of the paper.

The adopted definition of family control will correspond with that used by Mroczkowski & Tanewski (2004), who define a family controlled firm as “an entity controlled by a private individual, directly or indirectly, in conjunction with close family members” (p 10). Inclusion is based upon the following criteria: the existence of a founding member involved in management with greater than 20% of voting shares; the shareholder is CEO or a key member of the board (i.e., chairperson); at least one other related party is a member of the board and; the original shareholder and the related parties hold greater than 40% of the voting shares of the company. The dummy variable FF will take on the value “1” for firms that satisfy the above criteria or “0” if otherwise.

**Compensation-** The measurement of compensation variables requires an analogous technique to that used by Anderson, Bates, Bizjak & Lemmon (1998). Fixed emoluments (salary, cash bonus, superannuation, allowances motor-vehicle expense etc.) are aggregated to form the fixed portion

of total income (C\_FIXINC02 & C\_FIXINC02). A second measure calculates the value of the CEO's option portfolio (C\_OPTINC02 & C\_OPTINC01). Details on each executive option package were manually collected from annual reports (exercise price, time to maturity and the number of options granted). Share price information on DataStream was used to calculate six-month historical volatilities. The ex-ante dividend yield was approximated by the ex-post 2 year average. Separate firm-level volatilities and dividend yields were calculated for each of the 2 sample years. The Australian 10 year bond yield (as of the two reporting dates) was used to proxy for the shadow risk-free rate. The value of the portfolio was calculated using the Black-Scholes (1973) model adjusted for continuously paid dividends.

**Board of Directors** - Board composition is determined using Weisbach's (1998) trichotomous classification scheme. A director who is a full-time employee of the company is classified as an inside director. A director who is neither an employee nor has extensive dealings with the company is referred to as an outside director. All other directors, who are not full-time employees but have relationships with the company (eg. family relationships, consultants etc.) are designated as 'grey' directors. Director classification is determined by reading biographies in annual reports, analysing related party transactions and by inference from the definition of family firm.

**Performance** - Performance is measured using Tobin's Q ratios (Q). The adopted measure of Q is calculated by dividing the sum of the market value of equity by the book value.

## Empirical Specification

The models used to test H1 are similar to those used in Anderson, Bates, Bizjak, and Lemmon (1998) in the context of diversification and corporate governance, whereas H2 involves an adaptation of the methodology used by Agrawal and Knoeber (1996) in their analysis of alternative control mechanisms. The first set of regressions is as follows:

$$Var_{ij} = \beta_{0j} + \beta_{1j}FamilyFirm_i + \beta_{2j}Size_i + \beta_{3j}Industry_i + \varepsilon_{ij}$$

where the subscript i denotes the firm-level observation for each variable in 2002 and  $Var_j$  represents each of the possible corporate governance variables that may be used as dependent variables. It is proposed that each of the ownership, board composition and compensation variables be substituted as the dependent variable. The second set of regressions, directed at testing the sensitivity of compensation to performance, take the following form:

$$\Delta Compensation_{ij} = \beta_{0j} + \beta_{1j}FamilyFirm_i + \beta_{2j}\Delta MVE_i + \beta_{3j}\Delta MVE_i * FF_i + \dots \\ \dots \beta_{4j}\Delta EBITDA_i + \beta_{5j}\Delta EBITDA_i * FF_i + \varepsilon_{ij}$$

where  $\Delta Compensation$  is the first difference in any of the (j) compensation measures between 2002 and 2001. The compensation measures include the change in the level of fixed income, the change in the level of option income and the change in the aggregate of the two. The interaction terms test whether compensation is more (or less) sensitive to previous performance in family firms as opposed to non-family firms. Previous performance is measured by the change in the market value of equity (a stock performance measure) and the change in EBITDA (an accounting measure). If family firms adopt compensation policies that promote entrenchment, it is predicted that the direction of the interaction terms will be negative.

**2SLS Regression Analysis** - Tobins's Q is adopted as a measure of performance. However, extant literature highlights potential endogeneity problems surrounding regression analyses of corporate governance mechanisms and performance. For example consider the following equations:

$$(a) \text{ InsideOwnership}_i = \beta_0 + \beta_1 Q_i + \varepsilon_i$$

$$(b) Q_i = \delta_0 + \delta_1 \text{ InsideOwnership}_i + \delta_2 \text{ Size}_i + \delta_3 \text{ Industry}_i + \mu_i$$

Inside ownership is a function of performance (i.e., when firms perform well, insiders increase their holdings), however, performance is not exogenous. Performance is a function of inside ownership (i.e., inside ownership leads to a decrease in agency costs and an increase in performance) as well as other control variables. If  $\varepsilon$  and  $\mu$  are correlated, Q (a function of  $\mu$ ) will be correlated with  $\varepsilon$  and  $\beta_1$  in (a) will be biased. The simultaneous bias will occur as long as  $\varepsilon$  and  $\mu$  are correlated and equation (a) is over-identified (this is so even if inside ownership is not a determinant of Q in (b) but Q is not exogenous).

Agrawal & Knoeber (1996) propose the use of 2SLS (two-stage least squares) regressions in the context of endogenously determined corporate governance mechanisms. The method involves, first, estimating OLS predictions for each endogenous regressor. Secondly, each of the predictions is regressed on Q (the ultimate dependent variable) together to determine consistent estimates for each endogenous regressor. This method allows for the interdependence and alternative use of all of the governance mechanisms.

To test the second hypothesis, an analogous method to that of Agrawal & Knoeber is applied to a restricted sub-sample that includes only the 50 family-firms. A 2SLS regression is estimated by regressing 6 endogenous corporate governance variables on Q. Predictions for each of the endogenous independent variables is estimated from the following equations:

$$\begin{aligned}
 (1) \quad P\_CEO_i &= \beta_0 + \sum_{j \neq P\_CEO} \beta_j Var_{ij} + \beta_7 STDEV_i + \beta_8 SIZE_i + \beta_9 IND_i + \varepsilon_{ij} \\
 (2) \quad P\_OD_i &= \beta_0 + \sum_{j \neq P\_OD} \beta_j Var_{ij} + \beta_7 STDEV_i + \beta_8 B\_SIZE_i + \beta_9 SIZE_i + \beta_{10} IND_i + \varepsilon_{ij} \\
 (3) \quad P\_BLOCK_i &= \beta_0 + \sum_{j \neq P\_BLOCK} \beta_j Var_{ij} + \beta_7 INDEX_i + \beta_8 SIZE_i + \beta_9 IND_i + \varepsilon_{ij} \\
 (4) \quad B\_PO_i &= \beta_0 + \sum_{j \neq B\_PO} \beta_j Var_{ij} + \beta_7 SIZE_i + \beta_8 IND_i + \varepsilon_{ij} \\
 (5) \quad C\_PEQ02_i &= \frac{C\_OPTINC02_i}{C\_OPTINC02_i + C\_FIXINC02_i} = \beta_0 + \sum_{j \neq PEQ02} \beta_j Var_{ij} + \dots \\
 &\quad \beta_7 STK\_RET_i + \beta_8 SIZE_i + \beta_9 IND_i + \varepsilon_{ij} \\
 (6) \quad DEBT_i &= \beta_0 + \sum_{j \neq DEBT} \beta_j Var_{ij} + \beta_7 CFR_i + \beta_8 SIZE_i + \beta_9 IND_i + \varepsilon_{ij}
 \end{aligned}$$

where  $Var_{ij}$  (firm 'i', variable 'j') is the observed value of each of the seven endogenous variables for each firm-observation in the restricted sample (Q is also endogenous). Control variables have been adopted in line with Agrawal and Knoeber. By estimating each of the above regressions, predictions for each endogenous regressor may be purged of simultaneous bias. Hence, the coefficients of the independent variables in the following regression should be consistent:

$$(7) \quad Q_i = \beta_0 + \beta_1 \hat{P}\_CEO_i + \beta_2 \hat{P}\_CEO_i^2 + \beta_3 \hat{P}\_OD_i + \beta_4 \hat{P}\_BLOCK_i + \beta_5 \hat{B}\_PO_i + \dots \\
 \beta_6 \hat{C}\_PEQ02_i + \beta_7 \hat{DEBT}_i + \beta_8 SIZE_i + \beta_9 IND_i + \varepsilon_i$$

where the first 7 independent variables (excluding the constant term) are the predicted values from regressions (1) through (6). If the coefficients in (7) are significant, the null in H2 will be rejected: there is evidence to suggest that family firms adopt sub-optimal corporate governance structures.

## Results

Table 1 provides descriptive statistics on the ownership variables. Each variable seems to be consistent with both intuition and prior research. It should be noted at the outset that, because the incidence of family firms is greater in the sample (i.e., 50:50 family: non-family firms) than it probably is in the population (prior research cited earlier suggests a split of 20:80), it is possible that many of the summary statistics are a function of the overweighting of family firms in the sample.

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Insert Table 1 about here  
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Table 2 (Panel A to Panel D) reports the results of 14 regressions. In each regression, a family control dummy variable and a firm size control variable (the natural logarithm of total assets) are regressed on each of the ownership variables. The results of regressions demonstrate that the CEO is likely to hold 13% (.001) more of the outstanding capital in family firms than in non-family firms. The CEO's direct shareholding in family firms is not significantly different from that of CEO's in non-family firms. Rather, their incentives are likely to be derived from indirect shareholdings: typically nominee companies where the beneficial interest is held jointly with other family members. Similarly, outside directors are likely to hold 12% (.003) less of the outstanding capital. Consistent with the notion of reduced external monitoring, outside blockholders are likely to hold 17% less of the issued capital in family firms than in non-family

firms. Given the parsimony of the models, the R-squared values (9%, 7% and 18%) suggest that family control is an economically significant determinant of ownership composition. The regressions provide clear evidence that family ownership displaces non-family owners. Large blockholders are less likely to be prevalent. Moreover, outside directors are likely to hold substantially fewer shares (and, consequently, have less of an incentive to monitor). In both instances the scope for external discipline of the CEO's actions is reduced.

Table 2 (Panel C) supports the differences in board composition and while the proportion of insider representation is not significantly different between family and non-family firms, family control is associated with 18% less outsider representation, compensated by 15% more representation by affiliates. This result is robust to the inclusion of a firm size dummy (which is significant in 2 of the 3 models). The R-squared terms for the B\_PO (21%) and B\_PG (20%) variables further stress the economic significance of family control as a determinant of board composition. Regressions (7) and (8) find no evidence of any variation in board size between family and non-family firms.

Regression (9) is a logistic regression relating the probability of the chairperson and CEO roles being occupied by the same person to family control. Taking  $e$  to the power of 1.34, regression (8) suggests that singularity of the chairperson and CEO positions is 3.82 times more likely for family firms than it is for non-family firms. This is statistically significant at the 5% level. The regressions add further validity to the notion that family control is typically characterised by large shareholdings concentrated in the hands of a few family members who occupy most of the seats on the board. Non-family shareholders are offered little chance for either direct

representation on the board, or alternatively, indirect protection through the presence of external monitoring (through either outsiders occupying board seats or the presence of institutional activists or other blockholders).

Table 2 (Panel D) reports the results of 6 regressions examining the relation between family control and the level of compensation in 2002<sup>1</sup>. Firm size is significant in each of the 3 models. Interestingly, while the family firm dummy is not significant in either of the first two models (where family control is regressed on the fixed component and the equity component of income separately), the final model, that aggregates the two dependent variables of the previous models together, is significant at the 5% level for both specifications. Unfortunately, unlike the other corporate governance variables, which are fairly stable over time, the level of compensation is likely to vary considerably over time. Moreover, the sheer range in cross-sectional compensation levels isn't captured adequately by the small sample. There are many CEO's who are paid seven-figure salary's just as there are many who are paid five figure sums. A random sample of 100 firms will inevitably be thinly spread between the two extremes. It remains a limitation of this paper that the sampling constraints do not allow the notion of family firm compensation to be considered in greater detail. However, there would seem to be enough evidence to credibly prompt future research to examine the issue further with the luxury of a larger sample and, perhaps, a more detailed analysis.

Table 3 reports the results of the 2SLS regression on the sub-sample of 50 family firms. The first column includes 6 of the 7 endogenous regressors (Q is also endogenous). The suffix 'F' denotes

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<sup>1</sup> 2001 data was not examined as data was not collected for various control variables used to test the robustness of the results.

that the regressor is the vector of predictions from the first stage. Agrawal and Knoeber (1996) suggest that, once the optimal determinants of each endogenous regressor are derived in the first stage, any significance that persists into the second stage is inconsistent with the notion of optimal use. That is, positive coefficients on independent variables suggest that increasing the use of the mechanism would improve performance, whereas, negative coefficients suggest that reducing the use of the mechanism would lead to performance improvements. If the mechanism is used optimally, the marginal benefits from increasing its use should be offset by the marginal costs, that is: it should not be significantly related to performance in the second stage. Tests of the first hypothesis rejected the null of no differences between the corporate governance structures of family and non-family firms. The analysis has now been redirected to determine whether these differences are consistent with optimal use.

The coefficient on P\_CEO\_AF suggests that, at low levels, family firms could benefit from performance improvements by increasing the level of the CEO's shareholdings. At high levels (captured by the quadratic term), inside ownership is consistent with optimal use. Together, these results are consistent with the notion that family ownership improves the alignment of incentives between shareholders and managers. If anything, those family firms where the CEO has a smaller personal stake in the equity of the company may improve the alignment of interests further by issuing more shares to the CEO. More interestingly, the negative coefficient on P\_ODF suggests that family firms would derive benefits by reducing the proportion of shares held by non-family board members. It would seem that there is evidence to suggest that the presence of non-family shareholders on the board creates a tension that ultimately results in sub-optimal performance. Perhaps the long-term interests of family members compete with the

interests of non-family directors. In any event, the evidence would suggest that family firms would benefit by redistributing the shares of non-family board members to the CEO. It is not clear why this would remain in disequilibria.

The positive coefficient on P\_BLOCKF suggests that family firms could benefit from further oversight from external shareholders with large blockholdings. Although marginally significant, there is some weak evidence to suggest that there wasn't enough external monitoring from unaffiliated shareholders in the sample. This is difficult to reconcile with the negative coefficient on P\_ODF. Taken together, the two coefficients suggest that family firms have sub-optimally low levels of unaffiliated blockholdings and sub-optimally high levels of unaffiliated board-shareholdings. While the two aren't necessarily mutually exclusive (it is entirely possible that the monitoring incentives of shareholders on the board and external blockholders are completely different), the relation between performance and the former seems to be economically significant. The negative coefficient on B\_POF would seem to give credibility to the former explanation. However; it lacks sufficient statistical significance to determine the issue conclusively. This should not be unexpected given the weak nature of tests that seek to explain the contribution of board structure to performance based solely on board composition. On the balance, it would seem that family firms would benefit by avoiding outside monitoring.

The insignificance of the coefficient on C\_PEQ02F suggests that the fraction of equity based compensation is set at optimal levels. This is despite previous evidence suggesting that the proportion of the CEO's equity-based compensation is likely to be lower in family firms than in non-family firms. Interestingly, the coefficient on DLF suggests that family firms are sub-

optimally leveraged: family firms could benefit by increasing the amount of debt in their capital structure. Previous research has suggested that family firms experience a lower cost of debt capital (Anderson, Mansi & Reeb, 2003) than non-family firms. Moreover, Australian evidence has suggested that family firms are likely to be more highly leveraged than non-family firms (Harijono, Tanewski & Ariff, 2004). Despite this, the evidence suggests that family firms don't fully utilise this competitive advantage over family firms.

On balance, it seems that family firms utilise sub-optimal corporate governance structures. This is somewhat odd given that all the mechanisms examined should be determined endogenously by the firm's participants. While it is possible that the limited sampling period is insufficient to capture the market in equilibrium, evidence of suboptimal use of corporate governance mechanisms is consistent with the notion that family firms utilise different structures to non-family firms in a manner that ultimately affects performance. It is also possible that the 2SLS method is too crude a framework for correctly testing optimality.

### **Discussion and Implications**

This paper began by outlining the literature on the agency implications of family control. Within this context, family control was posited to be one of several alternative substitute or ancillary internal control mechanisms, with the potential to either ameliorate or exacerbate the ultimate agency problem. This paper produces evidence that family control does interact with other control mechanisms. Family control displaces other owners: large blockholders are less likely to hold the capital of family firms and board members are less likely to hold shares. As a

consequence family firms are less likely to be subject to the discipline of disinterested monitoring (disinterested in the sense that the monitor is not a party to the family). This paper also produces evidence that family firms are likely to have a lower proportion of disinterested directors on their boards than non-family firms. Moreover, just as the proportion of outsiders on family boards decreases, so does the proportion of 'grey' directors increase, suggesting that family firms substitute outsiders monitoring with interested bystanders. Furthermore, family firms are considerably more likely than non-family firms to allow the CEO and the Chairperson roles to be occupied by the same person. Together, these findings suggest that families maintain a close locus of control with little opportunity for external discipline.

Further evidence was produced to suggest that the compensation of family firm CEO's is less sensitive to prior performance than non-family firm CEO's. In contrast, there was some weak evidence to suggest that family firm compensation might be lower than that of non-family firms. However, while this might be consistent with the notion that family CEO's derive utility from a broader set of sources than non-family CEO's, the absence of a time-series dimension constrains the ability to generalise. In aggregate, these inferences are consistent with the notion that family firms adopt a set of corporate governance structures that are consistent with the expropriation of outside shareholder wealth.

Tests of the second hypothesis sought to discriminate between this interpretation and the alternative possibility that the differences were not inconsistent with wealth maximisation. The results were somewhat anomalous. While the results from the two-stage regression suggested that family firms have sub-optimally low levels of outside blockholdings, the results also

suggested that non-family board members hold too many shares. The two results aren't necessarily mutually exclusive, however, they are difficult to reconcile. In addition, it was found that family firms with low levels of CEO ownership would benefit from issuing more shares to the CEO. It was also found that family firms are sub-optimally leveraged; it would seem that family firms would experience performance improvements by increasing the amount of leverage in their capital structures. Overall, the results from the tests of the second hypothesis are not completely consistent with entrenchment. If some of the mechanisms are prevented from reaching equilibrium - because of other extraneous factors not accounted for in the model, or simply because the short time horizon captures the market out of equilibrium - it follows that significant results may persist. This paper leaves the issue to be taken up by future researchers. Ultimately, this paper evidences significant differences in corporate governance structures. The nature of these differences hint at entrenchment (in the sense they are largely consistent with *ex-ante* predictions). However, it remains a reasonably open empirical question whether this is indeed the case.

Furthermore, this paper produced strong evidence to suggest that family CEO's aren't likely to hold more shares in their own name than non-family CEO's. This supports previous evidence in the literature that suggested that family CEO's are motivated by altruistic concerns (that is, pursuing their self-interest through the welfare of others) rather than their immediate self-interest. Research that sought to clarify the distinction between altruistic and other motivations would be well advised to do so within the context of family firms.

In summary, this paper finds that family firms adopt substantially different corporate governance structures to non-family firms. Some evidence has been produced to suggest that these differentials ultimately impact upon firm performance. However, further research is necessary to pursue this notion with a larger sample over a longer time-frame to determine the degree to which this paper's results may be generalised.

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**Table 2(A). Regression Analysis of Ownership and Board Composition**

The odd-numbered Regressions are OLS regressions. Where White's (1981) test for homogeneity of variance is rejected, test statistics have been corrected using White's heteroskedastic-consistent variance-covariance matrix. Regression coefficients and p-values from the even-numbered regressions are derived through M-estimation using Huber's (1981) influence function.

| Panel A     |                    |                    |                    |                    |                   |                    |
|-------------|--------------------|--------------------|--------------------|--------------------|-------------------|--------------------|
|             | P_CEO_A            |                    | P_CEO_I            |                    | P_CEO_D           |                    |
|             | (1)                | (2)                | (3)                | (4)                | (5)               | (6)                |
| Intercept   | 0.2658<br>(0.166)  | 0.4251<br>(0.339)  | 0.2599<br>(0.132)  | 0.1775<br>(0.113)  | 0.0133<br>(0.933) | 0.0214<br>(0.140)  |
| FF          | 0.1252<br>(0.001)  | 0.0958<br>(0.003)  | 0.1119<br>(0.003)  | 0.0675<br>(0.003)  | 0.0059<br>(0.346) | 0.0024<br>(0.405)  |
| LN(TA)      | -0.0102<br>(0.334) | -0.1251<br>(0.416) | -0.0112<br>(0.273) | -0.0079<br>(0.200) | 0.0010<br>(0.792) | -0.0008<br>(0.999) |
| R-squared   | 0.0901             |                    | 0.0976             |                    | 0.0098            |                    |
| F statistic | 5.9041<br>(0.004)  | (0.000)            | 5.2443<br>(0.007)  |                    | 0.4798<br>(0.620) |                    |

| Panel B     |                    |                    |                    |                    |                    |                    |                    |                    |
|-------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
|             | P_OD_A             |                    | P_OD_I             |                    | P_OD_D             |                    | P_BLOCK            |                    |
|             | (7)                | (8)                | (9)                | (10)               | (11)               | (12)               | (13)               | (14)               |
| Intercept   | 0.0961<br>(0.622)  | 0.0997<br>(0.624)  | 0.0891<br>(0.618)  | 0.0905<br>(0.013)  | 0.0070<br>(0.945)  | 0.0243<br>(0.137)  | -0.0969<br>(0.608) | -1.1662<br>(0.007) |
| FF          | -0.1179<br>(0.003) | -0.0729<br>(0.000) | -0.0628<br>(0.082) | -0.0281<br>(0.000) | -0.0551<br>(0.008) | -0.0118<br>(0.000) | -0.167<br>(0.000)  | -0.1657<br>(0.000) |
| LN(TA)      | 0.0044<br>(0.683)  | -0.0023<br>(0.974) | 0.0010<br>(0.915)  | -0.003<br>(0.133)  | 0.0033<br>(0.550)  | -0.0004<br>(0.648) | 0.022<br>(0.037)   | 0.4978<br>(0.001)  |
| R-squared   | 0.0695             |                    | 0.0311             |                    | 0.0749             |                    | 0.1842             |                    |
| F statistic | 4.6994<br>(0.011)  |                    | 1.5580<br>(0.216)  |                    | 3.9252<br>(0.023)  |                    | 12.1733<br>(0.000) | (0.000)            |

**Table 2. Regression Analysis of Ownership and Board Composition (Cont.)**

**Panel C.** Regressions (1) ,(3), (5) & (7) are OLS regressions. Test statistics (t-statistics in curved brackets, p-values in square brackets) are reported below coefficient estimates. Where White's (1981) test of homogeneity of variance is rejected, test statistics have been calculated using White's heteroskedastic-consistent standard errors. Regression (8) is a logitistic regression (z-statistics in curved brackets, p-value in square brackets). R-squared is the adjusted R-squared except for in regression (9), in which case McFadden's R-squared has been reported. Regressions (2), (4), (6) & (8) are derived using Huber's (1981) M-estimator.

|             | B_PO               |                    | B_PI               |                    | B_PG               |                   | LN(B_SIZE)         |                    | B_DUAL             |
|-------------|--------------------|--------------------|--------------------|--------------------|--------------------|-------------------|--------------------|--------------------|--------------------|
|             | (1)                | (2)                | (3)                | (4)                | (5)                | (6)               | (7)                | (8)                | (9)                |
| Intercept   | 0.1958<br>(0.324)  | -0.7424<br>(0.115) | 0.6529<br>(0.000)  | 1.1392<br>(0.004)  | 0.1514<br>(0.300)  | 0.0000<br>(0.685) | -0.8244<br>(0.002) | -5.3310<br>(0.000) | 3.9680<br>(0.180)  |
| FF          | -0.1857<br>(0.000) | -0.1747<br>(0.000) | 0.0394<br>(0.268)  | 0.0361<br>(0.233)  | 0.1463<br>(0.000)  | 0.1429<br>(0.000) | 0.0389<br>(0.458)  | 0.0459<br>(0.385)  | 1.3396<br>(0.035)  |
| LN(TA)      | 0.0250<br>(0.023)  | 0.4885<br>(0.003)  | -0.0176<br>(0.073) | -0.2828<br>(0.057) | -0.0075<br>(0.351) | 0.0000<br>(0.693) | 0.1369<br>(0.000)  | 2.4850<br>(0.000)  | -0.3659<br>(0.032) |
| R-squared   | 0.2064             |                    | 0.0255             |                    | 0.1970             |                   | 0.4752             |                    | 0.1145             |
| F statistic | 13.8715<br>(0.000) |                    | 2.2949<br>(0.106)  |                    | 13.1401<br>(0.000) |                   | 45.8283<br>(0.000) |                    | 10.0646<br>(0.007) |

**Panel D (Compensation level variables).** Regressions (1), (3) & (5) are OLS regressions. Where White's (1981) test for homogeneity of variance is rejected, test statistics have been corrected using White's heteroskedastic-consistent variance-covariance matrix. Regression coefficients and p-values in (2), (4) & (6) are derived through M-estimation using Huber's (1981) influence function. N=99

|                    | LN(C_FIXINC02)     |                    | LN(C_OPTINC02+1)   |                     | LN(C_TOTALINC02)   |                    |
|--------------------|--------------------|--------------------|--------------------|---------------------|--------------------|--------------------|
|                    | (1)                | (2)                | (3)                | (4)                 | (5)                | (6)                |
| C                  | 6.106<br>(0.000)   | -4.9429<br>(0.004) | -4.2756<br>(0.492) | -24.4971<br>(0.151) | 5.1835<br>(0.000)  | -7.7581<br>(0.000) |
| FF                 | -0.1535<br>(0.185) | -0.1121<br>(0.340) | -1.8705<br>(0.119) | -1.8703<br>(0.119)  | -0.3077<br>(0.029) | -0.2971<br>(0.037) |
| LN(TA)             | 0.3756<br>(0.000)  | 6.165<br>(0.000)   | 0.637<br>(0.068)   | 10.9829<br>(0.064)  | 0.4452<br>(0.000)  | 7.254<br>(0.000)   |
| Adjusted R-squared | 0.587              |                    | 0.043              |                     | 0.585              |                    |
| F-statistic        | 70.6786<br>(0.000) |                    | 3.2253<br>(0.044)  |                     | 69.9557<br>(0.000) |                    |

**Table 3. 2SLS Results – Corporate Governance and Firm Performance in Family Firms**

In the first stage, predictions of 6 endogenous variables are modeled from the equations specified in section 5. The 6 variables are P\_CEO\_A, P\_OD\_A, P\_BLOCK, B\_POF, C\_PEQ02 and DL. In the second stage the predictions are regressed on Q along with Q's specific control variables (Ln(TA) and industry dummies). For the sake of brevity, estimates relating to each of the 12 industry dummies (reflecting ASX industry codes) have been omitted from the table. 6 of the 12 dummies were significant in the final model (at the 10% level) despite thin coverage of the sample over ASX industry classifications. The tests reported in this table were conducted exclusively on family firms (N=50). The 'F' suffix in the first column denotes that the variable is the prediction from the model specified in section 5.

|               | Q<br>(1)            |
|---------------|---------------------|
| C             | -6.2132<br>(0.003)  |
| P_CEO_AF      | 8.1719<br>(0.030)   |
| P_CEO_AF^2    | -1.4051<br>(0.739)  |
| P_OD_AF       | -14.7447<br>(0.001) |
| P_BLOCKF      | 5.5882<br>(0.094)   |
| B_POF         | -1.3909<br>(0.312)  |
| C_PEQ02F      | -1.9998<br>(0.138)  |
| DLF           | 2.0690<br>(0.001)   |
| LN(TA)        | 0.3447<br>(0.010)   |
| Adj R-squared | 0.919959            |
| F             | 29.159              |
| p-val         | (0.000)             |

INNOVATION IN SMES: WHO? WHAT KIND? WITH WHAT EFFECTS?  
PRELIMINARY RESULTS OF AN EXPLORATORY STUDY

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### **ABSTRACT**

The importance of innovation for firm growth and survival has been well discussed in the entrepreneurship and innovation literature. We studied the factors that are either helping or hindering innovation in small and medium firms especially those related to the lead innovator in SMEs, the entrepreneur, the opportunity at the origin of the venture, the industry in which the firm competes, and strategies used by the entrepreneur. Results indicate that an entrepreneur's education level and entrepreneurial experience are positively related to firm innovation whereas an entrepreneur's industry experience is marginally negatively related to firm innovation. Stronger positive relations are also observed between firm innovation and the entrepreneur's creative personality and growth and perenniality motivations whereas an entrepreneur's autonomy motivation is negatively related to firm innovation. The entrepreneur's subjective value of the opportunity at the origin of the venture is also positively related to firm innovation. Firm innovation is positively related to firm growth, especially management and product innovation. However, we observe that different types of innovations have an effect on firm growth according to the industries in which firms compete. Finally, we observe that there is a U-shaped curvilinear relation between the degree of innovation in SMEs and the innovation productivity in terms of firm growth.

### **INTRODUCTION**

Innovation is seen by many actors in society as an important component of a firm's growth and survival and regional and national economic growth. Indeed, several researchers have looked at the relations between innovation and performance or growth and its beneficial impact on the competitive advantage of small firms (Hult et al., 2004, Verhees and Meulenbergh, 2004, for instance). Other researchers have looked at the factors and determinants promoting innovation or at the barriers preventing innovation in SMEs (Bhattacharyya and Bloch, 2004; Gudmundson et al., 2003, Huergo and Jaumandreu, 2004, Kickul and Walters, 2002, McAdam et al., 2004, among others). We will now review some of the findings from these authors.

### **REVIEW OF LITERATURE**

Gudmundson et al. looked at the impact of the types of ownership and customers served and organizational culture on innovation in small firms. They found out that innovation was

positively related to the level of management support and empowerment of workers in the organizational culture. In addition, family firms, by creating a more supportive organizational culture, initiated and implemented more innovations than non-family firms. Finally, only partial support was found for the relation between the types of customers served and innovation: non-family firms selling to businesses were more innovative than family firms selling to businesses or non-family firms selling to consumers.

In a similar note, McAdam et al. found that firms in the manufacturing, construction, transport, storage and communication sectors in peripheral locations were hampered by a certain lack of vision for the future and organizational culture not conducive to innovation.

Huergo and Jaumandreu wanted to explore the changing probability of innovation with firm age in Spanish firms. Their results show the probability of innovation to be rather stable over time, varying considerably across industries, and increasing monotonically with size. Thus, newer firms seem to innovate more than older firms and larger firms seem to innovate more than smaller firms. As small size is clearly associated by itself with less innovation, it therefore seems clear that small entering firms must be regarded as having extra capabilities which outweigh the size handicap. They also noted that exit from the market appears to be associated with relatively poor pre-exit innovative performance, mainly in process innovation. Also the oldest firms in industry tend to show lower probabilities of introducing innovations, especially in product innovations.

Bhattacharyya and Bloch also explored the effect of firm size on innovation. They observed that innovative activity increases significantly with firm size, but at a decreasing rate. Firm growth is insignificant in inducing subsequent innovation and R&D intensity is significantly positive in influencing successive innovation. In the high-tech industries, innovation increases significantly with firm size, but at a decreasing rate. In the low-tech industries, innovation also increases significantly with firm size, but its effect decreases at a slower rate than in high-tech industries.

Finally, in their study of internet firms, Kickul and Walters observed that the relations between opportunities and new ideas and e-commerce innovations were moderated by the entrepreneur's proactive aspects in his personality. Indeed, proactive entrepreneurs were more likely to introduce new product/service offerings and build e-commerce solutions/applications to satisfy the needs of both the organization as well as their customers. The authors also found that many of the proactive entrepreneurs developed and implemented innovative internal business relationships or management innovations.

On the relations between innovation and firm performance, Hult et al. observed positive correlations between firm performance and innovativeness and entrepreneurial orientation in the firm. Verhees and Meulenbergh also found positive relations between innovativeness and firm performance.

In short, several factors have an impact on firm innovation: firm age, firm size, industry, type of ownership, type of customers served, organizational culture, and the proactive elements of the entrepreneur's personality.

## **RESEARCH QUESTIONS AND METHODOLOGY**

As we have seen, Kickul and Walters observed a relation between innovation and the proactive aspects of the entrepreneur's personality. In addition, Huergo and Jaumandreu alluded that small entering firms must be regarded as having extra capabilities which outweigh their size handicap in innovation. We propose that these small firms' "extra capabilities" are in fact related to the motivations and creativity aspects of the entrepreneur's personality.

One of the authors, in earlier studies (Baronet, 2001 and Baronet, 2003), had looked at the personality characteristics of entrepreneurs, especially creativity and motivations for growth, autonomy and perennality, and their impact on discovery of opportunities, strategies entrepreneurs engaged in, and firm growth. It seems natural that we continue this line of inquiry in studying the relations that might exist between an entrepreneur's characteristics and innovation activity in his firm. Indeed, we consider here the entrepreneur as the lead innovator in the firm he has created to exploit an opportunity.

### **Research questions**

Therefore, in this paper, we examine the impact of the entrepreneur's demographic and personality characteristics as well as other firm and industry elements on the innovation practices of 348 US and Canadian SMEs in different industrial sectors. The questions we try to answer are:

- Do an entrepreneur's industry experience, education level, entrepreneurial experience, and the fact he created the business alone or with an entrepreneurial team have an impact on the degree on innovation in his firm?
- Do an entrepreneur's creative personality and motivations for growth, autonomy, and perennality have an impact on the degree on innovation in his firm?
- Does the subjective value of the opportunity (Baronet, 2004 and Baronet, 2005) at the origin of the venture have an impact on the degree on innovation in the firm?
- Do the strategies the entrepreneur might engage in, such as export and differentiation marketing strategy, have an impact on the degree on innovation in the firm?
- Does the level of innovation activity in the firm have an impact on firm growth?
- What kinds on innovation activities have an impact on firm growth?

### **Methodology**

Since this was an exploratory research, we asked students to interview entrepreneurs for a class project and have them answer our questionnaire. The questionnaire included personality tests covering the entrepreneur's orientation, creativity and motivations, demographic characteristics, and a quantitative description of the firm and its strategies. It also included a 25-item scale of innovation practices (Cronbach alpha of .906). Those 25 items were reduced to five factors related to five types of innovation: management, marketing, partnerships and financing, process, and product innovation (Cronbach alphas for each sub-scale were between .707 and .862).

The general level of innovation in the firm and the levels for the five sub-scales of innovation were the dependent variables in the first part of this study. The entrepreneur's demographic and personality characteristics, the subjective value of the opportunity, the industry in which the firm operates, and the strategies of export and differentiation were the independent variables.

In the second part of the study, the general level of innovation and the five types of innovation were the independent variables and firm growth in sales the dependent variable.

The final sample showed good variability, covering different industrial sectors, a range of firms that have been in business for 3 to 35 years, a range of growth in sales and number of employees, different strategies used, etc. We eliminated partial non-respondents, firms where the entrepreneur founder was no longer present, and firms with less than 5 years and more than 25 years of operations. The median number of employees for the final sample was 15 and the median sales were 2.5 millions dollars.

## **RESULTS**

Table 1 illustrates the results from the multiple regression analysis we conducted on the general level of innovation in the firm and the five sub-scales.

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Table 1 about here

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### **Demographics of the entrepreneur**

Of the four demographic characteristics we looked at, the education level is the only one that is significantly and consistently related to innovation, either at the general level or within all the sub-scales except process innovation. Industry experience has a significant negative impact on product innovation whereas the entrepreneurial team has a significant positive impact on product innovation. Finally, entrepreneurial experience has a significant positive impact on process and product innovation.

### **Personality of the entrepreneur**

An entrepreneur's creative personality and growth motivation have a significant and consistent positive impact on firm innovation, either at the general level or within all the sub-scales. In fact, they have the strongest impact of all the variables on innovation in almost all the different types of innovation. Perenniality motivation has a significant positive impact on management and process innovation and autonomy motivation has a significant negative impact on product innovation.

### **Opportunity**

In earlier works (Baronet, 2004 and 2005), the subjective value of an opportunity was defined as a combination of perception of knowledge asymmetry favoring the entrepreneur and entrepreneurial risk. This value has a significant impact on general innovation and marketing and partnerships innovation.

### **Industry**

We can observe some significant positive impact of the manufacturing industry on process innovation and some significant negative impact of the service and retail industries on the partnerships and product innovation.

### **Strategies**

Export activity seems to have a marginal significant positive impact on innovation. A differentiation strategy has a significant positive impact on innovation, especially management and marketing innovation.

### **Innovation and growth**

Table 2 shows the results of the multiple regression analysis we performed on firm growth using the types of innovation as independent variables. We ran into a problem of collinearity on marketing innovation with one of our sub-samples, firms in the retail sector. We therefore dropped marketing innovation from the analysis to ensure good quality of the analysis.

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Table 2 about here

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We can observe the significant positive impact of management and product innovation on firm growth for the total sample. In the manufacturing and service sectors, only management innovation has a significant positive impact on growth. We also observe a significant positive impact on firm growth of product innovation in the technology sector and of partnerships innovation in the retail sector. Finally, in the agriculture sector, process and product innovations have a significant positive impact on firm growth.

### **Serendipitous findings**

By chance, we also looked at the productivity of innovation activities in terms of the growth produced by innovation. Without embarking on a full analysis of this new variable, including taking into accounts other elements generating growth in the firms we studied, we were able to discern a few findings.

First, innovation productivity differs from one industry to the next. Thus, for one additional degree of innovation, firms in the technology sector will be able to get on average 1.71% additional annual growth, whereas firms in the agriculture sector will be able to get only 0.26% additional annual growth, firms in the retail sector 0.56%, firms in the service sector 0.70%, and firms in manufacturing 1.04%.

Second, we also found that there is a U-shaped curvilinear relation between the degree of innovation and productivity of innovation. Productivity of innovation for our sample appears to be stronger at the low end and the high end of the curve, according to the following equation:

$\text{Log of Innov.Productivity} = 0.5968 - (0.03 * \text{DegreeInnov}) + (0.0003 * \text{DegreeInnov}^2)$ .

## **DISCUSSION**

It seems clear that our findings put forward the importance of the entrepreneur, as a creative individual, in the innovation activity of the firm. Indeed, as we saw, the personality characteristics of the entrepreneur have the largest impact on firm innovation among all the variables studied. This remains so even as the firm ages and becomes larger and for all types of innovations. We could thus propose that as long as the entrepreneur is present in a managerial capacity the firm will be as innovative as he is creative.

It is also clear that innovation in all its forms has an impact on firm growth. This impact will differ from one industrial sector to the next but it will be present. Indeed, it is hard to imagine that a firm can grow without any innovation. Here we have yet another confirmation of the impact of innovation on growth.

For those of us whose role it is to assist entrepreneurial activity and by extension economic growth in regions or nations, the creative personality scale used in this study might be a useful tool. To be sure, if growth is related to innovation and firm innovation to entrepreneurial creativity, knowing how creative the main innovator in a firm (the entrepreneur) is, will be useful in predicting the level of innovation a firm can expect to reach. If an entrepreneur is perceived as "not creative enough", maybe some outside help might be offered to compensate for this lack of creativity. Also, considering the impact of different types of innovation on firm growth according to the industrial sectors where they operate, we could thus offer useful advice as to the best types of innovation in which one might invest for better results.

The serendipitous finding of a curvilinear relation between the degree of innovation and innovation productivity opens up possible further studies as to why this happens. A brief overview of the results on this finding shows that this curvilinear relation gets stronger as a firm has been in operation for longer time and weaker as a firm grows in size. Perhaps, we need to study the learning curve of innovation in firms to better interpret this curvilinear relation.

### **Limitations**

Probably the main limit of our study is situated in the small sub-samples we have for some industrial sectors, namely retail and agriculture. This limits the significance of our findings. Even though the statistical analysis appears to show a significant relation, further study with larger samples in these industries is necessary to really predict an impact of certain types of innovations on growth within these industries.

### **CONCLUSION**

We set out to observe if a set of variables, but mainly the personal characteristics of an entrepreneur, had an impact on the level of innovation in his firm. The results of our study do show such an impact. In fact, the entrepreneur's personality, defined as a combination of creativity and motivation for growth, is the most important element of all the factors favoring or hindering firm innovation.

We also wanted to verify the impact of innovation on firm growth. Again our results indicate that such an impact exists. We were also able to qualify this impact in terms of the types of innovation having an impact according to the industry in which firms compete.

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Table 1: Standardized regression coefficients for types of innovation

|                             | Dependent variable: Total innov. | Dependent variable: Management innov. | Dependent variable: Marketing innov. | Dependent variable: Partnerships innov. | Dependent variable: Process innov. | Dependent variable: Product innov. |
|-----------------------------|----------------------------------|---------------------------------------|--------------------------------------|---|------------------------------------|------------------------------------|
| Industry experience (log)   | -.056                            | -.013                                 | -.047                                | .004                                    | -.027                              | <b>-.128**</b>                     |
| Education level             | <b>.138***</b>                   | <b>.111**</b>                         | <b>.110**</b>                        | <b>.172****</b>                         | .062                               | <b>.123**</b>                      |
| #Entrepreneurial experience | .069                             | .029                                  | .043                                 | .011                                    | <b>.107**</b>                      | <b>.086*</b>                       |
| #Team start venture         | .031                             | .040                                  | -.019                                | .052                                    | -.003                              | <b>.089*</b>                       |
| Creative personality        | <b>.198****</b>                  | <b>.165****</b>                       | <b>.219****</b>                      | <b>.108**</b>                           | <b>.087*</b>                       | <b>.203****</b>                    |
| Growth motivation           | <b>.276****</b>                  | <b>.230****</b>                       | <b>.189****</b>                      | <b>.376****</b>                         | <b>.124**</b>                      | <b>.165****</b>                    |
| Autonomy motivation         | -.058                            | -.071                                 | -.039                                | .039                                    | -.032                              | <b>-.103**</b>                     |
| Perenniality motivation     | <b>.129***</b>                   | <b>.204****</b>                       | .014                                 | .034                                    | <b>.174****</b>                    | .048                               |
| Value of opportunity        | <b>.114**</b>                    | .070                                  | <b>.153****</b>                      | <b>.127***</b>                          | .059                               | .038                               |
| #Manufacturing              | <b>.128*</b>                     | .111                                  | -.070                                | .017                                    | <b>.351****</b>                    | .084                               |
| #Service                    | -.107                            | -.061                                 | -.003                                | <b>-.181**</b>                          | -.070                              | <b>-.186**</b>                     |
| #Retail                     | <b>-.133***</b>                  | -.064                                 | -.074                                | <b>-.131**</b>                          | -.132**                            | <b>-.167***</b>                    |
| #Agriculture                | -.006                            | .020                                  | -.003                                | <b>.133***</b>                          | .042                               | <b>-.163****</b>                   |
| #Export activity            | <b>.093*</b>                     | .020                                  | .013                                 | .032                                    | .043                               | .048                               |
| #Differentiation strategy   | <b>.153****</b>                  | <b>.205****</b>                       | <b>.163***</b>                       | .080                                    | .063                               | .074                               |

Adjusted

R<sup>2</sup> .457 .304 .244 .363 .337 .341

F 19.27\*\*\*\* 10.47\*\*\*\* 8.01\*\*\*\* 12.82\*\*\*\* 12.03\*\*\*\* 12.19\*\*\*\*

\* p ≤ .10; \*\* p ≤ .05; \*\*\* p ≤ .01; \*\*\*\* p ≤ .0001

# denotes a dummy variable

Table 2: Standardized regression coefficients for growth

|                            | Dep. Var.:<br>Growth<br>All<br>industries | Dep. Var.:<br>Growth<br>Manufact-<br>uring | Dep. Var.:<br>Growth<br>Service | Dep. Var.:<br>Growth<br>Technol-<br>ogy | Dep. Var.:<br>Growth<br>Retail | Dep. Var.:<br>Growth<br>Agriculture |
|----------------------------|---|--|---------------------------------|---|--------------------------------|-------------------------------------|
| Management<br>innovation   | <b>.300</b>                               | <b>.265</b>                                | <b>.420</b>                     | .135                                    | .474                           | .163                                |
| Partnerships<br>innovation | .069                                      | .122                                       | -.026                           | -.047                                   | <b>.519</b>                    | .096                                |
| Process<br>innovation      | -.042                                     | -.052                                      | .050                            | .055                                    | -.181                          | <b>.398</b>                         |
| Product<br>innovation      | <b>.256</b>                               | .111                                       | .062                            | <b>.476</b>                             | -.199                          | <b>.344</b>                         |
| Adjusted R <sup>2</sup>    | .254                                      | .086                                       | .209                            | .228                                    | .611                           | .566                                |
| F                          | 29.28****                                 | 3.08**                                     | 11.80****                       | 3.15**                                  | 9.26****                       | 9.79****                            |

Significant betas are in bold characters.

\*\*  $p \leq .05$ ; \*\*\*\*  $p \leq .001$

# **SMALL BUSINESS JOB QUALITY FROM EMPLOYER AND EMPLOYEE PERSPECTIVES**

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## **ABSTRACT**

Job quality is usually assessed in terms of objective criteria such as wage levels, employment status (full-time, part-time, contract, casual etc), the provision of a skill-based career structure, provision of training, work environment, payment of benefits, and formal opportunities to participate in decision making. However in this paper we use an approach that takes into account structure and agency or the contexts (structures) within which people (agents) make decisions and take actions and therefore look beyond just objective measure of job quality. This paper addresses the question of ‘what is a quality small business job?’ from the perspective of small business employers and employees. We report on the results of a mail survey of 1000 (randomly selected) small business owners (or managers) and semi-structured interviews with 28 small business employers and 30 employees. The research was conducted in the Latrobe Valley, an old industrial area in south east Victoria, Australia where there has not been a vibrant small business culture due to a reliance on large industry centred around electricity generation. We conclude that subjective criteria are important in any assessment of job quality which is informed by prior experience as well as the history of the place in which the jobs are created.

## **INTRODUCTION**

Small business job creation is high on the Australian policy agenda and has been over the past decade. Yet the issue of job quality was only raised with the release of the report *Small Business Employment* (SEWRERC, 2003). This is surprising given that job quality is high on the EU’s agenda (Cowling and Storey, 1999; EFILWC, 2002; 2003; 2004; ILO, 1999; 2001). Part of the reason for Australian neglect is because the conciliation and arbitration system sets in place minimum standards of employment through industrial awards. Although at present there is widespread debate in Australia about the setting of minimum standards for employment, and with the federal Coalition government’s control of both houses of Parliament to take effect in July 2005, then we can expect radical change in this area.

Job quality impacts on individual and organisational performance, and has broader implications for business sustainability and growth but it is a difficult concept to measure and assess. As a result the findings about small business job quality are contradictory. That is, when job quality is measured in terms of objective criteria such as wage levels, employment status, job security, skill level, employment conditions, and training and career development opportunities, then small business jobs are found to be low quality jobs (Revesz and Lattimore, 1997). But when subjective measures, such as job satisfaction or quality of work life are used, then many small business employees are found to value the flexibility of their employment, the ability to see how they

contribute to the firm's performance, and the 'local' nature of their job (for example Considine and Callus, 2002).

The purpose of this paper is to address the question of 'what is a quality small business job?' This question will be examined from employers' and employees' perspectives and we will focus not only on the different attributes people perceive to make a quality job, but also the attitudes to work and employment of those who create the jobs and those who work in the jobs. This is an important task as it has been argued by Curran and Blackburn (2001) that very few studies of small business employment go beyond the question of 'what' ('what are the characteristics of the jobs?' or 'what are the characteristics of the small business employers and/or employees?') to ask 'why' ('why do small business employers create the jobs they do?', or 'why do people choose to work in small businesses?'). These 'why' questions are under-researched, even though they have implications for how the employment relationship is structured and managed, the quality of work life and sustainable economic development policy.

These 'why' questions about job generation and small business employment can be addressed using an analytical approach that takes into account structure and agency: that is the contexts (structures) within which people (agents) make decisions and take actions (Barrett, 1999; 2001; Barrett and Rainnie, 2002). This is important as it is this dialectical interaction of structure and agency that produces perceptions of job quality. Such an approach is supported by others such as Wilkinson (1999), Ram, Abbas, Sanghera, Barlow and Jones (2001) and Ram and Edwards (2003) who argue that employment relations are not only influenced by conditions in general and specific business environments but also by the employers' choices and actions as well as the employee's actions and interactions at the workplace and beyond. This paper utilises this approach to examine job quality and in doing so overcomes some of the theoretical and methodological problems inherent in many other studies of small business employment and employment relations (see Barrett and Rainnie (2002) and Ram and Edwards (2003) for an overview of these arguments and counter arguments). In particular this approach addresses the issue of small business heterogeneity and rather than resorting to size determinism and therefore this paper makes a contribution to understanding job generation and job quality on the basis of 'place': in this case the Latrobe Valley.

Restricting the analysis in this manner is essential as the history and socio-economic context of a region affects the way that people view themselves and their position within the labour market (Peck, 1995; *Labour and Industry* 13: 2, 2002, particularly Herod, 2002). As a result the type of small businesses that form, and the jobs created within them, differ between regions with contrasting socio-economic climates (for example metro v. rural or favored v. less favored regions). The Latrobe Valley has an interesting history being a small region with significant reserves of brown coal. The region has been dominated by the electricity generation industry (with strong, well organised and militant trade unions) but during the 1980s-90s the Latrobe Valley underwent massive industrial restructuring as the open cut brown coal mines and power stations were privatised (see Gough and Pullin, 1996; Fairbrother and Testi 2002; Fletcher, 2002; Pullin and Gough, 1996; Rainnie, D'Urbano, Barrett, Paulet and Grobbelaar, 2005). The region now has a significant small business (less than 20 employees) population and, in 2001, 92.8% or 2,632 of the 2,835 businesses that operated in the area were small (Snell, D'Urbano and Cunningham, 2002).

The paper is structured as follows. In the next section we address the issue of job quality in more detail and explore subjective and objective criteria in assessments of job quality. We then outline the research methodology and some of the results of our survey of small business employers and interviews with small business employers and employees. In the final section of the paper we discuss our findings and make some conclusions about job quality in a place such as the Latrobe Valley. In the final section we also address the contribution that this study can make to understanding small business and particularly to knowledge about job generation, job quality and the nature of work and employment in small business more generally.

### **SMALL BUSINESS JOBS: QUALITY AND QUANTITY**

Small business job quality is an important issue given that the 'small is beautiful' myth continues to be prevalent in the thinking underpinning small business policy. This is despite a widespread acceptance in the academic community that that neither 'small is beautiful' nor 'small is sweating' (bleak house) characterise small business employment relations (see for example Barrett, 1999; 2001; Barrett and Rainnie, 2002; Chapman, 1999; Holliday, 1995; Ram, 1991; 1994; 1999; Ram, Abbas, Sanghera, Barlow and Jones, 2001; Ram, Edwards, Gilman and Arrowsmith, 2001; Ram and Edwards, 2003; Wilkinson 1999).

Job quality is also an important issue given the resurgence of interest in small business employment. For example, the downward trend in Australian small business employment that emerged in March 2001 (Priestly, 2002) had led to a serious consideration of how small business jobs can be stimulated. Policy has focussed on structural conditions conducive to job creation and removing barriers to employment. In particular in Australia the focus has been on exempting small business from unfair dismissal provisions in the *Workplace Relations Act* 1996 (Cwlth) as this is said to be the major barrier to further employment growth. While it is highly questionable as to whether unfair dismissal actually does stop growth (see Barrett, 2003), the debate is effectively over. The federal Coalition government takes control of the House of Representatives and the Senate on 1 July 2005 and they have made clear in the media that one of their first steps will be to exempt small business from these provisions. They will then undertake a series of more radical workplace relations changes in the name of further stimulating employment, business and productivity growth more generally.

This interest in small business job generation is in part a response to the continual rhetoric about small business job generation, which was fuelled by Birch's (1979) seminal work on job generation in the United States showing 80% of new jobs were created by small business. This research was highly controversial, particularly as it relied on a dynamic, Schumpeterian view of capitalist markets rather than the more widespread static view associated with general equilibrium theory (Kirchhoff and Greene, 1998). Nevertheless, this research came at a time when increasing unemployment was beginning to concern many governments and therefore it was widely welcomed and continues to resonate through many small business policies.

The problem with such a policy interest is that research has produced inconsistent or diverging results about small business job generation (see Storey (1994) for analysis of UK research; Parker (2000; 2001); Revesz and Lattimore (1997) for Australian overviews). Kirchhoff and Greene (1998) illustrate the problem when they outline the differences between a comparative static analysis and a dynamic analysis of small business job creation, explaining that the use of the

former shows large businesses generate jobs and the use of the latter showing that jobs are generated by small businesses. Their conclusion is that although these methodological arguments are interesting they distract policy makers from small business economic development.

These methodological arguments also distract policy makers from the issue of job quality. Job quality is usually assessed in terms of objective criteria such as: wage level; employment status (full-time, part-time, contract, casual etc); provision of skill based career structure; provision of training; work environment; payment of benefits; job security; and formal opportunities to participate in decision making. Further, research mostly relies on sophisticated quantitative analyses of (usually) national level small business data (such as Baldwin, 1998; Cowling and Storey, 1999; Handel, 2005; Hohti, 2000), often with the intention of creating a job quality index (see [www.jobquality.ca](http://www.jobquality.ca) for example or Burgess, 2003). Job quality is high on the EU's agenda (Cowling and Storey, 1999; EFILWC, 2002; 2003; 2004; ILO, 1999; 2001). For example, the report by the European Foundation for the Improvement of Living and Working Conditions *Towards a sustainable corporate social responsibility* highlights the need to focus on issues such as job quality (EFILWC, 2003). *The Annual Review of Working Conditions in the EU* report 2003-2004 further emphasises the link between the improvement in job quality and the objective of raising employment levels (EFILWC, 2004). This supports the central goal of the *Social Policy Agenda* that is to achieve more and better jobs (EFILWC, 2004). However, the focus is largely on the objective aspects of the job quality.

Despite this, interest job quality is only beginning to gain attention in Australia (Burgess and de Ruyter, 2000) with the increasing incidence of non-standard employment arrangements. Part of the reason for Australian neglect is because the award system has set in place minimum standards of employment, although this is likely to change in the federal Coalition government's reform of industrial relations. However, despite minimums existing this does not necessarily mean these standards are met in small business and anecdotal evidence suggests they are likely to breach employment laws (see Kitay and Sutcliffe, 1989).

Studies that employ only objective measures to define or measure the job quality are often undertaken to claim that the quality of jobs has either declined or improved on various objective dimensions (see Handel, 2005 for an overview). But it is important to understand how employees themselves perceive the quality of their jobs and not to ignore the subjective dimensions of the employees' perceptions towards job quality. Few studies consider job quality from the small business employee's perspective and those that do primarily focus on job satisfaction (for example Blackburn, 1990; Curran and Stanworth, 1979; 1981a; 1981b; Goss, 1991). However, job satisfaction has an array of antecedents (Locke, 1976) including the individual's values, which are derived from an individual's socio-economic background as well as their geographic location (Rosenthal, 1989). The result is that individuals perceive situations differently, meaning two people doing the same job with the same pay and conditions may not both think their job is a quality job. This issue of values brings into question how useful studies relying on 'objective' criteria alone are to understanding job quality, and it is for this reason Cowling and Storey (1999: 73) argue that attempting to construct an "all encompassing index of job quality is fraught with danger". At the same time, however, if studies do not incorporate this information then the myth of small businesses being 'better' places to work, because of the closer and more personal relationships between the employer and employees and the employee's ability to see how their work contributes to the whole production process, will continue to remain pervasive, especially

in policy circles. This is why this paper examines job quality from both the employee and the employer perspective. In the next section of the paper we outline the research methodology for the study.

## **RESEARCH METHODOLOGY**

A mail survey was sent out to 1000 (randomly selected) small business owners (or managers) in the Latrobe Valley to collect the information required, which included data on the owner's background, previous business and employment experiences, education, motivations to establish or operate a small business, general business intentions, perceptions of local economic conditions, hiring intentions, recruitment practices and attitude to work and employment. The survey had a 21% response rate and was followed up by semi-structured interviews (Fontana and Frey, 2000; Lee, 1999) with 28 small business employers to examine the particular circumstances of their business in the context of the broader structures in which they make employment decisions. The interviews also explored employers' motivations to employ and the processes they used to recruit, select and manage employees.

As existing research generally neglects employees' perceptions of the quality of their jobs especially the subjective dimensions, we also conducted semi structured interviews with 30 small business employees. These employees were generally employed in the businesses run by the employers we interviewed (above). The purpose of these interviews was to understand why these people came to be working in the business, what they thought about their job and the quality of their job, why they thought that, what reference or comparators they used and whether these were based on direct experience or not. These interviews therefore covered: employee's background and previous experience; expectations of work generally and of this job in particular; perceived advantages and disadvantages of working in a small business; and job related attitudes (satisfaction, commitment, loyalty). An effort was made to explore in detail the subjective dimensions of the perceptions of employees towards the job quality as far as working in small business is concerned. In effect the purpose of the interviews was "to see the research topic from the perspective of the interviewee, and to understand how and why he or she comes to have this particular perspective" (King, 1994: 14).

## **FINDINGS AND DISCUSSION**

The survey sample characteristics are as follows. Of the respondents 28.3% employed no-one in the business other than themselves and 61.3% employed fewer than five people (including the owners) working in the business. The average firm size was 4.8 (standard deviation of 4.6). Most (91.3%) of these businesses were not part of a larger business and in the majority of the cases (68.8%) the business owner had started the business themselves rather than bought the business from someone else. The average length of time the current owner has been running the business was 21 years. Some 84.2% had total sales revenue for the last financial year of less than A\$1 million.

The majority (75.6%) of the respondent firms operated in the service sector, with retail traders the largest (29.6%) of the service sector groups. The small businesses operated under a range of legal forms with a private company structure being the most prevalent (41.6%), followed by partnerships (26.2%) and sole proprietorships (23.8%). The high incidence of private company

structures is associated with the degree of agreement with the firms being considered a family business – 59.3% of respondents indicated that their business was a family business with at least one (31%) to two (45.6%) members from the same family owning the business.

### **Business Practices**

By and large the respondents were not planners. For example, as Table 1 shows, only 36.5% had a business plan and only 22.2% had a staffing plan.

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Table 1 about here

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The questionnaire also addressed the existence of various policies covering employment matters and the results are shown in Table 2.

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Table 2 about here

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The questionnaire had a series of questions dealing with the employment practices of those businesses that either employed staff and/or intended to employ more staff in the next 12 months. Ninety nine respondents (57.6%) were intending to employ new staff: in 41.4% of cases this was because the business was expanding while in 35.4% of cases this was to replace another employee. Another 28 respondents also commented on their firm's employment practices as these employers had not made a conscious decision not to employ more staff.

Of those 127 respondents employing staff or planning to employ new staff over the next 12 months, the following employment (HRM) practices were used. There was a preference for recruiting new staff through referrals (77.5%) or using an agency (42.3%). While 73.9% of the 127 respondents used a list of skills and qualifications to recruiting, only 46.9% had job descriptions for all their staff. Interviews were used by 95.6% of the 127 employers to select new staff and 79.5% undertook reference checks.

In 45.5% of cases wages and conditions were set by the relevant federal award<sup>1</sup>, while another 29.5% used individual contracts and 17% used a verbal contract. Only 31.6% of employers regularly conducted a formal performance appraisal. In order to keep valued staff in the business the majority (95.7%) used praise and recognition followed closely by a salary increase (81.7%). Informal on-the-job training was offered in 67% of cases.

Respondents were asked about a range of possible concerns they had in relation to employment and these are rated on a 3 point scale of 1 (Not concerned), 2 (Concerned) and 3 (Very Concerned). The mean and standard deviation are shown for the different items in Table 3 in order of most to least concerned.

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Table 3 about here

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## Job Generation

A number of themes emerged from the survey and interviews and our initial analysis of this data provides some insight into the issues small business owners feel impact on their businesses and their ability to employ. For example, the problem of being unable to employ the 'right people' was thought to be made worse by the unfair dismissal regime and the shortage of skilled personnel in the region, obsolete school curriculum and a decreasing number of students taking up apprenticeships.

For example when it came to unfair dismissal employers were often confused about the application of the legislation. In the interviews a number of employers made it clear that they tend to avoid employing a new person unless it is really critical for the business. One business owner put it this way, "*It's just, it is a fear when you employ people, and I guess it's one you tend to try and avoid, I guess that is why you tend to employ people you feel you can relate to because you can perhaps communicate more with them*". As a result employers relied heavily on referral methods to recruit new staff. Others made it very clear that they had systems in place to ensure they did not fall foul of the law when dismissing staff. For example one said,

*We have this three month probation, we go through a pretty lengthy induction with them when they start and we give them a copy of what we call our own induction papers, which we go through with them. We then say 'take it home and talk about it with your wife or your partner or whoever and if at the end of the day you think this looks really good, this is the sort of organization I would like to work in, terrific, fill in the application and send it back. But if you think 'oh yeah right', well just don't bother' because that will do us all a favor then'.*

Another made the point that being a small business he has the capacity to make sure the fit is right. As he said,

*Being a small business means I can sit down with a lot of these people. I wouldn't say bluff them or drive them or anything, but you tend to give the staff member an opportunity to resign, because that's their best opportunity to get re-employment, and most people are aware of that now, if they get sacked, it's very difficult to get that next job. And if it comes to the point where... we've had one guy not so long ago, he understood that he wasn't going to get a job if he got that letter of 'see you later,' there was a lot of grounds that had records of, you know we tried to keep as much records as we could, Retail Traders Association gives us a lot of help with that, um, but we always give the person the opportunity. Probably out of the last ten years, five of those guys have taken up that option and have actually handed in a letter, so that's quite simple. Yeah, but it's always ugly if it goes down that line.*

In terms of skill shortages a recent report released by the Productivity Commission highlights the growing skills shortage in Australia (DEST, 2004). In our study a number of employers expressed the view that the region faces a shortage of skilled workers. Their belief was supported by their inability to find the 'right person' or in some cases even the 'right applicants' for a particular job that they had recently advertised. When asked about the staffing issue in the mail survey 48.8% respondents mentioned they were 'very concerned' about finding the 'right' staff and 42.4% mentioned they were 'very concerned' about finding the skilled staff. The inability to find the right person for a particular job is very disturbing for the businesses. A number of factors were perceived as being behind these shortages. For example there was a view that academic

institutions such as TAFEs and Universities should work very closely with industry to ensure the curriculum met their needs. A shortage of skilled staff was particularly felt in the trade professions such as plumbing and building. One view as to why there was this shortage was a lack of encouragement on part of the government for apprenticeships. Employers expressed concern about the ageing workforce and the lack of young people taking up the apprenticeships so that the country in general and region in particular has a viable workforce when baby boomers retire. One of the employers put it this way,

*We used to put an Apprentice on every year, but they're getting hard to find. We used to get work experience kids, but I've been told the government have stopped that because they [school work experience students] might be injured, so they can observe but not work. And they've just dried up.*

Another employer said,

*Yeah, it's hard to find skilled people.... and it's pretty hard to get kids. Like I've had some kids that can't even hold a drill, they don't even know the risks of a hammer drill jamming in a brick wall or something... they're just not taught how to use those sorts of things anymore, so it's very hard to get young kids that are good....*

All respondents were asked to indicate their level of concern about a range of external business environmental issues. The mean and standard deviation for their responses are shown in Table 4 where 1=Low, 2=None and 3=High.

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Table 4 about here

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In interviews employers identified over-regulation generally, high work-related insurance premiums, and the Victorian government's payroll tax regime as issues which could stall their business growth and hence their ability to employ. Many suggested governments should provide them with financial incentives to stimulate job growth. Table 4 shows that the GST and new tax system and high cost of public liability insurance were considered as having the most impact on the businesses. Many suggested governments should provide them with financial incentives to stimulate job growth.

As far as the infrastructure in the Latrobe Valley itself employers were generally satisfied with it although expressed the opinion that it could be improved with, for example, the fast rail link. Businesses expressed concern about the bickering between towns as a result of the amalgamation of the local councils during the 1990s. Employers were of the opinion that council could better serve business interests with a coherent investment and development policy. In general however, business owners are very positive about working in the Latrobe Valley. They agreed that the region had an 'image problem' but they were positive about the marketing programme for the Latrobe Valley to 'sell' it to outsiders and therefore, uplift its image.

### **Job Quality**

When asked about job quality, employers used objective and subjective criteria to define job quality in their business. As one employer said, "*job quality to me sort of goes into lifestyle and part of your whole life sort of thing*". This employer went on to argue

*It is not just a case of looking after people because they are people, it makes good business sense too. That is one of the things I am a bit surprised about with some of the new big companies that they talk the talk a lot but don't do too much walking at times. They seem to think that because they pay heaps so therefore they should have your soul. I don't think anyone could pay enough money for a soul anyway.*

However, many employers had limited capacity to offer incentives such as higher wages or other improved employment conditions, and they leaned towards subjective criteria to define job quality for employees. For example employers felt they were creating a good quality job when there was a good relationship between them and the employee, the employee lived close to the workplace and when the employee had flexible working hours. As one employer said,

*We have always, everybody has deaths in the family, everybody has births in the family and we have always just said to them 'right you just go, sort yourself out and when you are ready we'll cross that bridge', and hopefully they have been appreciative of that.*

Employees defined job quality using many of the same criteria as employers. Our analysis of the interview data suggests that employees were not necessarily motivated by wages and hours to work in a small business. For them these may be counted among the prime motivators but they were not necessarily the only motivators. As one employee put it,

*Money comes into it, because you can't work for nothing. But I think next would be appreciation. Promotion doesn't worry me much any more. I just enjoy my work now.....Don't get me wrong, money is... to be paid well to do a job is a good thing, but I don't always see money as being the ultimate.*

Another employee explained what a quality job meant to them.

*For me a good quality job is keeping busy, being happy, which is the main ones, get along with everybody..... I don't come around the corner and think, oh god, here I go again. I enjoy coming here. It's a laugh and you go home and to me that's a good quality job. I remember there was times when I worked at the [Name of large] Bank, I'd lie in bed in the morning and think, 'oh no, I just don't want to go'. Now to me that's when you shouldn't be there.*

Employees gave importance to having a close relationship with the 'boss', a flexible work schedule, 'not being just a number in the organisation', and, in some cases, short travel times to work. As one said, "I'm sure to get like road rage or something if I was stuck in an hour of traffic every single day." For another the close proximity to the boss was what made a quality job.

*I find it easier to go to someone like [Boss' name] and say 'have you got a problem,' or something. Whereas if you don't know someone in a large firm, you tend to not even bother, and then you'd feel 'well they wouldn't want to know or help,' or something, sort of thing. So I prefer the small group, the family type thing, instead of the big lot of people. You're more noticed and you're more welcome.*

In many cases the opportunity to stay within a particular geographical region close to friends and relatives was also cited as a motivator. For example one employee said:

*I love the Valley. You're in the middle of everything. It's only an hour and a half to Melbourne, I love the country feel. I live in a country town on an acre and, you know, it takes me 10 minutes to get to work and, I've got the best of both worlds.*

These subjective criteria were seen as measures to describe a 'quality job', for many fulfilling their aspiration to have a particular lifestyle that revolved around being close to friends and family.

Many of the employees we interviewed had been working since they had left secondary school and had not experienced employment in anything other than a small business. In most of the cases the employees were happy working for a small business, however there are limited opportunities in the Latrobe Valley to work in larger firms. Very few employees expressed any desire to leave their current employment.

## CONCLUSION

Politicians are in agreement that small businesses play an important economic and social role, particularly in terms of employment. Moreover, this role is significant to the functioning of rural and regional economies and communities. There is also agreement that 'something' must be done to boost small business employment and reverse the recent downward trend in employment growth. In the Senate report, *Small Business Employment*, there is an acknowledgement that not only must jobs be created but these must also be quality jobs. This is the case as the quality of any job has implications for workers' health and the long term sustainability of workplaces, communities, regions and the economy.

It is this dialectical interaction of structure and agency that produces perceptions of job quality. An analysis that takes into account both structure and agency to understand the job quality means three issues have to be addressed.

- a) The first is the process of small business job creation, which requires an examination of the structural conditions within which decisions are made to create jobs (employers) and to take jobs (employees);
- b) the second is to understand what small business employers perceive as being a quality job, which requires an examination of the attributes of new small business jobs in addition to the attitude of small business employers to work and employment; and
- c) the third is to question why people choose to work in small business, which requires an examination of what employees think about their jobs, their perception of that job's quality and what reference or comparators they use to make these decisions.

In this paper we have attempted to address these three issues. The study we report on incorporates both employer and employee perspectives of job quality as well as employer perspectives of the issues that help or hinder them create new employment. The study specifically focuses on one region, and a region that has had an interesting industrial history dominated by a single employer – the State Electricity Corporation (SEC) – until the 1980s.

The study highlights that a shortage of skilled workers and an inability to recruit the 'right' workers holds back employment growth. While there are not any statistics available on the extent of a skills shortage in this particular region, there are a growing number of reports in the national media highlighting the problems in regional areas. However, small business employers contribute to this problem by not planning or recruiting widely. This study shows that in a majority of businesses we surveyed, practices such as staff planning are seldom used. Further by using

referrals as the main method to recruit new staff, small business employers are losing out on a big pool of talent.

Over regulation is an area that has to be dealt with if governments want to give small businesses a chance to survive in the current environment of fierce competition from big businesses. Small businesses do not advocate scraping regulations but do want Government to look into areas where employers feel they are being unnecessarily over burdened. For example, in the area of workcover insurance, the premium charged to cover an employee who is at a substantial risk is same as the premium charged to cover an employee whose risk level is low. Such issues need to be addressed and streamlining such areas would go a long way in bringing some relief to the small businesses.

In terms of job quality, objective dimensions such as wage levels, employment status, and job security are not the only motivators for attracting and retaining staff. Subjective criteria play a critical role and these can be used by small business to attract staff and complement the basic objective motivators. In the regional context these subjective motivators may, for example, prevent the exodus of skilled people towards the cities.

A study of job quality using the approach outlined in this paper can assist policy makers in two key ways. First, the findings can help them to understand what people perceive to be a quality job and therefore what minimum employment standards and social welfare measures are needed to ensure small business employees are not disadvantaged because they work in a small business. Second, such a study sheds light on the process of job creation and therefore highlights the type of information, support, assistance, advice, mentoring and counselling arrangements needed by small business employers to create new jobs.

Finally, a study using the approach outlined in this paper benefits the academic community as it acknowledges small business heterogeneity and takes into account a) the contexts within which agents make decisions, and b) the actions and decisions of agents themselves within those contexts and how they impact on the quality of jobs created. In so doing a more general approach to analysing small business work and employment, which does not resort to size determinism, is the result.

## ENDNOTES

1. An award contains a range of terms and conditions of employment (no more than 20) and generally covers an industry sector. Federal awards are determined by the Australian Industrial Relations Commission, which is a statutory body set up under the *Workplace Relations Act* and as a result, awards are legally enforceable
2. Australia is one of two OECD countries, along with the USA, that does not provide paid maternity leave as an employee right.
3. The GST was introduced in July 2000, and increased the frequency and level of reporting to the Australian Taxation Office (ATO) (Dyt, 2003).
4. Public liability insurance has been problematic and increasingly expensive in Australia following the corporate collapse of the Australian insurance company HIH.

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## TABLES

*Table 1: Business practices in use*

|  | Yes (%) |
|--|---------|
| Regular income/expenditure reports           | 66.5    |
| Budget forecasting                           | 38.3    |
| Have a formal business plan                  | 36.5    |
| Formal networking with other business owners | 25.7    |
| Staff planning                               | 22.2    |
| Benchmarking of business performance         | 21.6    |

N=167

*Table 2: Written policies in use*

|  | Yes (%) |
|--|---------|
| Occupational health and safety           | 59.1    |
| Employee discipline policy               | 41.8    |
| Employee grievance policy                | 41.3    |
| Written policy on overtime               | 42.7    |
| Equal employment opportunity policy      | 33.0    |
| Written policy on drug and alcohol usage | 31.8    |
| Written policy on bullying or harassment | 29.1    |
| Written policy on flexible hours         | 23.6    |
| Affirmative action policy                | 21.1    |
| Written policy on Internet usage at work | 18.2    |
| Paid maternity leave policy <sup>2</sup> | 16.5    |

N=110

*Table 3: Employment concerns*

|  | M    | SD   | N   |
|--|------|------|-----|
| Concerned about finding the 'right' staff                  | 2.62 | 0.60 | 113 |
| Concerned about finding skilled staff                      | 2.44 | 0.72 | 112 |
| Concerned about increasing labour costs                    | 2.25 | 0.69 | 112 |
| Concerned about the high administrative cost of employment | 2.23 | 0.74 | 113 |
| Concerned about absenteeism                                | 2.07 | 0.85 | 113 |
| Concerned about the ability to retain good staff           | 2.16 | 0.78 | 113 |
| Concerned about the increasing cost of redundancy          | 2.06 | 0.81 | 112 |
| Concerned about the high cost training                     | 1.73 | 0.74 | 113 |
| Concerned about the ability to dismiss staff               | 2.02 | 0.79 | 113 |
| Concerned about the ageing workforce                       | 1.51 | 0.69 | 113 |

*Table 4: Business environmental concerns*

|  | M    | SD   | N   |
|--|------|------|-----|
| Concerned about Goods and Services Tax and new tax system <sup>3</sup>   | 2.12 | 0.93 | 169 |
| Concerned about the high cost of public liability insurance <sup>4</sup> | 2.08 | 0.91 | 169 |
| Concerned about high local unemployment                                  | 1.95 | 0.78 | 169 |
| Concerned about rising interest rates                                    | 1.82 | 0.84 | 169 |

|   |      |      |     |
|---|------|------|-----|
| Concerned about the increasing value of the Australian dollar | 1.79 | 0.76 | 169 |
| Concerned about increasing global insecurity                  | 1.72 | 0.57 | 169 |
| Concerned about the increasing ease of borrowing funds        | 1.68 | 0.64 | 169 |

**ADVISING THE NEW ENTERPRISE:  
PEOPLE ISSUES IN AN AUSTRALIAN FUNDS MANAGEMENT BUSINESS.**

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**ABSTRACT**

Small enterprises are often portrayed as static businesses with little sophistication and consistency in their human resource management practices. However, small enterprises can be characterized on a number of dimensions including complexity, sophistication, market position, value, industry, managerial versus entrepreneurial management and so on. The case of Axedale describes the stages of development in a small enterprise that deals with “the top end of town”. It provides a professional investment service to wholesale clients and, even though it is still a young firm, it has billions of dollars under investment.

The case describes the changes in organizational structure and leadership, and importantly, the attention given to human resource practices. Sophisticated recruitment, selection and extended realistic job preview/employment trial practices together with continuous daily objective performance assessment - albeit in a firm that stresses long-term value - along with paired/team bonus payments, a mix of entrepreneurial and, on occasions, somewhat autocratic management style, enrich our understanding of the range of characteristics of small firms. What makes this case different is the in-depth knowledge the researchers have of the people in the firm, which provides unique insights into the functioning of this influential enterprise in the financial services industry in Australia. The highly paid employees perform intensive knowledge work, the results of which can affect the well-being of thousands (if not millions) of people in their older years.

Although the firm has been successful to date, the risks it faces, particularly in human resource management issues, but also in its narrow client base, are noted.

## INTRODUCTION

Even though small firms account for the employment of the majority of workers in Australia (and, of course, in many other countries including the USA), small enterprises have almost been totally overlooked by the human resource management literature (Hornsby and Kuratko, 2003; Kaman, McCrathy, and Tansky and Heneman, (2003); Wilkinson, 1999). It has generally been assumed that small firms will be informally organized and have informal human resource management practices, but just as de Kok and Ulhaner (2001) found many exceptions to this expected pattern, Axedale – the focus of this paper – also forms an exception as it could be described as an entrepreneurial firm with formalized human resource management policies. Kaman et al (2001) suggest that human resource management practices in small firms might vary from autocratic, controlling and inconsiderate to modern, “high commitment” approaches. Axedale does have some high involvement human resource management practices, but they sit within an autocratic framework, thus suggesting that the literature tends to be somewhat too simplistic to encompass the complexity of small firms.

For service firms, the resource-based view of the firm – which suggests that long-term competitiveness will be dependent on resources that are durable and difficult to imitate and substitute - points to the importance of human resources and their management in the road to success. The efforts to get this part of the business correct will be the focus of this paper.

The business - which to preserve anonymity we have called Axedale Funds Management Ltd - was established in 1999 as a joint venture between a major international finance house and a small team of experienced, highly motivated and talented Australian investment specialists. The latter had worked in large Australian financial institutions and were attracted to the possibilities of setting up a boutique concern which they considered could compete effectively with what they saw as more cumbersome organizations. The aim of the new enterprise was to offer a professional investment service to wholesale clients (i.e. those with more than AUD2 million to invest) utilizing a disciplined, systematic and transparent investment process. A major component of this approach was its investment process incorporating strategic analysis, cash flow forecasting and valuation modeling. It was considered that such a disciplined approach together with knowledge of local markets, when combined with the financial backing, intellectual ‘know-how’ and systems support of the international partner, would ensure high levels of investment excellence and client service.

The major role in establishing this enterprise was taken by one person – whom we have called Peter Davies – at that time 36 years of age. He had previously been employed in a major Australian bank and whilst there had been involved in some teambuilding activities with one of the authors who had carried out consultancy activities in that organization. The other three founders – also highly talented financial professionals – were aged between 34 and 46. Peter Davies and his colleagues were acutely aware that the success or otherwise of their new venture would depend upon attracting and retaining talented individuals. Their view was that if they could gain a good reputation among their clients and be successful in developing an organizational culture that facilitated teamwork, they would enjoy a significant competitive advantage in the industry. In particular, three factors were seen as critical. One was a system of shared beliefs in both the investment philosophy and the processes developed. Another was the desirability of having

complementary skills and personalities within the team. The third was to recruit individuals of various ages. They appreciated that the development of the venture would be a challenging and demanding experience and thus it was important they complemented and supported each other. It was decided to seek some outside assistance in achieving these aims and the writers and another colleague have worked with Axedale with varying degrees of involvement since that time.

## **THE INDUSTRY CONTEXT**

The total amount of funds under management in Australia is in the region of AUD900 billion (a billion, in Australia, is one thousand million), of which wholesale accounts for 64 per cent and retail for about 36 per cent. Of this total sum, some AUD650 billion is represented by superannuation assets which were boosted as a result of the introduction by the Australian government of a superannuation (i.e. pension) guarantee levy in 1992. Initially this levy was for 3 per cent of an employee's salary and increased to 9 per cent in 2002. As a consequence, superannuation assets are estimated to grow at a compound average growth rate of nearly 12 per cent each year.

Typically, the industry is divided into three types of fund managers: large fund managers have more than AUD20 billion under management; medium sized managers have from AUD5 to AUD20 billion under management and the small fund managers have less than AUD5 billion under management. (PricewaterhouseCoopers, 2003). Industry consolidation has taken place over the past few years and the top ten firms in the industry account for almost 67 per cent of the market. Nevertheless it is still fragmented with some 65 participants and with no one fund manager having more than a 10 per cent share. Relatively low fixed operating costs and the low capital intensity of the industry made it possible for a number of smaller Australian equities managers, such as Axedale, to emerge in recent years. Such boutique organizations gain clients by offering superior long-term investment performance than their larger counterparts.

The Australian market did not suffer from the same volatility as some other OECD markets in recent years. A PricewaterhouseCoopers (2003) survey reports that negative employment growth occurred during the three-year period to 2003, with both profits and revenues down in the previous year. Respondents to this 2003 survey indicated that they anticipated that revenue growth in future years would come primarily from existing customers, but investment market performance and winning customers from competitors were also seen as important factors. In this industry a fraction of a percentage point is critical and, as a result, the pressure on performance is constant. One client removing a mandate, therefore, can have a dramatic effect, especially in the case of a smaller firm.

## **AXEDALE: STAGES OF DEVELOPMENT**

The start-up (1999 – 2001)

Although from the outset the potential vulnerability of an organization being heavily dependent on one person was recognized, the major lead in setting up Axedale was taken by Peter Davies. This interesting, intelligent and focused person possesses great reserves of energy and a high determination to succeed. His role was critical not only in the negotiations involved in establishing the firm, but also in gaining business (i.e. investment mandates) and in the selection and leadership of the analysts.

Initially, the organization consisted of three divisions, viz. Investment Management, Client Services and Business Operations. The Investment Management Division was headed up by Peter Davies and three analysts he had previously worked with, together with another two recruited the following year – one from elsewhere in the financial services industry and one from asset consulting. The Client Services Division was headed by another financial services professional and the Operations Division was led by an experienced administrator. The heads of these divisions were required to provide leadership in terms of the day-to-day management and strategic direction of their respective areas.

In order to encourage retention, all senior members of staff were offered equity participation. This is consistent with the research that has found profit sharing to increase organizational commitment (Coyle-Shapiro, Morrow, Richardson and Dunn, 2002). Corporate governance was provided by a Board of Directors (consisting of a chairperson and two other members from the international finance house, an independent non-executive director, Peter Davies and the Head of the Axedale Business Development Division). An Executive Management Committee, consisting of two Axedale representatives and two from the joint venture partner hold meetings monthly to oversee business operations, marketing and client service matters. An Investment Management Committee, comprising of the members of the Investment Management Division, meets weekly.

The new enterprise was fortunate in taking over the lease and fittings of high quality office accommodation at a prestigious location in the centre of the city. Visitors to the firm arrive at an attractive reception area and are shown into an impressive boardroom. In this respect their image to the outside world was of an established, successful and much larger organization. Similarly, this small enterprise also had some of the other attributes normally associated with major concerns, such as a detailed human resources manual which was a modified version of the human resource manual of the joint venture partner.

As mentioned above, Peter Davies had gained experience of a number of psychometric instruments whilst working with his previous employer, the major Australian bank. To assist in integrating the members of this new organization, they were provided with opportunities to complete and receive confidential individual feedback from the Cattell 16 Personality Factor Instrument; the Watson-Glaser Critical Thinking Appraisal and the Myers Briggs Type Inventory. All agreed to participate. These tests were administered to enable those concerned not only to provide some understanding of their likely interactions with others, but also to give them an objective assessment of their abilities and potential for development. Although encouraged to share their results with one another, the decision to do so or not was left to the individuals concerned. One approach where the results were shared by all concerned was based on the Belbin Team Role Model, with which Peter Davies had become familiar in his previous employment and considered might provide some useful insights for understanding how the new team would function.

#### The Belbin Team Role Model

The Belbin (1993) approach to team building and effectiveness began in the United Kingdom at what was then the Administrative Staff College (now the Henley Management College) in 1969. Belbin invited course members attending a senior

residential general management program to complete a battery of psychometric instruments before competing in teams in a one-week computerized business game. Each team had an observer who recorded the behaviour of the individuals concerned every thirty seconds using a system developed from Bales' (1950) interactive process analysis. Using the data obtained, the researchers then analysed the personality characteristics and critical thinking abilities of the various teams, comparing the successful with the less successful. With greater experience and insight into team functioning, Belbin and his co-workers began to predict before the game what the finishing order of the various teams would be.

It was from these investigations, some of which were later carried out at the Australian Management College, that Belbin defined eight team roles. A ninth role was added at a later date. Belbin (1981) defines a team role as: "A pattern of behaviour, characteristic of the way in which one team member interacts with another so as to facilitate the progress of the team as a whole." Brief details of these team roles are shown at Figure 1. Later, two further developments took place. One was the introduction of a Self-Perception Inventory designed to give users some insight into their own team role. The other was what Belbin (1988) terms a computer-based Human Resource Management System - Interplace - which produces reports based on both self-perceptions and assessments by independent observers.

A member of the Belbin research team, Mottram (1982), suggested that certain combinations of team roles made for more effective teams and noted that the team role of an individual was not necessarily associated with his or her functional role. He noted that the most effective managers seemed to be those that recognized their own best team roles correctly; perceived the most effective contribution they could make in the situation or the team they were working in and were prepared to work to their strengths rather than allow their comparative weaknesses to affect their performance. Mottram went on to propose that the ideal team consists of individuals occupying a range of the Belbin roles, although different team roles are likely to be seen as crucial at various stages in the growth of an organization. For example, someone with the Shaper role would be likely to be important in getting a project started, whilst the follow-through activities of a Completer Finisher could ensure its completion.

The results obtained from administering the Belbin questionnaires within Axedale are shown in Figure 2. These suggest that, with the exception of the Implementor team role, this was a well-balanced group. Three individuals, one of which was Peter Davies, were found to have the Shaper team role as their most preferred or secondary team role. Belbin (1993) describes a person in such a role as: "Challenging, dynamic, thrives on pressure. Has the drive and courage to overcome obstacles," and suggests that individuals with this team role can provoke others and hurt people's feelings. Fisher, Hunter and Macrosson (2000) suggest that such a person is likely to have: "A proneness to frustration and irritation and an inability to recover situations with good humour or apology." Experience suggests that Shapers have difficulty in working with one another unless the boundaries of their roles are very closely defined. Nevertheless, the drive associated with this team role would be expected to be particularly useful in a start-up situation, although a strong sense of direction has the risk of being seen as authoritarian.

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By way of contrast, the Team Worker role was the most preferred role of only two people, one of these being the part-time non-executive director and the other a junior analyst. Team workers are mild, sociable individuals with a concern for others. They are good listeners, perceptive and operate with great sensitivity in work situations. The absence of anyone with the Implementer role was not surprising amongst this ambitious and highly-educated group. Typically, Implementers are people whose loyalty and interest lie with their organization and are not particularly concerned with the pursuit of self-interest.

Despite the espoused interest in teams, as mentioned above, the investment analysts in Axedale worked on their own, reporting to Peter Davies in his role as the Chief Investment Officer. Each member of the team, in addition to their responsibilities for researching, analyzing and making security selection decisions in particular Australian Stock Exchange sectors, was also responsible for the development and implementation of a part of the investment process.

All the employees initially recruited were accustomed to the leadership of Peter Davies and expressed admiration for his abilities as a fund manager. They pointed out to the writers that he had gained a national award for his performance as a fund manager and suggested that he could greatly enhance his salary if he were to leave and join one of the larger finance houses. All these factors – his role in setting up the business, the admiration and respect of his colleagues, his personal drive and demonstrated competence – combined to give Peter Davies a special status in Axedale. Nevertheless, several members of staff mentioned that they experienced difficulties in their dealings with him, reporting that he rapidly dismissed any concerns they might express and had a distinct tendency to dominate all discussions. He was seen as particularly competent in putting forward his views and had a distinct need to win any arguments.

In the first year of operation, the results obtained were above expectations with Axedale Funds Management exercising control over AUD1.1 billion in funds.

The second phase (2001 – 2002)

The initial success was reinforced the following year when the funds under management increased to AUD2.4 billion and the number of staff went up from six to fifteen. Shortly into this period, however, a number of mandates were withdrawn and by the end of 2002 the total amount of funds under management had been reduced to AUD1.3 billion. The management team was determined to rectify this situation and amongst other steps commissioned the writers to carry out an organizational review involving every member of staff. This culminated in a two-day offsite retreat.

Before this event took place the writers interviewed each member of staff, during which time they asked them to complete a short questionnaire. It was found that members of the firm were proud to work for it. On a five-point scale, for example, the average score for job satisfaction was 4.75 and that for satisfaction with the firm as an employer 4.5. The staff perceived the strengths of the firm to be its professional quality; the investment process that had been established; its people and particularly the diversity of personalities; their achievements in the short period of existence as a firm; the strength

of the joint venture arrangement; the equity sharing by staff and their team skills – although some were perceived not to be team players. The staff said they liked the generally relaxed environment; the smallness of the firm; its openness; the work ethic and their colleagues.

On the other hand, the reduced performance of the firm was seen as a major issue and raised by everyone. Reasons put forward for this could be summarized as a lack of clarity concerning the strategy of the business, the mechanistic nature of the investment process and the levels of stress experienced by some members of the Investment Management Division. These issues were all discussed in a very open and extremely frank manner and plans were drawn up to address them.

With regard to strategy, several said that they considered that there was no clearly-articulated vision. A few believed that the Board was aware of the strategy, but that this had not been disseminated. What was made very clear, they said, was the need to perform, exemplified by the expectation that they should work long hours and by the daily posting of the results of each analyst's stock selections. Sadler-Smith et al (2003) refer to obsession with measurement and performance management as being indicative of a non-entrepreneurial style. However, in this type of business it might be seen as a necessity, given its fiduciary responsibilities and how the market will assess the firm. Several put forward the view that all was in place for outstanding performance in the future, but that the enormous difficulties in developing an organization from scratch had been under-estimated by all concerned. Some of the staff stated that their aim was to make a lot of money and take early retirement. It was also evident from the interviews that the team had no shared vision except to make money, which is not generally considered as sufficient to drive the performance of an organization in the longer term – usually a more noble purpose is perceived to be necessary (Albrecht, 1994; Grant, 1998).

The investment process attracted a great deal of comment from the members of the Investment Management Division. This was seen as complex and took far longer than had been anticipated for those not familiar with it to be able to use it. Some analysts considered that this process was given undue emphasis and that the very complicated models in use should be subject to review. A few believed that the use of such a process caused delays which could prove to be costly.

Although many respondents had commented favourably about the openness and relaxed environment in the firm, there were many more comments about the lack of effective communication. Some felt that there was insufficient information provided to them on how well the firm was doing overall, some felt isolated and wanted fewer "closed doors". There was a feeling that it was sometimes hard to obtain a positive decision, that people were viewed as performance generators rather than as human beings and treated as children rather than as mature professionals. Some said that Peter Davies was not open to new ideas and not good at listening.

Concern was expressed about whether or not the teams were performing as well as they should. The analysts considered that they were constrained by attempting to outperform the industry averages. Although they were each supposed to take an interest in the activities of another analyst in order to provide back up, the pressure of work they experienced and lack of any reward for this resulted in only spasmodic attempts to do so. Levels of stress and conflict were reported to be high. Staff worked very long hours (actually 8.00am – 6.00pm during the week and at least one day at the week end) and any

overtime – for which payment was not made – had to be recorded in a register. Leaving the building at lunch time was seen to be disapproved of. As a result of these factors, several of the more junior staff reported that they found the organizational climate at that time to be oppressive.

The difficulties in leadership concentrated mainly on Peter Davies. Whilst applauding his achievements in the quest for technical excellence, his outstanding contribution to the marketing of Axedale and his drive to succeed, some of the analysts experienced difficulties in their dealings with him. He was perceived by all as being intellectually able, but a very dominant person. Several saw him as not being prepared to listen to their views and to impose his own. Whilst his prerogative as Chief Investment Officer to make final decisions was fully accepted by all, many thought that he would be wise to engage far more in genuine consultation before arriving at a final decision. His strong work ethic was seen to make him intolerant of those who worked fewer hours or whom he saw as less committed. It was said that when he was under pressure he could be curt and dismissive of his colleagues and sometimes did this in front of others. Finally, although it was recognized that he was generous with his time (with some, but not all the analysts), they felt that he was somewhat ‘distant’ and not an easy person to deal with. To assist Peter Davies in overcoming some of the interpersonal difficulties reported, one of the authors was asked to work with him in this task over the next couple of years and monthly meetings between them took place to assist Peter achieve this goal.

The keys to success in this industry were perceived to be team stability, relationships with assets consultants and with the superannuation industry as a whole, together with the capabilities and know-how of all staff. Within Axedale, the problems to be faced were how to cope with predicted growth, the ownership structure and consolidation in the industry. Also of some concern was how to manage the succession of the two older members of the team, in terms of replacement of their skills base but, importantly also of their management of client relationships and cost issues.

Although some of the feedback that he received must have caused him some personal concern, Peter Davies was remarkably open to what had been reported and a number of changes were made. He decided to relinquish the management of all his existing stocks to enable him to concentrate on portfolio investment decisions, the investment process and employee development. The Head of the Business Development Division was appointed as Chief Operating Officer in which role he was to determine the Axedale strategic direction, be responsible for managing the relationship with the joint venture partner and oversee the Operations Division.

At this time it was also decided to make redundant a member of the Investment Management Division. This was a most difficult task to undertake as the person concerned had been one of the original employees of the business. In the experience of the writers, such a step is frequently avoided, with the founder often preferring to wait until the person concerned reaches retirement age.

The third phase (2003 – 2005)

At the beginning of this period funds under management remained at AUD1.3 billion, but some 80 per cent of these funds had been mandated by one client organization. Fortunately, this client approved of the investment strategy adopted and was seen as

unlikely to remove their mandate. During the year a further mandate of AUD82 million was made by a prestigious institution.

Some further organizational changes were made within the Investment Management Division. The analysts were grouped into teams of two, each lead by a senior analyst. The performance objective of each team is to generate at least 1 per cent excess return over the industry average per annum over a three to five year period. In this new team arrangement, two-thirds of an analyst's performance bonus arises from the joint effort of the team and this is assessed in purely quantitative terms. The remaining third is assessed on qualitative factors. It is very much in the interests of the analysts, therefore, to work well with their partners as their bonuses will depend on both how they and their partner's stock responsibilities perform.

To assess how the changes made were seen by those concerned, a series of interviews was held in May 2003. Although a range of views was expressed, the outcome was generally positive with most of those seen reporting improvements in both performance and organizational climates. As one put it: "The whole place is now more cheerful and sociable." These impressions were confirmed by a response to the statement on a questionnaire: "The changes had left the organization more efficient," where the overall result was 4.1 on a five-point scale. Similarly, when scoring the statement: "The changes have resulted in a happier atmosphere," the overall result was again 4.1. (This result should be seen as only indicative, as due to some staffing changes, the group of people completing the scale on the second occasion were not identical to that which had done so on the first round.)

Generally, members of the investment teams spoke favourably about the support they now gained both from the Chief Investment Officer and the other member of their team. One spoke in glowing terms about the improvements that had taken place in communications and reported that - as a result of the changes that had taken place - everyone throughout the firm had become more aware of what the portfolio was doing. Several mentioned that the quality of decision-making had improved significantly, claiming that the analysts had become more confident, and thus bolder in making investment decisions.

Paradoxically, when the first series of interviews had taken place in 2002, the long hours of work had been a cause of complaint by the younger members of the firm. On this occasion, however, two of them were critical of what they saw as the lack of commitment to the firm by some of their senior colleagues. In particular, they expressed concern at the amount of time that senior people were spending in working at home and felt that this practice made it difficult to develop team spirit. Evidence to support that this view was more generally held was provided by the responses to the statement: "People at all levels in this organization work very hard." On a five-point scale, the overall score obtained was 3.9 whereas previously it had been 4.38. Overall the responses to the questions on job satisfaction and satisfaction with Axedale as an employer remained at high levels, but were slightly lower than on the previous occasion.

Most of those interviewed were positive in their comments about the changes in the role of the Chief Investment Officer, although some provisos were made. All approved of his decision to relinquish the management of an equity portfolio. Many referred to the improvements that had occurred in the way that Peter Davies carried out his role. Others appreciated that the role was still evolving and that Peter was also still developing in the

role. He was still held in awe by some of his colleagues, who commented on his experience in the industry and how valuable this was to Axedale. Two expressed the view that he did not exercise his power of veto over choice of stocks often enough and believed that this was due to his confidence having been shaken by some recent mistakes he had made. Others believed that these had provided a useful learning experience for him in that it enabled him to see more clearly that people did make mistakes and, as a result, had made him more tolerant. Two believed he should concentrate more on portfolio management and the understanding of major risk positions and spend less time on the development of models. There were still some criticisms of his management style with several reporting that they found it difficult to ascertain what he was thinking or feeling. What they sought was a more relaxed and informal relationship with him.

The criticisms were by no means restricted to Peter Davies. The four founders as a group were seen to be wanting in a number of respects and were portrayed by their critics as followers rather than leaders. As one put it: "If Peter doesn't see the need, the other founders are not strong enough to stand up and say so." Such a situation - where the founder is surrounded by a group of loyal lieutenants - is by no means rare in entrepreneurial concerns, but was perhaps surprising in an organization consisting of high-calibre individuals where so much overt attention was given to teambuilding.

A further organizational change was made with the appointment from within the organization of a Head of Research, responsible for identifying new stock investment opportunities and reviewing the research process and major assumptions underlying the strategic analysis of the research teams. Another analyst was made redundant. It was also recognized that the investment process which had been developed in the 1990s had been untested in the "bear market" and changes were introduced to make this more robust in dealing with different market situations.

As a result of partner mergers and takeovers, the ownership of the original Axedale joint venture partner has changed on two occasions. It would appear that the business philosophy of the present partner may not align as closely to Axedale as was previously the case, and it is possible that there may be some changes in the joint venture relationship in future years.

During this time the funds under management increased to AUD2.97 billion, with Axedale providing investment advice for funds of AUD312 million under in-house management. A recent survey by Intech Investment Consultants (2005) reported that Axedale had achieved a return in excess of nearly 36 per cent on its investments during the last year with the firm's performance ranked in the top 10 of the 57 Australian fund managers included in the survey.

## **CONCLUSIONS**

Peter Davies stated his motivation for establishing Axedale was the building of an organization. As he put it: "I want to create a business that goes well beyond me and I will judge my success by the development of Axedale." In the six years of its existence Axedale has grown and carved a niche for itself in the Australian financial services industry.

The success achieved is due to a number of factors. A major factor was the choice of the joint venture partner which has played an important role throughout. The normal financial risk associated with setting up a business has been reduced as the international finance house has provided financial backing. In addition, the joint venture partner has been important in giving systems support in a number of areas and guidance to those managing this new enterprise. Association with this major international finance house has also enabled Axedale to develop the ethos and characteristics of a larger professional organization, likely to foster confidence in its clients or potential clients. The firm was also particularly fortunate in acquiring the lease and fittings of the offices at a prestigious location. The general ambiance would be expected to assist in projecting the professional image of the organization.

In the view of the authors, however, the attention and importance given to human resource management issues were significant factors determining its success. Experience in the financial services industry has led to the view that human resource policies in this field are not generally regarded as crucial, although this is not the case for some of the larger finance houses which have very sophisticated human resource practices. Many roles in financial services require a high level of intellectual ability and, normally, a quantitative background. Frequently, those involved appear to be more interested in ideas and concepts than in people and their management. As a result, tasks associated with what are seen as the main purpose of the business – making investment decisions or the development of a theoretical model for investment purposes – are highly regarded. On the other hand, management issues – such as devising an appropriate reporting structure, developing an organizational culture and the development of individuals – are often seen as less important or even peripheral.

The situation at Axedale was very different. A keen interest in people issues and an understanding of how important these could be in determining the success or otherwise of an enterprise were mentioned by Peter Davies in the first discussions held with him. Interestingly, he also mentioned that when negotiations were underway to establish Axedale, the joint venture partner had expressed interest not only in the backgrounds and experience of the individuals concerned, but also in how they would perform as a team. Thus from its earliest days considerable attention was paid to the management of people and, in particular, to recruitment and the development of team spirit.

Of course, there have been problems and on occasions the management of individuals could have been better. In the early days, for example, young, inexperienced analysts were given major responsibilities and, as a result, experienced considerable work pressures. Again, in an organization which from its beginning had many of the trappings of a bureaucracy – detailed job descriptions and complex performance assessment of individuals – it might be expected that there would be some conflict between these control mechanisms and the need for the personal initiative, flexibility and entrepreneurial flair required. Such conflicts certainly occurred, but were dealt with in a constructive manner. In considering some of the difficulties discussed above, it should also be borne in mind that the management of talented people – often with delicate egos and strong opinions – is notoriously difficult to achieve, but is critical for the survival of such a knowledge-based enterprise.

Generally, the firm has been fortunate in the selection of its staff. Some assistance in assessing candidates' intellectual abilities, motivation and the likelihood of whether or not they would fit in the Axedale culture has been provided by the authors. In every

case, however, it has been made clear that any test results (which were always first discussed with the applicants) should be regarded as additional data to assist in the decision-making process, and that the decision on whether or not to hire remained the responsibility of the management. Should a top performing analyst leave to join a competitor, there is always the danger that the funds they manage will be transferred by their clients to the new employer. It is significant, therefore, that not one of the Axedale analysts has resigned, thus demonstrating that the strategies adopted for employee retention have been successful to date. The status Axedale now enjoys in the marketplace is such that it now mainly recruits analysts from a major Australian business school. Successful applicants for employment are required to complete a three-month period as an intern and, if deemed suitable after this initial period, are offered a full-time position.

Peter Davies and his colleagues have demonstrated considerable courage and judgement in coping with the problems encountered. They modified the investment process, reduced staffing levels which included retrenching one of the original team members, achieved considerable reductions in operating costs (with the founders agreeing to a substantial reduction in their own reward packages), and worked hard at gaining new and retaining existing mandates.

The organization structure has been changed to meet new demands and over time the leadership has become more shared as those involved have become more experienced. The new structure appears to be working well, particularly after the appointment of the Chief Operating Officer. Peter Davies – recently appointed as Executive Chairman in addition to his role as Chief Investment Officer - has modified the ways in which he plays the latter role. As he put it: “I see myself in a role akin to that of the coach in football. In other words, I’m concerned with recruiting good talent, inspiring the staff and getting rid of those no longer able to perform.” Rousseau (2001) argues that knowledge workers have considerable power to negotiate their employment conditions and expect flexibility and idiosyncratic deals in their employment relationships. Thus family friendly policies and greater work-life balance may be called for to prevent burn-out. There is some evidence that this is occurring in Axedale as analysts are now actively discouraged from working at week ends and are given five weeks annual holiday. On average they work some 50 hours a week. As a fledgling organization is unlikely to have the financial resources to attract and retain the services of an outstanding analyst from one of their competitors, the development of able, young people is important in fostering team spirit and employee retention.

Given the lack of a shared vision, and the reliance of the firm on knowledge workers with distinct competencies, it is likely that further adjustments to the human resource policies and modus operandi will be required. As a consequence, the adoption by Axedale of the human resource policies of their much larger joint venture partner, for example, may no longer be appropriate in future years as the firm adapts its policies to meet the needs of its staff and the markets served. The importance of adapting human resource practices in this way, of course, has relevance to many small enterprises and particularly those employing mainly knowledge workers.

As to the wisdom of involving consultants in the task of developing such an organization, Peter Davies has summed this up as follows:

“Long-term stability is a critical ingredient of a sustainable high performance funds management organization. However, most

managers of funds management teams ignore the science of team structure and team management. Using consultants has provided our team with frameworks that make individual differences an enduring team strength in terms of skills, personalities and ages... and the formula seems to work.”

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**Figure 1: The nine team roles (Belbin, 1996, p.122)**

| <i>Roles and descriptions –<br/>team-role contribution</i>                          | <i>Allowable weaknesses</i>   |   |
|---|---|---|
|    | <p><b>Plant:</b> Creative, imaginative, unorthodox. Solves difficult problems.</p>  | <p>Ignores details. Too preoccupied to communicate effectively.</p>                               |
|    | <p><b>Resource investigator:</b> Extrovert, enthusiastic, communicative. Explores opportunities. Develops contacts.</p>       | <p>Overoptimistic. Loses interest once initial enthusiasm has passed.</p>                         |
|    | <p><b>Co-ordinator:</b> Mature, confident, a good chairperson. Clarifies goals, promotes decision-making, delegates well.</p> | <p>Can be seen as manipulative. Delegates personal work.</p>                                      |
|    | <p><b>Shaper:</b> Challenging, dynamic, thrives on pressure. Has the drive and courage to overcome obstacles.</p>             | <p>Can provoke others. Hurts people's feelings.</p>   |
|    | <p><b>Monitor evaluator:</b> Sober, strategic and discerning. Sees all options. Judges accurately.</p>                        | <p>Lacks drive and ability to inspire others. Overly critical.</p>                                |
|    | <p><b>Teamworker:</b> Co-operative, mild, perceptive and diplomatic. Listens, builds, averts friction, calms the waters.</p>  | <p>Indecisive in crunch situations. Can be easily influenced.</p>                                 |
|    | <p><b>Implementer:</b> Disciplined, reliable, conservative and efficient. Turns ideas into practical actions.</p>             | <p>Somewhat inflexible. Slow to respond to new possibilities.</p>                                 |
|  | <p><b>Completer:</b> Painstaking, conscientious, anxious. Searches out errors and omissions. Delivers on time.</p>            | <p>Inclined to worry unduly. Reluctant to delegate. Can be a nit-picker.</p>                      |
|  | <p><b>Specialist:</b> Single-minded, self-starting, dedicated. Provides knowledge and skills in rare supply.</p>              | <p>Contributes on only a narrow front. Dwells on technicalities. Overlooks the 'big picture'.</p> |

**Figure 2: AXEDALE FUNDS MANAGEMENT LTD  
Distribution of Belbin Team Roles - November 1999**

| NAME  | PL | RI | CO | SH | ME | TW | IMP | CF | SP |
|---|----|----|----|----|----|----|-----|----|----|
| PETER DAVIES                                  | 3  |    |    | 1  |    | 9  |     |    | 2  |
| HEAD OF<br>BUSINESS<br>DEVELOPMENT            |    | 1  | 3  | 2  |    |    | 9   |    |    |
| SENIOR<br>ANALYST                             | 3  | 9  |    |    | 1  | 2  |     |    |    |
| ANALYST                                       | 1  | 3  | 9  |    |    |    |     |    | 2  |
| SENIOR<br>ANALYST                             | 9  | 3  |    | 2  | 1  |    |     |    |    |
| NON-<br>EXECUTIVE<br>DIRECTOR                 |    | 3  | 2  | 9  |    | 1  |     |    |    |
| SENIOR<br>MANAGER -<br>BUSINESS<br>OPERATIONS | 9  |    |    |    | 2  |    |     | 1  | 3  |
| SENIOR<br>ANALYST                             | 9  |    |    |    | 2  |    |     | 1  | 3  |
| ANALYST                                       |    | 1  | 2  |    | 9  | 1  |     |    |    |

**1 = Most preferred role 2 = Secondary role 9 = Least preferred role**

**ICSB 2005**

**Building Relationships and Social Capital Development**

**Building Relationships and Social Capital for  
Women's Enterprise Development.**

**Research and practice from an award winning support initiative Women Into  
the Network (WIN)**

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**1. Introduction**

A wide range of support initiatives have evolved in the UK, aimed at assisting women to start and develop their businesses. These include training programmes on a range of personal and business specific topics, mentoring programmes, dedicated business premises and financial services. This paper looks at the development of networks as a means of supporting women in business. Networking has been demonstrated to be a powerful tool for new venture creation and business development yet it has been shown that women are often excluded from many traditional business networks and/or lack access to information about such networks. This paper, based on action research primarily in the north east of England examines:

The concept of relationship building through networking and networking as a vehicle for building social capital for women's enterprise as a critical component in helping to build self-confidence and self esteem. This paper is not an academic critique of models supporting women's entrepreneurship. It is however, based both upon practise of an award winning business support initiative Women Into the Network (WIN) based in the UK and action research (a study of bankers and their clients and a survey 1000 women running businesses) together with regular evaluations of WIN members that have been undertaken over the four years as part of an activities of the broader WIN Project. The research aimed to develop a better understanding of how networking helps to develop women's social capital. It identifies a number of themes related to networking support and raises a range of issues relating to the effective promotion of relationship building and social capital for women's enterprise and highlights implications for future interventions. The development of social capital is a relatively under-researched, understood and as such an under supported aspect of women's entrepreneurship.

This paper highlights how;

- Social asset building is critical for successful women's entrepreneurship
- Networking related support encourages and helps women to build contacts and confidence in doing this.
- Relationship and social capital building is a dynamic process, which involves life long learning for both women and the support sector – highlighted by a case study of an awards process.
  - Work on this aspect of 'doing business' - social capital and asset building for women- needs to be given more explicit attention by support providers and policy makers

In recent years there has been much commentary upon the ever-growing importance of women in the global market and that the growth of women's economic activities and their general level of activity in the paid economy can significantly influence the success or failure of each country's long-term economic health (OECD, 2003). Indeed, it is often claimed that women are the producers, suppliers and customers of the future.

Levels of entrepreneurship within a society has long been recognised as a prerequisite and a useful indicator of an economy's health. Although the relationship between entrepreneurial and economic growth is complex, recent international economic reports such as the Global Entrepreneurship Monitor Reports (GEM) ([www.gemconsortium.org](http://www.gemconsortium.org)) has clearly highlighted the positive correlation between economic growth and entrepreneurship and recently has highlighted the role of women's entrepreneurship. In the 2001 and 2002 GEM reports for the UK, noting that 'Expanding the involvement of women in entrepreneurship is critical for long term economic growth *in the UK*' (GEM, 2001,2002). In turn this was endorsed by the UK's Department of Trade and Industry (DTI, 2003), which recognised women's entrepreneurship, as a key way of enhancing the competitiveness of the economy

## **2. The State of Women's Entrepreneurship in the UK**

Women have always played a key part in enterprise ownership in the UK, but typically, this has been hidden by the invisible support roles they have played – rarely being 'seen' as the owners or entrepreneurs as such. Good quality data on women's entrepreneurship is problematic as with statistics on small businesses per se (Carter et al, 2002) in particular there is little cumulative information about the experience of women business owners in the UK, which would help to understand the factors that underpin women's attitudes and experiences around the whole area of business ownership. Although there are difficulties in obtaining consistent data across different countries on the actual economic impact of women's entrepreneurship in most OECD countries; there is sufficient research to illustrate the challenge that the UK faces as regards the growth of this sector (DTI, 2003, FSB, 2002, Lloyds TSB, 1998 & 2000, Carter, 2000, and Cabinet Office, 2001, Carter et al 2002, Marlow, et al, 2003, Harding et al 2004)

Despite considerable social and cultural change within the UK, the proportionate increase in the number of women starting their own business in the last two decades has been half that of other countries such as the USA. In simple terms the GEM 2001 UK Executive Report noted that men were currently around two and a half times more likely to be entrepreneurs than women. The 2002 GEM report, shows a slightly smaller gap between male and female entrepreneurship in the UK, but highlights a continuing low level of female entrepreneurial activity in comparison with many other countries taking part in GEM, including Canada, the USA, Australia, Norway and most countries in the Far East and South America.

In Spring 2000, 3.2 million people were self-employed in their occupation (Table 1). The self-employed constituted approximately 11% of the workforce, however women were underrepresented with only 845,000 (27%) in self-employment, which was nearly two-thirds less than that of men. The majority of men who were self-employed worked full-time (91%), while the full- and part-time split was more even for women (53% and 47% respectively). However, this was a steady growth in female self-employment as in 1979, women accounted for only 18% of all self-employed (Cabinet Office, 2001). Labour Force Survey figures (LFS, 2003) show that the number of full-time and part-time self-employed workers is 3.45 million (12.9% of all employed), with women still representing some 27% of all those running their own business, this represents some 7-8% of the total female workforce compared to 16-17% of the total male workforce running their own business. Research by Barclays Bank reinforces this showing in their samples that men are twice as likely to become entrepreneurs than women. "Over the five years the study has been running, the percentage of those surveyed (aged 16-64) who said they were setting up a business was 5.3% for males and fell to 2.3% for females" (Barclays 1999 and 2003 p5).

These numbers of female entrepreneurs puts the UK near the bottom of global rankings – UK women's business ownership is on a par with other Northern European countries but is far lower than USA levels. GEM (2003p24) found that female attitudes towards opportunities for business start-ups are far more negative compared to men, with only 22.1% of the sample seeing good opportunities compared with 31.8% of the male sample. Women were also more likely than men

to let fear of failure prevent them from setting up a business and although women have the skills to start their own businesses, they themselves do not see this.

### **3. An Overview of Supporting Women's entrepreneurship**

Whilst there has been significant growth in the number of women owned businesses in the UK over recent decades has been achieved over the years, it has been noted repeatedly that women owner-managers still face a number of problems, for example, (Allen and Truman, 1993, Richardson and Hartshorn, 1995, FSB, 2002, Lloyds TSB, 1998 & 2000, Carter, 2000, and Cabinet Office, 2001, Carter et al 2002, Marlow, et al, 2003, Harding et al 2004). Interest in assisting women as business owners in their own right began to emerge in the 1980's with a range of local, regional and more recently initiatives providing specific support to women being launched throughout the 1980s and early 1990s. Most of these initiatives have focused on helping women to start up their own businesses and have looked at the very overt barriers they face to doing this i.e. concerning their abilities and skills, their experience both generic and business specific, their ideas and their access to resources – see Figure 1 overleaf.

These issues have been dealt with by the design and delivery of a whole range of training programmes both women-specific programmes and generic business development programmes and those targeted at different groups of women (*Cabinet Office, 2001, Small Business Service SBS, 2003*). ) These support activities include training programmes on a wide range of personal and business specific topics, mentoring programmes. In addition specific interventions have been developed addressing the type of ideas and markets that women's business are located with a view to helping them to build on their ideas and to move out of locally saturated markets into broader opportunities. Targeted schemes have tackled the problems that women face in accessing physical resources both financial and non-financial such as business premises in the form of incubators. Particular attention has been given to the barriers that women face in getting start up money be this using their own capital, and the role of banks other institutions and the place of micro-finance initiatives as financiers (Koper, 1989; Read, 1998; Lloyds TSB 2000 Marlow, et al, 2003, Harding et al 2004).

# Ingredients for a Successful Business

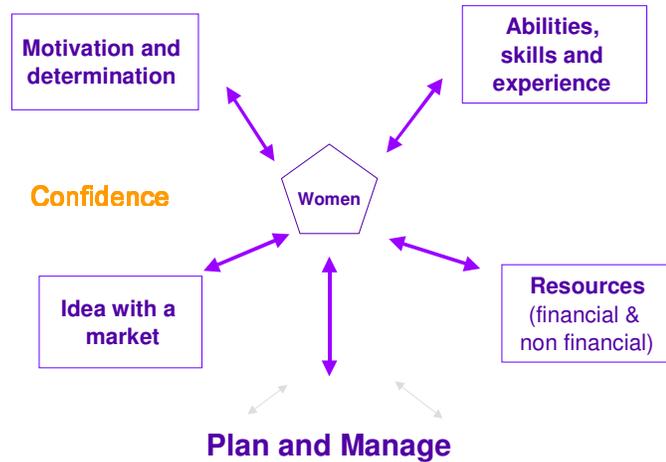


Figure 1

Based on the work of Gibb and Ritchie (1986) (Understanding the Process of Starting Small Businesses, Journal of European Industrial Training 14.1)

In the past five years there has also been a focus on the development of women's business networks and helping women to effectively network for their businesses. Networking as a business activity has been demonstrated to be a powerful tool for new venture creation and business development See for example (Hall and Bennett, 1999 and 2002) and yet it has been shown that women are often excluded from traditional business networks and /or lack access to information about such networks (Shaw, 1998). This note looks at networking as a means of supporting women in business.

## 4 Confidence Networking and Social Capital for Business

Most of the above support measures whilst focusing on tackling the resource problems faced by women have also aimed to increase women's confidence about business ownership. In this way issues concerning confidence were tackled implicitly, with issues of motivation, determination and confidence being grouped together under the broad label of 'confidence' or more particularly 'lack of confidence'. Confidence or lack of confidence is a factor that is quoted by much of the research that has looked at the differences between men and women starting and running businesses. While confidence is no doubt an issue for men, they do not raise it as an issue or researchers do not address it explicitly when talking to men in business. Gould and Parzen (1992) are just one example of researchers who posit that women entrepreneurs often face barriers not usually encountered by men. These barriers are usually associated with the following:

- Their dual role and domestic responsibilities;
- Low self esteem and lack of confidence (Halpern and Szuruk, 1989);
- Lack of socialisation to entrepreneurship in their homes, school, and society.
- Exclusion from traditional business networks and lack access to information (Shaw, 1998).
- Discriminatory attitudes of lenders, gender stereotypes and expectations that label women entrepreneurs as are 'dabblers' 'hobbyists' or merely lifestyle business owners.

Godfrey (1992) supports this and adds that women have a socialised ambivalence about competition and profit together with a lack of self-confidence! The GEM reports also add to these views stating that 'Women are more likely to let fear of failure prevent them from setting up an entrepreneurial business than men' (GEM 2003). Comments such as the above present very broad generalisations about all the attitudes of women considering or practising business. Confidence is a complex, very personal and relative issue concerning a whole range of psychological, sociological, cultural and economic issues impacting upon individuals and their choices in life. It is not the place of this paper to explore the whole concept of confidence rather it looks at a dimension of confidence that comes from people's – in this case potential and practising business women - relationships with others in their networks.

Much research has shown that contact networks and developing relationships with a range of different people both formally and informally are critical for business success (Hall and Bennett 1999, 2002). Successful entrepreneurs note that having a strong network of people behind them helps to build confidence in doing business. Such contacts and networks are often termed 'social capital' and the remainder of this paper looks at the nature and role of networking in helping to build social capital for women entrepreneurs and with it the confidence of women as business owners.

In addressing the issues of different forms of capital when initiating or growing a venture, it is clear that capital can take a number of different forms: *Physical capital* which can include plant, machinery and other assets; *Natural capital*, including clean air, water and other natural resources; *Human capital*, consisting of knowledge, skills and competences; *Social capital* which consists of the networks, norms, relationships, values and informal sanctions that shape the quantity and co-operative quality of a society's social interactions and *Financial capital*, used to fund, acquire or invest in the other forms of capital. Some writers also subscribe to the concept of *Cultural capital*, this includes familiarity with society's culture and the ability to understand and use educated language (Bourdieu, 1986 quoted in Aldridge et al, 2002).

These different forms of capital are not wholly independent of each other but mutually interdependent and re-enforcing. As noted above previous support has tended to focus on helping women to access human assets in terms of training and mentoring to recognise and use natural assets in helping women to use their local resources to build business ideas; to access financial assets in terms of women's savings, their own capital and interactions with financial institutions and the provision of physical assets in terms of premises, safe spaces, access to physical markets in

terms of doing business. Until recently less assistance has been given to explicitly helping women to build their social assets for business. See Figure 2 overleaf.

Social capital has been described as "...features of social life – networks, norms and trust – that enable participants to act together more effectively to pursue shared objectives... social capital, in short, refers to social connections and the attendant norms and trust" (Putnam, 1995, quoted in Aldridge et al 2002). Others highlight three main types of social capital: *bonding* social capital (e.g. among family members or ethnic groups); *bridging* social capital (e.g. across ethnic groups); and *linking* social capital (e.g. between different social classes). From this it can be seen that networking, developing contacts and relationship building are all integral to building social capital.

# Individual Capital/Assets

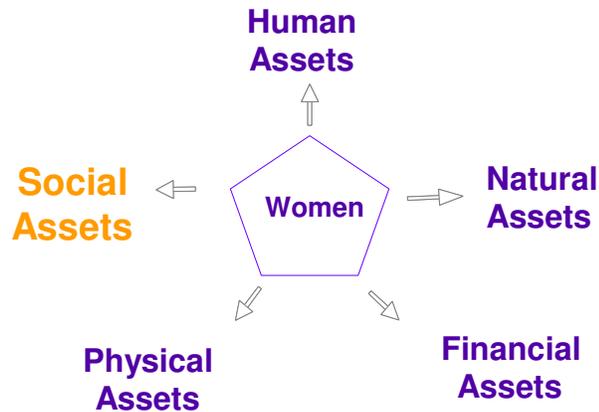


Figure 2  
Based on Richardson and Howarth (2002)

## 5. WIN in the North East

The North East of England, has one of the lowest self-employment rates in the country, (ONE, 2002). It also boasts one of the poorest records of business formation and survival rates. For example, during 1999 and 2000, 8,500 new VAT registered businesses were created, but a similar number deregistered and the formation rate per 10,000 head of adult population was 21 at a time when the national average stood at 38. In addition, women's self-employment rates in the region had been and were still seen as being particularly poor as Table 2 below indicates, with three times more men in self-employment in the region than women.

**Table 2: Percentage of People in Self-employment by Gender**

|              | North East | UK   |
|--------------|------------|------|
| <b>Men</b>   | 13.7       | 16.8 |
| <b>Women</b> | 4.1        | 8.1  |
| <b>All</b>   | 8.4        | 12.9 |

Source: Labour Force Survey, August 2003

It was this profile, which provided the backcloth that led to the establishment of Women Into the Network (WIN). WIN was launched in 1999. It began in 1998 when a piece of market research conducted in the North East of England had found that there were over 700 networks and organisations in the region that said they were providing assistance to existing and potential business women, but the majority of potential and practising women business owners interviewed were unaware of the existence of most of these networks and of what they offered (The Journal, 1999). There was a major mismatch between supply and 'customers' with the result that many women were potentially, missing out on a range of opportunities. Faced with such evidence Women Into the Network (WIN) was established to support the creation and management of effective businesses by women, through addressing their lack of integration into mainstream Business Networks.

WIN set out with the twin aims of '**integrating women into existing and new business networks and to bridge the gap between providers of business and professional support and women themselves**'. It does this by delivering a wide range of network related activities along with a wide range of partners throughout the northeast region and beyond. In its first three years, it has assisted in the creation of over 800 new jobs in women owned businesses.

WIN is an initiative composed of multi level – activities and key services which it designs delivers and disseminates with a wide range of partners.

- **Hosting Events** – around 30 per annum from training workshops to lunches. Regular networking lunches, dinners and workshops are offered which are aimed at facilitating new contacts these events offer an excellent informal opportunity to extend networks and offer encouragement and inspiration.
- **Establishment of Annual Women's Business Awards in the North East** – Since 1999 WIN has held an annual competition, which has rewarded the efforts of a range of successful women entrepreneurs in the North East. This has not only raised the profile of women through this competition but has encouraged more women to apply for other mainstream regional and national business awards. It is discussed in more detail in section 6 below.
- **Communications and Publications** –The primary objective of WIN is to facilitate good communication within the network. A survey of 1000 members demonstrated that many women were not on mailing lists or databases of any type and therefore missed out vital information. To overcome this a number of communications media are used: The online service gives an overview of the entire network ([www.networkingwomen.co.uk](http://www.networkingwomen.co.uk)) and its activities and offers the opportunity to register on a free business directory. A newsletter coupled with regular email bulletins circulates network news, diary dates and reports recent successes and opportunities. A series of

simple 'how to' start up and business development guides are available through the network.

- **Role models** – The importance of having positive role models to encourage women in business has been well documented (Richardson, and Hartshorn, 1995; Carter et al 2001). Another objective of WIN is to promote appropriate and accessible role models. It does this by promoting women business owners from a diverse range of backgrounds and sectors through various media outlet, at WIN events and through a specialist publication called Northern Lights.
- **Sectoral initiatives.** The development of new and existing businesses is integral to the objectives of WIN. A variety of workshops and programmes provide access to business training and personal development opportunities at affordable prices. Working in collaboration with local organisations, training programmes in pre-start up, start-up and business development will be delivered as bespoke packages or one-off events.
- **Research.** Research not only facilitates innovation and progress, but also confirms the appropriateness of existing ventures. WIN is currently undertaking research to:
  - Benchmark existing provision of business support for women in the North East region and to conduct and up-to-date needs analysis
  - Progress understanding of the factors contributing to the low number of women entrepreneurs within the technology and construction sector.
  - Understanding the relationship women entrepreneurs have with their bankers. It is this research that has helped to inform WIN's work on relationship building as a dimension of developing social capital. The research examined the relationships that entrepreneurs have with their banker. The nature of these relationships was explored through a qualitative study using a comparative sample of men and women to assess whether gender has any impact on this relationship<sup>1</sup>. It investigated the perceptions of both the bankers and owner managers in order to develop a more informed understanding of these issues (Bennett, 2000). This research was primarily based in the North East and geared towards practical learning and application.
- **Signposting** – WIN works with a range of partner organisations and signposting of women to appropriate support services is an important element of its work. These organisations include private sector (banks,

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<sup>1</sup> Ten female business owners and ten male business owners together with sixteen bankers took part in this qualitative study. The bankers were representative of the five main business banks in the North East: All the bankers held the position of Business banker or senior business banker and had portfolios of small business customers ranging from 150 to 400.

other business professionals, associations etc), public sector (local authorities regional development agencies etc), voluntary sector as well as peer group providers.

- **Dissemination of best practice** – WIN acts as a key gateway of sharing good practice in women’s business support. The experience of WIN and its activities has already been ‘exported’ to a number of different regions throughout the UK as well as further field. WIN also endeavours to bring into the Region good practice from elsewhere.

The delivery of these services over the past 5 years has brought WIN into contact with thousands of women - both potential and existing women business owners as well as hundreds of business support organisations and consultants. Currently WIN has a membership base of some 1500. It is the experiences of these members and their feedback to WIN that underpins the following reflections on the role and value of networking for building the social capital and confidence of women entrepreneurs.

## 6 Lessons Learned from Practice and Research to Date

### Making Networking Explicit

Networking is a much-used term – business owners are encouraged to network and to build their networks but what does this actually mean? WIN ‘unpacks’ the concept of networking by researching perceptions surrounding networking and the practice of it. In this way it has developed a deeper understanding of networks and networking for women in business – especially how networks operate within different business cultures. Skills and competencies required for effective networking by women are identified from this work and passed on to women. The key lesson from this work to date is that women invariably have strong local ties and strong ‘core’ social capital from family and friends but benefit from help to develop ‘bridging’ and ‘linking’ social capital – especially if there has been no experience of business ownership in their immediate family or peer group. To assist with the development of such capital WIN has recognised the following in its work.

- *It is important to offer ‘easy entry points’* to enable women to access existing networks, services or activities. Segmentation of the women’s market is an integral part of this as it highlights the needs of different women and hence for a range of interventions and activities in a variety of venues.
- *Providing Rehearsal space.* WIN offers women the opportunity to practice their networking and relationship building skills before moving on and being integrated into more mainstream business networks. This space affords the opportunity to build their confidence alongside their peer group as well as developing their skills for networking.
- *Both women only and mixed provision is provided.* The question is often asked whether WIN supports women only provision – it supports both. Targeted women-only business support is not an alternative to ensuring that mainstream business support is women-friendly. Although the option of women-only provision is available for many WIN events and services, it is acknowledged that many women will prefer to develop their business in a mixed-gender setting. The key message is that all business support providers should take into account the particular needs of women and base their services on these needs.
- *WIN provides a conduit for the support sector* - Many business support agencies fail to reach their target group particularly women from more disadvantaged communities. WIN helps in this respect through signposting and offering ‘getting to know spaces’ where business owners and support providers are able to meet new clients at events and vice versa.
- *Lobbying for change to existing business networks.* Many of the mainstream networks still field sexist racist speakers at events, which reinforce negative perception of women in the community and deter women from attending. WIN challenges such practices and promotes

the use of speakers who are more aware of the profile and diversity of their audiences.

### **Segmentation is Critical**

Recognising individual needs is critical when helping people to develop social capital – relationships and trust are integral and how people build these with others is a very personal thing. Consequently segmenting ‘women’ as a client group is critical in attempting to really address and meet their needs.

- ***Women are not a homogeneous group!*** Whilst everyone states this fact it is surprising the number of researchers, policy makers and business support providers who still talk and deliver services for ‘WOMEN’. WIN is conscientious about segmenting its market/client base in a variety of different ways for both accessing women and supporting their development. Clearly WIN cannot serve the needs of all women all of the time – and in this respect signposting women onto other support providers can be critical and is an important aspect of how WIN works.
- ***‘Place, Space and Pace’*** are important issues for the delivery of any form of support. Taking these factors into account recognises that women at different ‘levels’ of business awareness, development and confidence require quite different forms of support at different times and venues. Offering networking opportunities at different times of the day, week, month and year is important. Likewise location is crucial with events being held in a variety of places and venues from slick inner city hotels to village halls.
- ***Self-selection is the key ethos.*** WIN makes efforts not to presume that it knows what women want. Instead the ethos is to clearly articulate what is on offer, what events are aiming to achieve and then it is up to the women themselves to decide whether the offering is appropriate for their needs.
- ***Churn is seen as positive.*** WIN doesn’t intend to hold onto their women members and welcomes women joining other networks relevant to their needs. WIN only ever intended having a membership of 100 women at any time but it now boasts 1400 members as women have felt the benefit of its activities and although they participate in other organisations and activities they opt to remain with WIN. Also WIN recognises that you cannot please everyone all the time – as noted above women are not a homogeneous group and WIN is not right for all!

### **Mixed Perceptions and Expectations**

Having a good relationship with your professional advisers, such as bankers can be critical for business success. As noted earlier it has been well documented, that women face particular problems accessing appropriate

funding and financial advice when setting up and running their own businesses. These problems include of issues of credibility when dealing with bankers i.e. this is often a weak area of social capital for many women entrepreneurs – especially those with no history of business ownership in their peer groups. The bankers research by WIN referred to earlier raised a number of points for helping women to communicate more effectively with banking professionals. The two key lessons from this were:

- **Varied Expectations need to be acknowledged**
  - Women wanted their banker to be more proactive and interested in their business. They viewed the bank as an important stakeholder.
  - Men merely saw the bank as a service provider and no more
  - Women viewed access to the bankers networks as the added value aspect of their relationship
  
- **Different Modes of Meeting needed.** Modes of meeting and venues used by banks were often not appropriate for women. For example women are invited to golf days and football matches and many tended to decline these invitations. Consequently they were potentially missing opportunities for developing their networks, especially 'linking' contacts as well as doing business. One positive outcome from the research is that subsequently interventions have been developed to highlight these issues and address them – for example WIN training seminars for women how to better manage their bank managers, seeing them as a help to develop 'bridging and linking social capital' contacts as well as effective financial support. Seminars are also held for bankers – in helping them to segment their market and provide more effective services for their women clients.

## **Role Models**

Again the powerful impact of introducing women to appropriate role models has long been recognised. The critical issue is the term 'appropriate'. Women role models have to be accessible to the women concerned otherwise the example is not someone who the women can model themselves upon. The UK has some very powerful women entrepreneurs such as Anita Roddick, founder of The Bodyshop. However she is too 'different and distant' – the bridge in social capital terms is too far! This is especially the case for many women in the northeast where as was noted earlier there are low levels and small numbers of women in business. Consequently WIN has focussed on developing and disseminating local role models from a variety of backgrounds taking up business ownership at different stages in their lives.

- WIN has been very active in developing publications with a diverse range of inspirational, aspirational and achievable role models from the north east and further field.
  
- WIN sees it is critical to disseminate local role models in order to highlight that it is not unusual for women to be in business and to be successful in business.

- Also once again the issue of heterogeneity of women - be this by business type, size or sector - is highlighted.
- Role model publications offer powerful visual imagery –that is overt and explicit. These publications are also used educational tools and promotional vehicles for the women who are featured in them and WIN itself.
- WIN has also brought leading national and international women entrepreneurs to the north east – so that local women can easily access opportunities to interact with very successful women who outside of their normal networks.

### **Stereotyped Assumptions & Impressions of business support providers**

Biased/naïve assumptions about women in business and their support needs by frontline staff in business support services often present challenges for effective and trust based relationship building and can close off areas of support to women.

Examples from WIN research include:

- A woman in a rural area, having made a decision to visit her bank manager, spent time and resource arranging domestic and care responsibilities prior to the meeting and most certainly had garnered confidence for the meeting. Her overwhelming impression was that of 'not being taken seriously' as a 'part time business owner' with her 'country lifestyle'. She never approached any other business support agency until many years later when her business was ready for substantive growth- first impressions are critical especially when the transaction costs of getting to the meeting for the women are high.
- All too often home based portfolio or part time businesses are viewed as diminutive by the support and professional service sector and hence not worth time or attention. Such stereotyping is not uncommon by support agencies and is a critical issue determining women's access to effective support.
- It is not uncommon to hear of women searching websites for support, to find that the search using the word 'women' generates references to activities for the 'socially excluded' or 'disadvantaged'. This 'label of disadvantage or social exclusion' is one that is used by many business support agencies whose funding comes with these 'eligibility tags' attached to it. However to be quizzed whether one falls into these categories as one of the first questions in response to an initial enquiry instantly gives a negative message and deters women from further pursuing support.

### **8. The Awards – a case study of how to practice networking and provide a vehicle for building confidence through social capital.**

Taking WIN's annual awards event as a case study we can look at the development of social capital and its role in building confidence.

### **The Awards and development of the Award Process**

WIN has developed and hosts 'The Annual Women Entrepreneur of the Year Awards'. This event is a powerful mechanism for developing and promoting women's business role models to both men and women throughout the region and has become a very popular occasion with seats selling out very quickly – see Table 3 overleaf profiling the awards

**Table 3 Facts and Figures about the Award Process**

|            | No of Awards | Total Applicants | No. Attending | Press coverage | Nomination Events                         | Launch  |
|------------|--------------|------------------|---------------|----------------|---|---------|
| WIN 1 2000 | 5            | 51               | 200           | 9              |   |         |
| WIN 2 2001 | 6            | 52               | 210           | 7              | 15 October                                |         |
| WIN 3 2002 | 8            | 103              | 240           | 11             | 19 September                              | 26 July |
| WIN 4 2003 | 9            | 130              | 319           | 54             | 3 July<br>2 September                     | 29 May  |
| WIN 5 2004 | 9            | 144              | 450           | 27             | 10th June<br>19th August<br>3rd September | 7th May |

However the event also provides another important opportunity – it is a live case study on networking. Through the practicalities of organising the award event each year, WIN engages in a series activities that practically demonstrate a multi-levelled process of relationship building. This ranges from winning support for awards (sponsorship) through to effective engagement with the media and the business support sector (communication) and most importantly of all encouraging buy in from those the awards are directed (women entrepreneurs themselves).

WIN are very clear as to why they set up ‘The North East women Entrepreneur of the Year Awards’ The current awards in the region were called the Business Man of the year Awards which was an appropriate title as only men were entering and winning them. However in 1997 a women won the awards for the first time in and she too was called the Businessman of the Year. WIN challenges language and visual imagery in terms of the message they are imparting to women and felt this was inappropriate. Win lobbied to have the names of the awards changed to Businesses Executive of the Year

and also found that very few nominations were coming from women hence the need for awards to celebrate successful women running businesses. WIN is clear that these awards would have a clear focus of women in enterprise and not women in management or women of achievement of which there are a plethora. WIN is also clear that the award categories would be very much business focussed and certainly not award prizes in the names of Greek goddesses for example. In 2000 when the WIN awards started there were five different categories in 2004 there are nine – including rural, ICT, International business, newcomer, innovative and social.

In 2001 The Susan Dobson Memorial Fund, set up to honour a remarkable women entrepreneur who hailed from the North East and who was passionate about both her native region and women in business, approached WIN to explore ways of working together. It was decided that the Memorial Fund would sponsor the main award itself each year as a fitting tribute to Susan who died of breast cancer in 1999.

Beginning with the Launch Event where key stakeholders in women's enterprise, award sponsors, past winners, existing and aspirant women business owners gather to hear about the effect of winning both on women's confidence and the development of their business. These are followed up by Nomination Events in smaller settings where women are encouraged to enter for the next year's award. At these events previous award winners and runners up tell of their own experiences of entering the awards and the benefits to them and their businesses. The regional business paper runs a series of weekly media coverage examining each business category in the awards and profiling previous years winners. The Awards Event, where the awards are presented each year and which grows year on year this year attracting 550 people, is now a truly mainstreamed event attracting a variety of men and women from the regional and national business communities. After the event itself a series of post Award activities take place and media coverage continues through until the next cycle of nominations.

### **Individual benefits that arise from the awards**

For women who are short listed, runners up and winners the benefits include:

- Increased confidence
- Greater visibility
- a voice which is now heard (women have said that they say the same things as winners as they said before but now newspapers want to quote them and they are invited as guest speakers at a variety of events)
- Increased contacts and networks
- More business

### **Collective benefits that arise**

For women entrepreneurs in the North East

- Increased profile and credibility
- Greater interest, the Small business editor insists on profiling at least women in the business pages each day.
- Voice – the media both regional and national regularly want to quote these women in articles on a variety of topics
- Acceptance into mainstream business networks. People see that women do do business and should therefore be invited to and accepted on mainstream business committees and events

### **Benefits for others**

- Support agencies are given credit for support and have their profiles raised. They are also given access to women role models that they can use to generate business.
- Media – newspaper and journals have ready-made copy for articles on women in business.
- Funders, are aware of the profile they are given for their sponsorship monies that goes far beyond the awards themselves
- Access to women entrepreneurs

The lessons learned from this process are about proactively increasing opportunities for social contacts in terms of volume, quality, diversity and in a variety of different contexts and enabling women to develop social capital out of the

## **9 In Summary**

Women's business ownership is on the increase in the UK albeit at differing rates within the country and at a much slower rate than the US. Much research looking at the experiences and trends of women's enterprise have identified a number of barriers facing women in their pursuit of business ownership. Business support in the UK, to date, has tended to focus on the explicit/ 'visible' and practical barriers for women primarily relating to lack of skills, appropriate finance, childcare support and access to non local markets. One barrier, which is seen as gender specific to women is that of low, or lack of self-confidence. Lack of confidence is seen as a somewhat 'umbrella' term being the reason behind women's s/lower start up rates, especially in non-traditional sectors; their allegedly risk averse attitudes to business; their unwillingness to borrow and their reluctance to grow more substantive businesses. One more recent form of support - networking and relationship building has sought to address the area of self-confidence by helping women to understand the place and importance of relationships for business, to review their own range of contacts and build additional contacts and relationships where there are gaps. This paper gives a brief insight into how

WIN, a networking based business support initiative for aspiring and practising women entrepreneurs, has sought to use more effective networking to help build women's self confidence about business through helping to build their social capital.

In essence WIN has been helping women to build their social capital especially 'bridging' and 'linking' social capital through accessing them to new contacts and new contexts. WIN has achieved this – largely 'implicitly' through its broad portfolio of networking and networking related activities. In reviewing these activities with members WIN has found that these activities seem to have really encouraged women and helped them to build contacts and confidence in themselves. The WIN project has also seen the emergence of and encouraged other local women's' business networks within the Northeast region. WIN has shown that hundreds of jobs have been created in and by women owned businesses within region and WIN has been selected as best practice model by a EU commissioned survey on women business support and the WIN model and approach is being disseminated to four other regions in the UK as well as three different countries.

The key conclusion from WIN's research and experience so far is to work more explicitly with social capital and asset building. Social asset building is critical for successful women's entrepreneurship and work on this aspect of 'doing business' needs to be given more attention – making the tacit explicit. WIN has supported networking as a development tool for business and a means of helping women to build their confidence. To date WIN's experience shows that relationship and social capital building is a dynamic process, which involves life long learning for all concerned. A more in-depth understanding, mapping and tracking of the concept, 'relationship building' and its role in social capital accumulation and building self confidence is now an integral part of WIN's work.

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# **SYNDICATION IN THE VENTURE CAPITAL INDUSTRY DURING DIFFERENT STAGES OF THE BUSINESS CYCLE**

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## **ABSTRACT**

In this paper we describe and analyse the development of the Swedish venture capital industry and its syndication pattern during the years 1996–2004. These nine years can be divided into three different stages in the business cycle. The period from 1996–1998 is considered to be a period of moderate growth, where the Swedish economy and capital market was still recovering from the crisis in the early 1990s. The level of investment and syndication was relatively low in comparison with the following years and the primary reason for syndication was that of sharing risks. In the overheated Swedish economy between 1999 and 2001 supply of capital to early stage investments were plentiful and new venture capital firms entered the market every month. Since capital was plentiful the investors was in constant search for new ventures to invest in which made it easy for venture capitalists to find syndication partners for their second round financing at a good valuation. After the drastic downturn in the venture capital industry in 2001 the level of investments was relatively low during 2002–2004. In all, the total number of investment during the period 2002–2004 was lower than during 2001. Furthermore, the investments during this period were to a large extent in the form of syndication. During the shake out period, the survivors of the industry were more prone to do

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first round syndications again. The sharing of monitoring costs and risk sharing were the most common reasons for syndication in this period.

## **INTRODUCTION**

In comparison with other European countries, the Swedish venture capital market is relatively large (Reynolds, et al. 2002). As with other business sectors it has had its ups and downs. During the prolonged recession of the early 1990s the level of investment within the venture capital industry was very modest. Starting in the mid 1990s the venture capital sector started a remarkable recovery and expansion that culminated in the first year of the new millennium. The downturn began in March of 2001, with the crisis in the telecommunications and information technology sectors. Over night hundreds of Swedish venture capital funds found them selves in a situation where they had thousands of investments with no functioning second hand market. Since then, the Swedish venture capital sector has been subject to far-reaching consolidation and restructuring. The surviving venture capital firms seem to be more prone to syndicate than they were before the crisis.

European venture capital has over the last couple of decades been more targeted towards the later stages of the development of firms as compared to the U.S. venture capital (Brouwer & Hendrix, 1998). There is a widespread belief within the Swedish debate that the pro-longed crisis within the telecommunications and information technology sectors has contributed to this development. The investors are less willing today to accept the relatively high risk associated with investments in early stages. Hence there is less traditional venture capital (Bygrave & Timmons, 1992) and more capital is allocated to the later stages of the firms' development, i.e buy-outs and buy-ins. The trend towards more buy-outs and buy-ins is widespread across Europe (Brouwer & Hendrix, 1998). In short, the growth of venture capital

in Sweden seems to have been generated to an extent by large investors diversifying their holdings in public companies by also investing in later stages of the business cycle. For a number of years venture capital became a high-risk investment opportunity for capital that would otherwise have been allocated to the already inflated stock market.

### **REASONS FOR SYNDICATION IN THE VENTURE CAPITAL INDUSTRY**

In Bygrave (1987; 1988) the syndication patterns between venture capital funds is described and analyzed. The results indicate that syndication is more common in situations characterised by high levels of uncertainty, such as investments in high technology firms in early stages. Syndication is seen from this perspective as a means to reduce the uncertainty by acquiring competence and information from other venture capital firms (Lerner, 1994; Lockett & Wright, 2001). A second reason for syndication among venture capital firms is to reduce the financial risk (Bygrave, 1987). This can be seen from two perspectives. First, according to classical financial theory (see e.g. Markowitz, 1991) the overall risk in a portfolio of investments can be reduced by investing in firms belonging to different industries or different stages of development. Second, the overall investment in a portfolio firm can be too large for one venture capitalist. Syndication might be one way to overcome this problem. According to De Clercq & Dimov (2004) syndication can also be seen as a means to increase the deal flow. If one venture capital firm invites another one to take part in an investment, this increases the likelihood for more investments from the latter part in the future (De Clercq & Dimov, 2004). In times where the competition between venture capitalist firms increases, as is the case in a booming market, we would expect that syndication is a way to reduce the bargaining power of the entrepreneurs seeking financing.

The purpose of this paper is to analyze the development of the Swedish venture capital industry and its syndication patterns in during the period 1996–2004. We postulate that during the overheated venture capital market in the late 1990s, a number of actors poured into the market with little or no competence as regards business development. Instead they were attracted by the profits made by the already established venture capital firms.

The hypothesis put forward in this paper is that the reasons for syndication will be different depending on which stage of the business cycle that the investment is being made. Firstly, on a relatively stable market with few new entrants and little competition between the actors, the foremost reason for syndication will be that of sharing risks both by acquiring competence and capital from other actors. Second, in a booming market, with an increased inflow of capital and many new entrants, the foremost reason for syndication is postulated to be that of increasing the possibilities of picking a winner among the portfolio firms. Finally, in the bottom of the business cycle in a market characterized by low levels of investments and investors with few exit options, we postulate that the foremost reason for syndication is to reduce monitoring costs and the financial risk.

### **METHODOLOGY AND SAMPLE**

The empirical data for this paper has been acquired from Förvärv & Fusioner AB (“Mergers & Acquisitions Ltd”); a Swedish firm specialized in collecting data on investments and divestitures in the Swedish venture capital industry. The data covers the period from 1996 to 2004 and consists of all the 1740 new investments made by Swedish and international venture capital firms during the investigated period. In all 199 different venture capital firms made at least one investment during the period 1996-2004.

## EMPIRICAL FINDINGS

In this section we will describe the development of the Swedish venture capital industry and its syndication patterns. We have divided the period 1996–2004 into three different phases that will be described below. But first we will give the reader a brief review of the entire period.

As can be seen in figure 1, the investment activity has shifted dramatically during the investigated period. From a relatively low level of investment activity in 1996, the industry picked up speed in the following two years. The period 1999–2001 saw a massive entrance of new venture capital firms into the booming venture capital sector, many of which had very little or no experience of business development. The downturn in investment activity in the venture capital sector started with the stock market crash in the spring of 2001. A very low level of investments characterizes the period from 2002 to 2004. Many of the new entrants from the earlier period have left the scene or have made very few investments in the latter period.

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Figure 1 about here

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As can be seen in figure 2, the numbers of venture capital firms that have made investments over the years have also changed rather dramatically. From only 30 venture capital firms doing a new investment in 1996 to 141 firms in 2000, back to almost 30 in 2004. It is notable that many of the old venture capital firms that were active in 1996 are still the ones that are making new investments in 2004. Many of the very high profile venture capital firms from

1998-2000, who were focused on investments within the IT and telecommunications sector, have in a number of cases filed for bankruptcy, and are not around anymore.

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Figure 2 about here

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### **The years of recovery and moderate expansion – 1996–1998**

With 57 total investments 1996 is actually a better year for VC investments than both 2003 and 2004. It signals a recovery from the recession in the early 1990s. The venture capital fund 3i, originally from Great Britain, heads the group of investors, by investing in a mix of manufacturing, IT and biotech. The largest investors in terms of number of investments are private investors. The government-owned The Swedish Industry Fund only manages 3.5 percent of total investments, but is later to grow into one of the most important investors on the market. The fund's purpose is to support Swedish industry by making substantial investments in areas of strategic importance for Swedish industry. SEB Företagsinvest and Investor Growth Capital are both members of the Wallenberg sphere in the Swedish economy. Wallenberg as an old industrial family with roots in the 1850s, and benefactors of the great Swedish industrial expansion, holds an important part in Swedish industrial life.

As regards the nature of the investment, it is notable that a relatively large share of the investments being made during the year can be considered to be low-tech, such as investments in breweries, wholesalers and paper mills. The level of syndication is relatively low, in that only 15.8 percent of the total investments are syndicated. The most common type of

syndication is first round syndication that accounts for 80 percent. Furthermore, there was no third round syndication during 1996.

During 1997 the interest in venture capitalism is on the rise in the Swedish economy as more investors chose to enter the industry. 3i is still the largest fund, with a wide range of investments but Health Cap, soon to become the giant in Swedish biotech financing, now joins 3i. Health Cap starts off with an array of investments in medicine and biotechnology, Innovationskapital emerges in Sweden's second largest city close to Chalmers Technical University. This fund starts off with investments in telecom, medicine, engineering and IT. SEB Företagsinvest and Investor Growth Capital manage 6.6 percent of investments in total and trails the major three.

The foremost area of investment during the year is that of biotechnology and information technology. But some investors, foremost MBO/MBI funds, continue to do investments in low-tech sectors. As regards syndication, the second round syndication emerges as the most common type of syndication during the year, although by a slim marginal to the first round syndication. There is still no third round syndication within the industry.

During 1998 two governmental funds takes over as the most active investors on the venture capital scene. At the same time the venture capital industry is more diversified as the largest investors shrink well below 20 percent of the total number of investments. The Swedish Industry Fund mainly invests in manufacturing, as is their traditional policy. The 6<sup>th</sup> Pension Fund invests funds for pensioners and chooses mainly manufacturing as well for its investments. Novestra starts out by investing in high-risk IT projects. They will continue to do

so, but their recognition as one of the most active investors will be short-lived. They are, however, an advertisement of the types of investments to come in the venture capital industry.

The investments being made during 1998 are again focused on biotechnology and information technology. Yet another rapidly expanding sector has raised the interest among venture capital firms – the Internet consultants. Still, some of the largest deals in the year were made in more mature industries. The syndication pattern is the same as in 1997, with second round syndication being slightly more common than first round syndication. During the year the first third round syndication has been made in firms within the biotechnology sector.

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Table 1 about here

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### **The high tide of the Internet era – 1999–2001**

The total number of new investments in 1999 was an impressive 344. In the same year, the expansion of the number of new entrants continues as the big three's share of the total investments falls to 16.0 percent. The 6<sup>th</sup> Pension Fund takes the lead as The Swedish Industry Fund is hit with a one-year stop for investments in the wake of some troubles in earlier investments. Investor Growth Capital and SEB Företagsinvest together manage to accumulate 9.0 percent of total investments and since the total number of investments increase dramatically it is clear that the Wallenberg family intends to make venture capital their kind of game. The range of investments is remarkable, with everything from the odd ABBA musical (actually turns out to be a good investment) to IT, biotech and telecom. The industrial background does not appear to prevent a genuine diversification. 3i makes a

comeback at third, but the major news is the startling amount of new venture capitalists appearing on the scene. The primary investment focus of these new entrants is IT related businesses.

The syndication pattern among the venture capital firms is the same as in 1997 and 1998 in that second round syndication is slightly more common than first round syndication. During the year approximately 10 percent of all syndication were in the form of third round syndication. These syndications were almost all within the biotechnology sector, with some exceptions in that a couple of investments being made in Internet related firms.

In the year 2000 it is the relatively small but very fast moving venture capital investors who occupy the leading positions. These new venture capital firms have an approach to venture capital and management inspired by the American venture capital industry. Many of the new entrants are furthermore very specialised in that they only invest in IT related businesses. The Swedish venture capital scene has never been more diversified, in all 141 different venture capital firms made new investments during the year. 3i moves into the IT industry while the government owned 6<sup>th</sup> Pension Fund and The Swedish Industry Fund staunchly refuses to leave manufacturing. It is also noteworthy that a number of very large international funds make investments in Sweden, not via Swedish venture capital firms, but by themselves.

As regards the investment focus, the biotechnology, information technology and software industry stands out. The largest deals of the year however are once again in low-tech areas. A major shift in the syndication pattern can be seen in 2000. The second round syndication stands out as the most important form of syndication with almost 60 percent of the total syndications. Furthermore, the third round syndication is now more common than the first

round syndication. These third round syndications were primarily directed towards growing IT firms, rather than biotechnology firms. A number of the relatively large syndications during 2000 have been some of the more spectacular failures within the Swedish economy in the beginning of the new millennium.

As the momentum disappears from the Swedish venture capital scene in 2001, some old actors reappear as the most common investors. The Swedish Industry Fund now invests more into IT-related areas whereas world-leading venture capitalists 3i continues to invest in a vast range of industrial fields. These two actors dominate as the number of actors making new investments decreases. Brainheart Capital picks up third place with investments in the wireless industry, thus telecom related investments. Most of the smaller investors disappear from the scene. The fall is indeed dramatic. So does The 6<sup>th</sup> Pension Fund with two final investments, as the government decides that retired people's capital belong in the stock market. Thus a major player is gone, even though they are to be found in indirect investments through a number of other venture capital firms.

As regards the syndication pattern it is clear that the second round syndications is losing ground to first round syndication, even though the former is still the most common. More than 20 percent of the syndication in 2001 is third round syndication. In comparison with 2000 it is clear that the biotechnology sector has gained some ground on the IT sector when it comes to third round syndication.

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Table 2 about here

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### **The last charge by The Swedish Industry Fund and a dormant market – 2002–2004**

For the second year in a row, the total number of investments was once again cut in half. In all 131 new investments were made in 2002. The big three this year actually consists of the big one. The Swedish Industry Fund stampedes its colleagues by a whopping 26.0 percent of total investments. FöretagsByggarna consists of a couple of veterans in the venture capital industry, with investments in IT, medicine and telecom. CapMan is another venture capital firm with relatively experienced investment managers, controlled by the Finnish venture capital firm CapMan. The year is in the whole rather disappointing as it is very clear that the good times for venture capital investments are long gone by. Even 3i has by now all but left the scene with only three investments during the year, to be followed up in 2003 by one more investment. Once again biotechnology firms and software producers are the ones that venture capital firms seem to be most willing to invest in.

The syndication patterns in 2002 reveals the relatively largest numbers of third round financing during the period 1996–2004. Approximately one third of all syndications are in the form of third round syndications, foremost within the biotechnology industry. Second round syndication is still the most common type with almost 50 percent of all syndications.

In 2003 the investment activity reaches a new bottom level, with only 55 investments. Again, the big three dominate the dormant market by a sheer lack of competition. The Swedish Industry Fund receives new life and in true Keynesian economics fashion bolsters what is left of the venture capital investment market. New funds are far between for entrepreneurs as biotechnology dominates. The Swedish Industry Fund's less than impressive total of eight

investments are made in manufacturing and medicine. CapMan and Innovationskapital pitches in with four investments each in biotech and IT.

A shift can be traced in the pattern of syndication amongst the surviving venture capital firms. For the first time since 1996 the most common type of syndication is once more the first round syndication. It is obvious that the still active venture capital firms are less interested in making the deals on their own.

The total number of investments is not cut in half yet again in 2004 but the fall continues. The big three holds 21.6 percent of total investments, but three investments each is the only requirement to hold first place, a far cry from the ten or so investments most venture capitalists in the top flight managed merely a couple of years ago. The three most active investors are; Nordic Capital that mainly is a MBO/MBI fund and Scope Capital Advisory that is a foreign-based investor that focuses on early stage investment, but is a relatively small fund, and Amplico Kapital that invests for The 6<sup>th</sup> Pension Fund and goes with the times in basing its business on reconstruction of ailing companies. The sweepers of the industry have arrived.

As in earlier years, biotechnology and information technology are the preferred areas of investment for venture capital firms. The largest deals of year are as before in rather low-tech areas. As syndication is concerned first round syndication once more is the dominating form of syndication. In comparison with 2000 and 2001 the investments as such were rather modest, foremost in relatively small IT firms.

## ANALYSIS AND DISCUSSION

In this paper we have analysed the development of the Swedish venture capital industry in the last nine years. Starting from a relatively low level in the first year of our study, the industry reached unprecedented heights in 1999 and 2000. New venture capital firms were established on a weekly basis and the competition within the industry accelerated. The downturn came in the first quarter of 2001, when the IT related stocks plummeted on the Stockholm Exchange. The venture capital firms faced a completely different world than they were used to. The IPO market was more or less closed for firms in biotechnology and information technology in the years coming. Furthermore investors were less prone to back new venture capital funds owing to the bad track record of many of the new entrants in the industry. Hence, the venture capital firms were squeezed between two forces that were hard to come to terms with. The result was a far-reaching consolidation of the surviving firms and very few new investments in the following years. Many of the high profile newcomers to the business filed for bankruptcy in the aftermath of the crisis in 2001. When we compare the active investors from 1996 and 2004 it is clear that many of the active firms in 1996 are still active today.

The syndication patterns have differed a lot over the investigated period. As can be seen in figure 3, the syndications were at a relatively low level in the years 1996–1998. In those years less than one out of five investments made by venture capital firms were made together with another partner.

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Figure 3 about here

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The interest in syndication increased as new entrants entered the venture capital industry in 1999 and 2000. The supply of capital was reaching new heights and the need for syndication

from a risk sharing perspective was less important than during the earlier period. Instead, it seemed as though many venture capital firms were set on making as many deals as possible to be able to find the new Apple or IBM. In the aftermath of the crisis of 2001, the interest in syndication has surged. In the year of 2003, almost half the investments made by the venture capital firms were made together with at least one other venture capital firm. In a time where the IPO market was ice cold and many investments turning out bad, the survivors of the industry tried to reduce the monitoring costs by sharing their investments. In short supply of new capital from the backers of their funds, the emphasis of reducing the risks by sharing information and competence between syndication partners was also an important factor behind these syndications.

As regards the syndication pattern it is also apparent that it is a pattern of which venture capital firms that syndicates with one other. Venture capital firms with a track record of good investments in the first half of the 1990s with experienced investment managers had even before 1996 made some investments together and continued to do so through out the investigated period. The new entrants on the other hand were less prone to syndicate than the more experienced venture capital firms, and if they did syndicate they tended to do so with other new comers in the industry. It is reasonable to assume that they in many instances lacked the legitimacy in the eyes of the more experienced actors in the market.

We have also noticed that small funds in many cases need to team up with a larger partner to be able to see the investment through to exit. Even though the small fund will see its share of the portfolio firm be reduced through second or even a third round of financing, the alternative might be not to be able to make the investment at all.

The preferred type of syndication in the period as a whole is second round syndication. In all but three years this was the most common type of syndication. During the first three years of our study the first and second round syndications were totally dominating the deals, as can be seen in figure 4. But as we move into the high tide of the investments in IT firms, the level of first round syndication drops, especially in 2000 and 2001. Instead, many of the relatively large portfolio firms, mainly within the biotechnology and IT sectors, swallow huge amounts of capital, therefore third round syndications become more frequent. Finally, in the aftermath of the stock market crash in 2001 the tables have turned again, and once more the first round syndication is the preferred form of syndication.

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Figure 4 about here

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## FIGURES AND TABLES

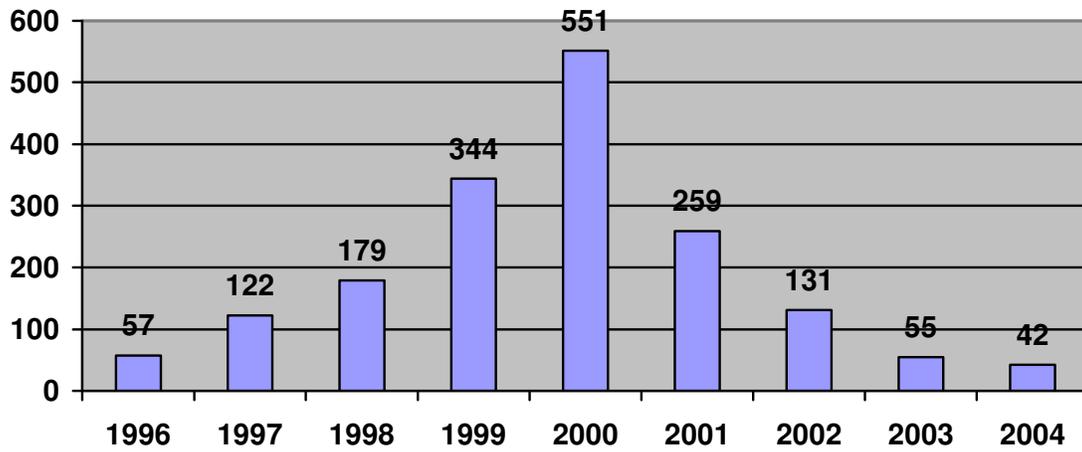


Figure 1. Total investment activity per year in the period 1996–2004

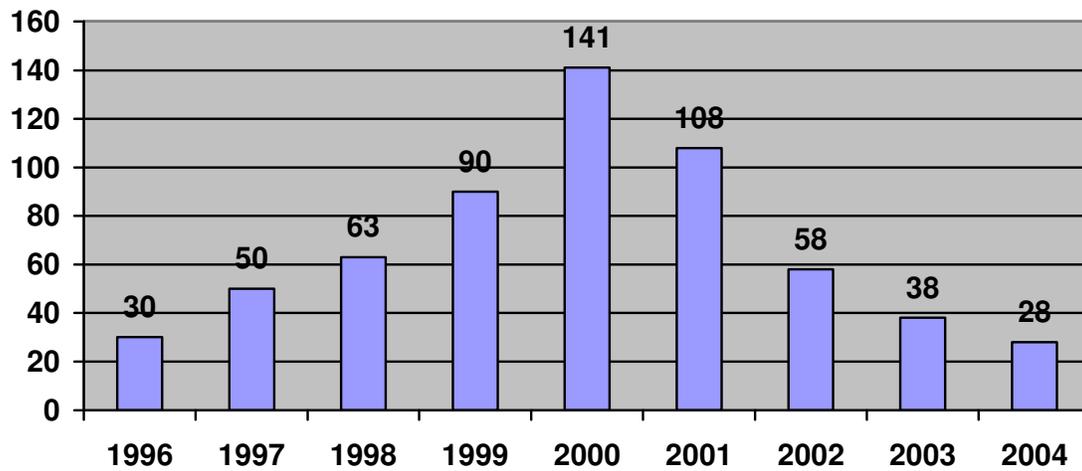


Figure 2. Number of VC firms that have made a new investment during 1996– 2004

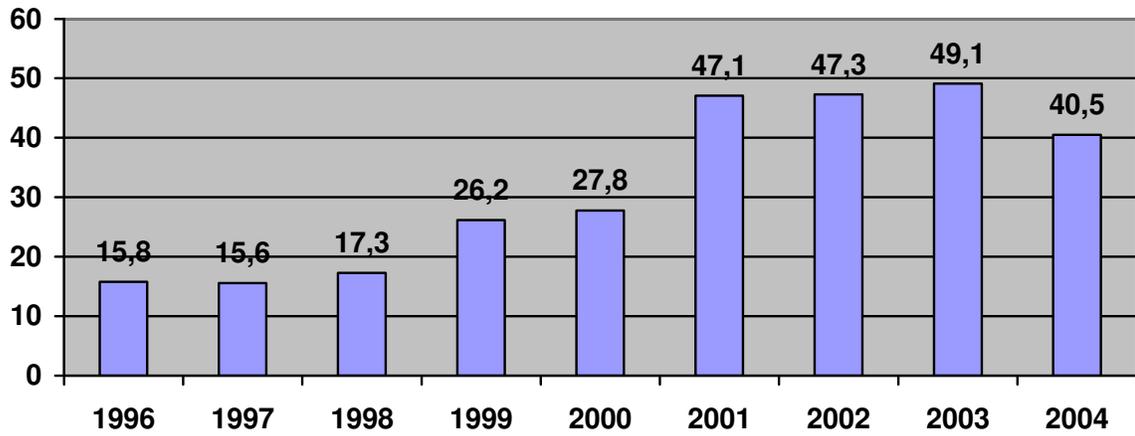


Figure 3. Percentage of syndicated investments of total investments 1996–2004

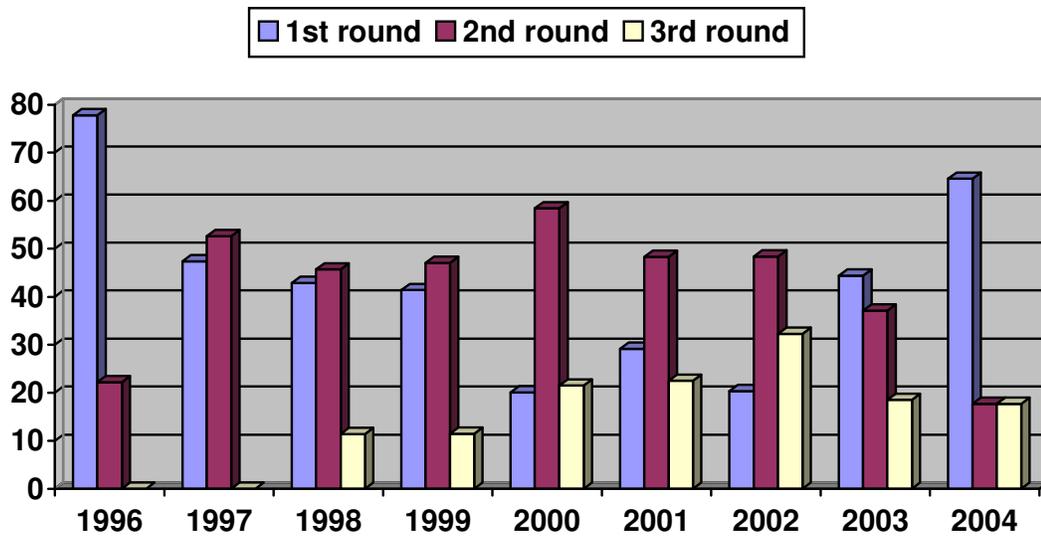


Figure 4. Percentage of type of syndication per year 1996–2004

| Most active investor 1996 | Percentage of total investments | Most active investor 1997 | Percentage of total investments | Most active investor 1998        | Percentage of total investments |
|---------------------------|---------------------------------|---------------------------|---------------------------------|----------------------------------|---------------------------------|
| 3i                        | 10.5 %                          | 3i                        | 7.4 %                           | The Swedish Industry Fund        | 7.3 %                           |
| SEB Företagsinvest        | 7.0 %                           | Health Cap                | 7.4 %                           | The 6 <sup>th</sup> Pension Fund | 5.0 %                           |
| Start Invest              | 7.0 %                           | Innovationskapital        | 6.6 %                           | Novestra                         | 5.0 %                           |
| <b>Total big three</b>    | <b>24.5 %</b>                   |                           | <b>21.4 %</b>                   |                                  | <b>17.3 %</b>                   |

**Table 1. The three most active investors 1996–1998**

| Most active investor 1999        | Percentage of total investments | Most active investor 2000 | Percentage of total investments | Most active investor 2001 | Percentage of total investments |
|----------------------------------|---------------------------------|---------------------------|---------------------------------|---------------------------|---------------------------------|
| The 6 <sup>th</sup> Pension Fund | 5.8 %                           | Ledstiernan               | 4.9 %                           | The Swedish Industry Fund | 9.3 %                           |
| Investor Growth Capital          | 5.5 %                           | Provider IT Advisor       | 4.2 %                           | 3i                        | 8.9 %                           |
| 3i                               | 4.7 %                           | Affärsstrategerna         | 3.3 %                           | Brainheart Capital        | 3.9 %                           |
| <b>Total big three</b>           | <b>16.0 %</b>                   |                           | <b>12.6 %</b>                   |                           | <b>22.1 %</b>                   |

**Table 2. The three most active investors 1999–2001**

| <b>Most active investor 1999</b> | <b>Percentage of total investments</b> | <b>Most active investor 2000</b> | <b>Percentage of total investments</b> | <b>Most active investor 2001</b> | <b>Percentage of total investments</b> |
|----------------------------------|--|----------------------------------|--|----------------------------------|--|
| The Swedish Industry Fund        | 26.0 %                                 | The Swedish Industry Fund        | 14.5 %                                 | Nordic Capital                   | 7.2 %                                  |
| Företagsbyggarna                 | 5.3 %                                  | Innovationskapital               | 7.3 %                                  | Scope Capital Advisory           | 7.2 %                                  |
| CapMan                           | 3.8 %                                  | CapMan                           | 7.8 %                                  | Amplico Kapital                  | 7.2 %                                  |
| <b>Total big three</b>           | 35.1 %                                 |                                  | 29.1 %                                 |                                  | 21.6 %                                 |

**Table 3. The three most active investors 2002–2004**

**ARE ENTREPRENEURS BORN OR MADE?  
VIEWS OF ENTREPRENEURS AND VENTURE CAPITALISTS**

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March 2005

We would like to thank the entrepreneurs and venture capitalists who agreed to participate in this study—especially vSpring Capital for help in obtaining entrepreneurial respondents. We thank Matt Wassum for his research assistance and the Center for Entrepreneurship and the Kevin and Debra Rollins Center for eBusiness at Brigham Young University for financial support.

## ABSTRACT

What characteristics do entrepreneurs believe make them successful? We interview entrepreneurs and venture capitalists (VCs) to determine traits that each of these groups perceive as necessary for entrepreneurial success. We show that entrepreneurs cite traits inherent to their nature (e.g., hard working, persistent, risk-taker) significantly more than VCs. We also test to see if entrepreneurs are able to identify factors that VCs consider most important for the funding decision. We find that entrepreneurs who do not have previous VC funding experience differ significantly from VCs in what factors are important for VC funding; whereas, entrepreneurs with previous VC funding experience did not differ from VCs in identifying important funding-decision factors. Overall, our results demonstrate that even though entrepreneurs believe factors they are born with are most important to achieve success, they still learn through experience.

## 1. INTRODUCTION

The question, “What makes entrepreneurs successful?” is important to multiple constituencies. Despite the interest in this question, measuring success has proven problematic because there is no agreed upon definition of what constitutes a successful entrepreneur (Rogoff, Lee, and Suh 2004). In general, most research studies use company longevity as a proxy for entrepreneurial success without consideration of other qualitative or quantitative measures. While there could be many viable definitions of success, a fruitful first step would be to ask entrepreneurs and their capital providers what entrepreneurial traits lead to a successful business venture and whether these traits are an inherent part of an entrepreneur’s character or whether they can be acquired through experience or training. For instance, would an entrepreneur who sought venture capital in the past learn from this experience and change his/her approach and thinking?

A continually debated question in the popular press is whether people are “born” or “made” to be successful. Each year companies spend millions of dollars hiring consultants to train their staff to be successful—with some companies claiming that it worked and others believing it was a waste of time and money. Numerous books, articles, and internet sites argue about what aspects of success are inherent to a person’s nature versus what is learnable through study or experience.

Successful entrepreneurs also carry out this debate with varying opinions about how much of entrepreneurial success can be attributed to nature versus nurture. On one end of the spectrum, Bo Peabody—an internet entrepreneurial multi-millionaire—stated, “One does not decide to be an entrepreneur. One is an entrepreneur. Those who decide to be entrepreneurs are making the first in a long line of bad business decisions (Farrell 2005).” On the other end of the

spectrum Lloyd Shefsky—author, entrepreneur, and adjunct faculty—claims that through his research of more than 200 entrepreneurs that successful entrepreneurs are made and not born (Shefsky 1996). Finally, in the middle of the spectrum are voices like Herb Kelleher, co-founder and former CEO of Southwest airlines, who believes that successful entrepreneurs have a combination of innate character traits and training (Watkinson 2004).

This study asks entrepreneurs and venture capitalist to identify characteristics of entrepreneurs that are important for their success. First, we report which specific *traits* entrepreneurs believe make them successful, thus addressing what entrepreneurs believe in the born versus made debate. Second, we compare the entrepreneurs’ responses to an important “gatekeeper” in small business success—venture capitalists (VCs)—and show that entrepreneurs overweigh inherent characteristics. Third, we demonstrate a statistically significant difference in what the two groups consider to be the most important factors for venture capital funding decisions. Finally, we show that entrepreneurs who have solicited funding from venture capitalists seem to learn from this experience and are able to identify what venture capitalists are looking for in their funding decisions.

The rest of this paper proceeds as follows; in the next section, we discuss relevant literature and our research questions. In section three, we present the methodology used to evaluate our research questions followed by a discussion of the results in section four. In section five, we discuss implications of our findings. We conclude in section six with limitations of our research and recommendations for future studies.

## **2. LITERATURE REVIEW AND RESEARCH QUESTIONS**

### **Entrepreneurial Success**

Many studies have attempted to catalog factors that contribute to entrepreneurial success (Sahlman 1990; Sapienza 1991; Timmons 1994; and Rogoff et al. 2004) and failure (see Zacharakis, Meyer, and DeCastro 1999 for a review of the relevant literature). Past research about entrepreneurship has attempted to define the personality of entrepreneurs, hoping to show that entrepreneurs are intrinsically different from other people (see Smith-Hunter, Kapp, and Yonkers 2003 for a review of the literature). The underlying theme of this type of trait-based research is that no amount of training will make an entrepreneur (Smith-Hunger, Kapp, and Yonkers 2003). However, the results of this stream of research have not produced a definitive personality of an entrepreneur. From these studies, the only consistent difference found between entrepreneurs and nonentrepreneurs is that entrepreneurs have higher achievement motivations (Shaver 1995).

The inability of this line of research to define a specific entrepreneurial personality has caused a debate about the efficacy of personality-based research as a way of finding significant differences between entrepreneurs and others (Aldrich 1999; Begley and Boyd 1987; Gartner 1988; Johnson 1990; Mueller and Thomas 2001; Shaver 1995; Shaver and Scott 1991; Shaver, Gatewood, and Gartner 2001; Spangler 1992). In contrast to the trait-based research, another line of research is looking for ways to better understand the factors that influence how entrepreneurs behave (Baron 1998; Douglas and Shepard 2000; Simon, Houghton, and Aquino 2000). We contribute to this line of research by examining what traits entrepreneurs believe contribute to their success so that future studies can have an established baseline from which they can measure to see if psychological theories predict entrepreneurial behavior.

In a recent study, Rogoff et al. (2004) focused on what makes entrepreneurs successful by asking entrepreneurs and a group of “experts”<sup>1</sup> to define factors that contributed to business

success. They found that entrepreneurs attribute a disproportionate amount of success to factors inherent to an entrepreneur's nature—consistent with their attribution theory motivation—when compared against a group of experts. Of particular interest, the broad sample of entrepreneurs cited individual characteristics (e.g., hard work, ethics, knowledge, dedication, and professional service) 39.8% of the time as factors contributing to their success. In contrast, the experts cited individual characteristics only 27.8% of the time. These results suggest that entrepreneurs overemphasize individual inherent characteristics as contributing to the success of an entrepreneur when compared against a group of experts.

We build on the work of Rogoff et al. (2004) by examining the character traits that entrepreneurs believe create success. Motivating our research is the question, what traits make entrepreneurs successful? Specifically, we measure whether entrepreneurs believe that some entrepreneurs are born to be successful versus being able to learn how to be successful. This question is of particular interest considering the wide range of opinions about whether entrepreneurs are born or made as described in the introduction. Our first research question stated formally is:

Research Question 1 – Do entrepreneurs perceive traits related to inherent attributes as more important for success than traits that can be learned or acquired through experience?

### **Venture Capital Providers**

VCs serve an important role in helping businesses succeed. Previous research has shown that VCs are very successful at predicting new venture success (Sandberg and Hofer 1987; Hall and Hofer 1993). Extensive research has been conducted about how VCs make this decision—most of these studies have produced lists of criteria that VCs consider in the decision process (e.g., Tyebjee and Bruno 1981; 1984; Gorman and Sahlman 1986; MacMillan, Siegal, and

SubbaNarasimha 1985; MacMillan, Zemann, and SubbaNarasimha, 1987). To our knowledge, no study has looked at the traits of entrepreneurs that venture capitalists consider most important for success. We therefore test to see if entrepreneurs and VCs differ in the traits they believe make an entrepreneur successful. Our principal investigation is whether entrepreneurs view inherent traits as more or less important than do VCs. Since VCs are skilled at predicting future venture success, we believe they provide a strong benchmark against which we can compare entrepreneurs' responses. Our second research question stated formally is:

Research Question 2 – Do entrepreneurs perceive that traits related to inherent attributes are more important determinants of success than do VCs?

If entrepreneurs and VCs perceive different characteristic traits as important for success then they might also have different opinions on which companies should receive funding.

Although extensive research has examined what factors VCs consider to be most important in the funding decision, this study investigates how well entrepreneurs understand those factors. Our final research question stated formally is:

Research Question 3 – Do entrepreneurs and VCs differ in their opinion of what factors VCs consider to be most important when making funding decisions?

### **3. METHODOLOGY**

To answer our research questions we interviewed 28 entrepreneurs and 13 VCs, all operating in the state of Utah. Descriptive statistics are presented in Table 1.

Insert Table 1 about here

We categorized the 28 entrepreneurs into seven different industry groupings using the MoneyTree survey definitions.<sup>2</sup> The entrepreneurs belong to the following industries: business products and services, consumer products and services, electronics/instrumentation, IT services, financial services, software, and other. The average number of years the entrepreneurs'

businesses had been in existence was 11.7 (standard deviation=7.8, median=8.5), ranging from 1.5 years to 32 years.

The companies had on average nearly 66 employees (standard deviation=56.5, median=45) ranging from five employees to 200 employees. We selected these entrepreneurs in two ways. First, one of the VC firms provided us with a list of names of entrepreneurs who had received some type of external funding (e.g., VC funding, loan from bank, etc.). Second, we received names from the Brigham Young University Center for Entrepreneurship. All 28 entrepreneurs were operating primarily in Utah.

The 13 VCs are from seven different VC firms and represent the major Utah-based VCs that control virtually all VC money that flows into the state. The investments the VCs make in a single company range from \$230 thousand to \$12 million with an average of just more than \$4 million (standard deviation=\$4.0 million, median=\$3 million). Combined, the VCs had invested in 169 companies in the last five years (ranging from three companies for the smallest VC firm to 41 companies for the largest VC firm). An averaging of investment preferences reveals that the companies collectively prefer to invest most often in early stage companies, followed by expansion stage, later stage, and seed stage, respectively.

To collect our data we had two interviewers meet in person or over the phone (via speakerphone) with all the interviewees and asked them the following two questions:

1. What are some common traits of successful entrepreneurs?
2. How do you (or, How do venture capital providers) decide which companies to fund?

The interviewers recorded the interviewees' responses and then together transcribed the responses into individual phrases. In order to prevent interview and coding biases, the interviewers were not told the research questions. After the interviewers finished transcribing

the conversations, one of the authors combined similar phrases and established category titles for the responses. For question one, the categories included attributes (defined as traits inherent to the entrepreneur's nature), skills (traits that can be taught), experience (traits gained over time), and other (did not fit in the other categories). For question two, the categories included future returns (responses directly related to profits the VC can earn), management (responses related to the management team in place), product/service (responses relating to the good or service the company provides), and other (did not fit in the other categories).

The remaining three authors independently categorized the responses into the different groupings. The authors that performed the coding did not see how many times each item had been mentioned by different interviewees before they categorized the responses. The inter-rater reliability for each question was well within the typical inter-rater reliability scores of 66 to 95 percent as reported by Berelson (1952) (71.1% for question one and 78.3% for question two).

For question one, the entrepreneurs identified 39 unique answers and the VCs identified 30 unique answers. For the entrepreneurs' responses, at least two of the authors did not agree on groupings for two traits. For the VCs' responses, at least two authors did not agree on the grouping for one trait. For question two, the entrepreneurs identified 35 unique answers and the VCs identified 13 unique answers. For the entrepreneurs' responses, at least two of the authors did not agree on groupings for two traits, but for the VCs responses, at least two authors agreed on groupings for all the traits. We exclude from our analysis the traits that at least two authors did not agree upon.

#### **4. RESULTS**

Our first research question asks whether entrepreneurs perceived traits inherent to the entrepreneur's nature as more important for success than traits acquired through learning and

experience. The results, as listed in Panel A of Table 2, show that entrepreneurs cite attributes (inherent traits) 62 times out of the 83 total responses (75%). Skills were cited 11 times (13%) and experience 9 times (11%). Even when skills and experience are aggregated, entrepreneurs still cite traits inherent to their nature more often than acquirable traits.

Insert Table 2 about here

An analysis of the individual responses provides stronger evidence that entrepreneurs believe attributes are the most important factor in success. The five individual traits cited most frequently, as shown in Panel B of Table 2, include five attributes (% of total responses): hard-working (14.5%), persistent (10.8%), risk-taker (8.4%), vision (7.2%), and independent (4.8%). From these results we conclude that entrepreneurs consider traits related to attributes inherent to the entrepreneur's nature as more important for success than learnable traits.

Our second research question asked whether entrepreneurs and VCs differ in what traits they believe are most important for success. The VCs' responses, also listed in Panel A of Table 2, indicate that attributes were the most important factor for success (cited 43 times out of 97 or 44% of the time), followed by experience (33 responses or 34% of the time) and skills (21 responses or 22% of the time). The overall distribution of responses by the VCs was significantly different than the responses by the entrepreneurs when skills and experience are considered separately (chi-square distribution test  $p\text{-value} < 0.0001$ ) and when skills and experience are combined into one category (chi-square distribution test  $p\text{-value} < 0.0001$ ).

To test if each category grouping response is significantly different between entrepreneurs and VCs, we use a binomial test where the number of successes is the number of times cited by the entrepreneur and the hypothetical  $p$  is the category response rate as a percentage of total citations from the VCs. Using this test, we find that entrepreneurs cite

attributes as more important for success significantly more often than VCs ( $p\text{-value}<0.001$ ). In addition, we find that VCs cite experience significantly more often than entrepreneurs ( $p\text{-value}<0.001$ ). Although VCs cited skills (22%) more often than entrepreneurs (14%), the difference is only marginally statistically significant ( $p\text{-value}=0.063$ ). If we combine skills and experience into a learnable traits category, we still find that the difference is statistically significant ( $p\text{-value}<0.001$ ) and that entrepreneurs believe the combination of skills and experience is less important than VCs believe.

Additional analysis of the individual factors that VCs consider as the most important traits for success is also telling (See Panel B of Table 2). While the five most important traits listed by entrepreneurs were all attributes, VCs list three experience factors and two attributes as the most important overall traits for success including (% of total responses): industry/domain/market experience (9.3%), marketing experience (8.2%), passionate (7.2%), leadership (7.2%), and start-up experience (6.2%).

From these analyses, we conclude that entrepreneurs and VCs have significantly different views of important entrepreneurial success traits. Entrepreneurs view characteristics inherent to their nature as more important than VCs. VCs, on the other hand, place significantly more weight on experience than do entrepreneurs.

Our third research question asks whether entrepreneurs and VCs differ in their opinion of what factors VCs consider to be most important in making the funding decision. As seen in Panel A of Table 3, the overall distribution of responses is significantly different (chi-square distribution test  $p\text{-value}=0.024$ ). We found that VCs reported that future returns are the most important factor (40%), followed by management (36%), and then products/services (24%). Entrepreneurs believe that VCs use future returns more for their decision (49%), management

less (25%), product/service less (14%), and other factors more (12%). Comparing the individual categories we find that VC's look significantly more at management and product/service than entrepreneurs believe they do (p-values of 0.043 and 0.046 respectively).

Insert Table 3 about here

A comparison of the top five responses by each group reveals some differences. As seen in Panel B of Table 3, entrepreneurs cited the management team 14 times (18.2%), followed by growth potential five times (6.5%), profitability five times (6.5%), ROI five times (6.5%), business plan four times (5.2%) and market size four times (5.2%). In contrast, VCs cited experienced management 10 times (22.2%), followed by market size six times (13.3%), first-mover/sustainable advantage and patented technology five times each, respectively (11.1% each), and trustworthy management four times (8.9%).

In conclusion, entrepreneurs differ from VCs in the overall distribution of factors that VCs consider most important in the funding decision. Specifically, VCs look significantly more at management and product/service issues when deciding who to fund than entrepreneurs believe they do.

To investigate further the differences between VCs' and entrepreneurs' perceptions of important funding factors, we split our sample of entrepreneurs into two groups: (1) those who have applied for VC funding (nine subjects – experienced entrepreneurs), and (2) those who have not (19 subjects – inexperienced entrepreneurs). We then test for differences in the responses of these groups.

As seen in Table 4, inexperienced entrepreneurs differ significantly from VCs in identifying what VCs look for when making funding decisions (chi-square distribution test p-value=0.025). However, experienced entrepreneurs do not differ significantly from VCs in

identifying what VCs look for when making funding decisions (chi-square distribution test p-value=0.484). Inexperienced entrepreneurs differ most significantly in their view of the importance of management to the funding decision; they cite management as an important factor only 21% of the time compared to VCs who cite management 36% of the time. Experienced entrepreneurs cite management 33% of the time and are not statistically different from VCs. These results suggest that entrepreneurs learn what VCs are looking for only after experience with a VC funding decision.

Insert Table 4 about here

## **5. DISCUSSION AND IMPLICATIONS**

Using a survey of entrepreneurs and VCs, we demonstrate that there is significant difference in what the two groups perceive as the most important traits that an entrepreneur should possess to be successful. Our results demonstrate that entrepreneurs believe that traits that entrepreneurs are born with make up 75% of the factors that contribute to entrepreneurial success. In contrast, venture capital providers believe that only 44% of the traits necessary for success are inherent to an entrepreneur's nature. Venture capital providers believe experience is far more important in determining an entrepreneur's success than entrepreneurs believe.

These results are important to entrepreneurs, VCs, and other groups that deal with entrepreneurs because they show that entrepreneurs believe that success is more a factor of who they are than what they learn: "Entrepreneurs are born not made." Entrepreneurs may therefore undervalue opportunities to gain experience and skills because they do not believe these traits will help them to become successful.

Since we found a difference in what entrepreneurs and VCs identify as the traits necessary for management to be successful, we would expect a difference in what they view as

important factors for deciding which companies VCs should fund. With our second question, we examined the factors that entrepreneurs and VCs consider to be most important in the funding decision process. Congruent with the expectations derived after our first analysis, we find that the two groups emphasize different factors. VCs claim to look at management issues more than entrepreneurs believe they do.

We conduct an additional analysis to determine if entrepreneurs with previous VC funding experience are able to better identify factors that VCs look for than entrepreneurs with no VC funding experience. We find that experienced entrepreneurs were able to better identify the factors VCs consider important for funding decisions. These results suggest that entrepreneurs do learn through experience, even if they believe success comes mostly from inherent characteristic traits. Entrepreneurs who want funding—especially those who have not previously applied for VC funding—may want to consider these findings before applying for venture capital.

## **6. LIMITATIONS AND FUTURE RESEARCH**

The limitations to our research study present opportunities for future research. As with most academic studies, the generalizability of these results may be limited. Because we did not take a random sample of entrepreneurs or VCs, our results may not generalize to the entire population of entrepreneurs and VCs. Also, we examine a relatively small number of entrepreneurs and VCs and our sample is derived entirely from one geographic location. Future studies may wish to extend our study by interviewing more entrepreneurs and VCs, collecting a random sample of entrepreneurs and VCs, or, expanding the geographic coverage in their sample.

In our study, we give equal weight to the interviewees' answers and therefore if a factor was mentioned it carries equal weight with all other mentioned factors. Although there is a clear difference in the number of times each factor was mentioned, entrepreneurs and VCs may place more emphasis on some factors compared to other factors. Future studies may wish to extend our study by seeing if the frequency of factors mentioned is the same as the individual weighting of factors by entrepreneurs and VCs.

We only examined the views of entrepreneurs and VCs and therefore did not capture the views of other important parties such as informal or angel investors, investment-banking firms, and other service providers. Research into what these other parties consider to be important could also provide needed insights.

The final limitation is that we interviewed entrepreneurs about what they perceive to be important traits for success. Although the businesses of all of our entrepreneurs were currently succeeding in the sense that each business was still solvent, we did not attempt to measure the "successfulness" of each entrepreneur. Future studies may want to test whether these attitudes are similar for entrepreneurs that have succeeded and those who have failed.

Future research may also wish to address implications from the results of this study. For example, future research may wish to address such questions as the effects of the "high-inherent-factor attitude"; do entrepreneurs benefit from a university education or training programs given their disposition to believe success is inherent to an entrepreneur; do entrepreneurs with this type of attitude succeed more often; and, is this attitude a result of success, or is it truly inherent to entrepreneurs' thinking.

## ENDNOTES

1. The group of experts used by Rogoff et al. (2004) consisted of professors of entrepreneurship, graduates of an M.B.A. program who majored in entrepreneurship, and business counselors in a college-based entrepreneurship center. One advantage of our study over Rogoff et al. (2004) is that we use VCs as a comparison group. VCs evaluate entrepreneurs and businesses on a frequent basis and prior research has shown that VCs are very successful at predicting new venture success (Sandberg and Hofer 1987; Hall and Hofer 1993).
2. MoneyTree survey definitions can be found online at <http://www.pwcmoneytree.com/moneytree/nav.jsp?page=definitions#industry>.

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**Table 1**  
**Entrepreneurs and VC Demographics**

---

| <b>Entrepreneurs (n=28)</b>    |    | <b>Venture Capitalists (n=13)</b> |                      |   |
|--------------------------------|----|-----------------------------------|----------------------|---|
| <i>Industries</i>              |    | Number of Firms                   |                      |   |
| Business Products and Services | 5  | <i>Average Size Investment</i>    |                      |   |
| Consumer Products and Services | 8  | Less than \$2 million             | 2                    |   |
| Electronics/Instrumentation    | 3  | \$2 million - \$5 million         | 3                    |   |
| IT Services                    | 5  | More than \$5 million             | 2                    |   |
| Financial Services             | 3  | <i>Stage of Investment</i>        |                      |   |
| Software                       | 3  | <i>First Choice</i>               | <i>Second Choice</i> |   |
| Other                          | 1  | Seed Stage                        | 0                    | 3 |
| <i>Number of Employees</i>     |    | Early Stage                       | 4                    | 1 |
| 1-20                           | 5  | Expansion Stage                   | 1                    | 3 |
| 21-40                          | 7  | Later Stage                       | 2                    | 0 |
| 41-60                          | 7  |                                   |                      |   |
| More than 60                   | 9  |                                   |                      |   |
| <i>Firm Age</i>                |    |                                   |                      |   |
| 5 Years or Less                | 4  |                                   |                      |   |
| 6-10                           | 14 |                                   |                      |   |
| 11-20                          | 6  |                                   |                      |   |
| More than 20                   | 4  |                                   |                      |   |

**Table 2****Panel A: What are some common traits of successful entrepreneurs?**

| <i>Category</i> | <i>Entrepreneurs<br/>Times cited (Percentage<br/>citations)</i> | <i>VC's<br/>Times cited (Percentage<br/>citations)</i> | <i>P-value*</i> |
|-----------------|---|--|-----------------|
| Attributes      | 62 (75%)  | 43 (44%)   | <0.001          |
| Skills          | 11 (13%)  | 21 (22%)   | 0.063           |
| Experience      | 9 (11%)   | 33 (34%)   | <0.001          |
| Other           | 1 (1%)  | 0 (0%)   | -               |
| <b>Total</b>    | <b>83 (100%)</b>  | <b>97 (100%)</b>                                       |                 |

Difference in distribution of responses significant at  $p < 0.0001$ , (chi-square distribution test)

*Category Coding from Interviews*

|                   |   |
|-------------------|---|
| Attributes<br>(A) | Ability to Focus, Analytical, Attitude of Success, Constantly Learning, Creative, Determined, Discipline, Dreamer, Drive to Succeed, Energy, Flexible/Non-Structured, Good Leaders, Hard Working, Independent, Instinct, Intelligent, Leadership, Likeable, Optimist, Passionate, Persistence, Quality-Minded, Realistic, Risk-Taker, Scrappy, Prime Mover, Self-Starter, Stubbornness, Team Player, Trustworthy/Integrity, Vision, Will to Win |
| Skills<br>(S)     | Ability to Delegate, Close Deals, Communication Skills, Create & Share Vision, Human Relation Skills, Know Numbers, Masters/PhD, Network, Plan in Mind, Presentation Skills, Recruit Top Management, Sales Ability, Skill Sets, Step Down, Strategic Thinking   |
| Experience<br>(E) | Experience Raising Money, Feel for their Business, Good Network of Contacts, Industry/Domain/Market Experience, Knowledge of Industry, Learn from Experience, Marketing Experience, Organize Resources Well, Sacrifices, See Market Gaps, Skin in Game, Start-up Experience, Understand Competitors & Customers, Well-capitalized   |
| Other (O)         | Luck  |

\* Reported p-values are two-tailed results using the binomial test where the number of success is the number of times cited by the entrepreneurs and the hypothesized  $p$  is the % of total citations from the VC's.

**Panel B: Top Individual Responses**

| <i>Entrepreneurs<br/>Category - Times Cited (% of Total Citations)</i> | <i>VC's<br/>Category - Times Cited (% of Total Citations)</i> |
|--|---|
| A - Hard Working, 12, (14.5%)  | E - Industry/Domain/Market Exp., 9, (9.3%)                    |
| A - Persistence, 9, (10.8%)  | E - Marketing Exp., 8, (8.2%)                                 |
| A - Risk-Taker, 7 (8.4%)   | A - Passionate, 7, (7.2%)                                     |
| A - Vision, 6, (7.2%)  | A - Leadership, 7, (7.2%)                                     |
| A - Independent, 4, (4.8%)   | E - Start-up Exp., 6, (6.2%)                                  |

**Table 3**

**Panel A: How do you (VCs) decide which companies to fund?**

| <i>Category</i> | <i>Entrepreneurs<br/>Times Cited (% of<br/>Total Citations)</i> | <i>VC's<br/>Times Cited (% of<br/>Total Citations)</i> | <i>P-values*</i> |
|-----------------|---|--|------------------|
| Future Returns  | 38 (49%)  | 18 (40%)   | 0.104            |
| Management      | 19 (25%)  | 16 (36%)   | 0.043            |
| Product/Service | 11 (14%)  | 11 (24%)   | 0.046            |
| Other           | 9 (12%)   | 0  | -                |
| <b>Total</b>    | <b>77 (100%)</b>  | <b>45 (100%)</b>                                       |                  |

Difference in distribution of responses significant (p=0.024 chi-square distribution test)

*Category Codings from Interviews*

|                      |   |
|----------------------|---|
| Future Returns (FR)  | Ability to Pay Back, Accelerated Growth, Business Plan, Exit Potential, Financials, First-Mover/Sustainable Advantage, Growth Potential, High Reward/Low Risk, Initial/Potential Sales, Liquidity, Margins, Market Size/Potential, Merger Possibility, Quick Payback, Possibility of "Home Run", Potential for Profits, Reliability of Projections, ROI, Strong Syndication (Several VC'S), VC'S Ability to Borrow against your Company |
| Management (M)       | Equity Positions of Entrepreneur, Experienced Management, History of Company, Management Team, Management's Track Record, Owner Invested Personal Cash, Trustworthy Management  |
| Product/Service (PS) | Believe in Product or Service, Demand for Product, Glamour Product, Idea, Must-have Technology, Patented Technology, Product adds Value, Targeting well Understood Problem, Unique Solution, VC has Personal Interest in Product or Service   |
| Other (O)            | Gut Feeling, Job Creation, Industry That VC's Interested in, No Idea, VC's have Knowledge of Industry   |

\* Reported p-values are two-tailed results using the binomial test where the number of success is the number of times cited by the entrepreneurs and the hypothesized *p* is the % of total citations from the VC's.

**Panel B: Top Individual Responses**

| <i>Entrepreneurs<br/>Category - Times Cited (% of Total Citations)</i> | <i>VC's<br/>Category - Times Cited (% of Total Citations)</i> |
|--|---|
| M - Management Team, 14, (18.2%)                                       | M - Experienced Management, 10, (22.2%)                       |
| FR - Growth Potential 5, (6.5%)  | FR - Market Size, 6, (13.3%)                                  |
| FR - Profitability, 5, (6.5%)  | FR - First-Move/Sustainable Adv., 5, (11.1%)                  |
| FR - ROI, 5, (6.5%)  | PS - Patented Technology, 5, (11.1%)                          |
| FR - Business Plan, 4, (5.2%)  | M - Trustworthy Management, 4, (8.9%)                         |
| FR - Market Size, 4, (5.2%)  |   |

**Table 4**  
**How do you (VCs) decide which companies to fund? Differences based on entrepreneurial experience with VC funding.**

| <i>Category</i> | <i>Entrepreneurs with No VC Experience (ENOV) n=19 Times Cited (% of Total Citations)</i> | <i>Entrepreneurs with VC Experience (EVC) n=9 Times Cited (% of Total Citations)</i> | <i>VC Responses (VC) Times Cited (% of Total Citations)</i> |
|-----------------|---|--|---|
| Future Returns  | 28 (53%)  | 10 (42%)   | 18 (40%)  |
| Management      | 11 (21%)  | 8 (33%)  | 16 (36%)  |
| Product/Service | 8 (15%)   | 3 (13%)  | 11 (24%)  |
| Other           | 6 (11%)   | 3 (13%)  | 0   |
| <b>Total</b>    | <b>53 (100%)</b>  | <b>24 (100%)</b>   | <b>45 (100%)</b>  |

| <i>Category</i>  | <i>P-value* between ENOV and EVC</i> | <i>P-value* between ENOV and VC</i> | <i>P-value* between EVC and VC</i> |
|--|--------------------------------------|-------------------------------------|------------------------------------|
| Future Returns   | 0.123                                | 0.068                               | 1.00                               |
| Management   | 0.059                                | 0.026                               | 0.836                              |
| Product/Service  | 0.681                                | 0.149                               | 0.236                              |
| Other  | 0.840                                |                                     |                                    |
| Overall difference in distribution using chi-square test | 0.217                                | 0.025                               | 0.484                              |

\* Reported p-values are two-tailed results using the binomial test where the number of success is the number of times cited by the entrepreneurs and the hypothesized *p* is the % of total citations from the VC's.

**UNDERSTANDING BUSINESS PERFORMANCE. EXPLORING THE  
RELATIVE CONTRIBUTION OF CONTEXT, STRATEGY AND OWNER  
MANAGERS' CHARACTERISTICS**

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This paper examines the ways in which entrepreneurial characteristics interact with organizational context and business strategy to influence business performance. Three conceptual areas are included: *business characteristics*, *owner manager orientation* and *business strategy*. We anticipated differences in the performance of firms according to *business characteristics*: including sector, size and age of enterprise. The influence of the *owner-manager orientation* is, however, more debatable. Whilst qualitative studies emphasise the influence of owners on business goals, processes and performance, quantitative surveys strive for multidimensional explanations. The orientation constructs include factors captured through a series of statements on, for example, whether business owners considered themselves to be '21<sup>st</sup> Century entrepreneur' or a 'traditional business owner', and whether they were 'happy to take risks provided the rewards were high' or they 'make decisions based on known facts'. We cover the notion of *business strategy* through a range of variables to embrace the way in which businesses plan resource use (marketing, human resource), evidence of the take-up of new technologies and involvement in external collaboration. It was anticipated that there would be a positive relationship between these factors and business performance. Three main measures of business performance used include employment change over two years; turnover change over three years; and profitability. We employ 'path analysis' to explore an original data set of 360 business employing 5 – 249 employees. The results build on a growing body of literature seeking to understand the relative importance of context, orientation and strategy on business performance.

**REACHING THE BUSINESSES THAT OTHER POLICIES HAVE FAILED TO  
REACH? DEVELOPING ETHNIC MINORITY BUSINESS SUPPORT IN THE  
UK THROUGH INCREASING ENGAGEMENT WITH MINORITY  
COMMUNITIES**

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One of the fundamental issues in the landscape of UK business policy is the unevenness in the take-up of mainstream support and advice by businesses, particularly by ethnic minority owner managers who have tended to rely instead on self-help and informal sources of assistance. This paper contributes to the debate on the development of policy designed to reach the businesses that have traditionally been under-represented in the client base of mainstream business support agencies. The paper analyses a model of business support which seeks to enhance the activities of existing, community-based organisations and utilise them as a vehicle to reach business owners within their own ethnic minority groups. *A priori* the advantages of this approach includes the ability to develop support that is appropriate to the needs of ethnic minority owned businesses and reach those business owners who require support. This culturally embedded model has the potential to overcome the barriers that have historically impeded the appropriate development and take-up of business support. On the other hand, questions may be asked of the quality of the support and assistance provided if business advisers are not sufficiently trained and connected with the mainstream. The paper concludes by placing the role of culturally embedded support into broader policy debates.

## **EXPLAINING GENDER DIFFERENCES IN PERFORMANCE AMONG SMALL BUSINESS OWNERS IN GHANA.**

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### **ABSTRACT**

Programs designed by International development agencies and implemented in various developing countries often fail to achieve the desired outcomes because they are not tailored to the specific situation of the recipient countries. In this paper we employ two gender based theories (the liberal and social feminist theories) to explain differences in performance, business strategy, resources, and owner-manager characteristics between male and female owner-managers. From our review of the literature we develop a framework for examining gender differences in performance among small business owners in Ghana and develop propositions for subsequent investigations. We conclude that whilst the experiences of Ghanaian women are similar in some respects to those of women in the Western world, the differences are significant enough to merit programs tailored specifically to the Ghanaian situation. Assistance programs that aim at addressing differences in educational background and managerial experiences between the genders and at educating parents about the potential of their female offspring should provide a longer-term solution to any gender disparities in performance.

### **INTRODUCTION**

The small business sector is recognized as an integral component of economic development and a crucial element in the effort to lift countries out of poverty (Wolfenson, 2001). To this end, the World Bank and other international funding agencies have linked grants to developing countries to the implementation of policies and programs aimed at creating stable macro-economic environments conducive to private investment, and in particular to developing the small and medium enterprise (SME) sector (Cook & Nixon, 2000). For example, the International Monetary Fund's (IMF) Structural Adjustment Program (SAP) implemented in Ghana in the 1980s, emphasized reduction in government influence on economic activities, enhancement of the private sector and reduction in barriers to free market operations. Specific reforms executed as part of the program include devaluation of the national currency, liberalization of trade and exchange control, withdrawal of subsidies, retrenchment of labor, and reduced government expenditure (Steel & Webster, 1992). Whilst the SAP did enhance macro-economic indicators such as annual growth rate, it failed to generate employment and enhance the wellbeing of the average Ghanaian (Cook & Nixon, 2000). The contribution of SMEs to the economic development of Ghana is still very low. The sector accounted for 15.5 percent of the labour force and 6 percent of the Gross Domestic Product (GDP) in 1998 (Kayanula & Quartey, 2000), although on average 95% of registered enterprises are small (Boeh-Ocansey, 1996). The experience indicates that for economic programs to be successful they must be tailored to a country's specific situation (Baffoe, n.d.).

The performance of the small business sector as a whole is dependent on the performance of the individual firms that comprise the sector (Kotey & Meredith, 1997; Watson & Everett, 1993). Thus, in addition to macro-level reforms, policies and programs that address problems

at the micro (or grass root) level is necessary to improve performance of the sector. One area consistently mentioned in the popular press as a setback to development of the SME sector in Ghana is the impact of gender on small business performance. Whilst various programs have been implemented to address the problem the boundaries of the problem and the factors associated with it are not clearly understood. In this paper we draw on the Western literature to develop a theoretical framework of performance and its determinants that is used in conjunction with the liberal and social feminist theories to draw propositions for examining performance differences between male and female small business owners in Ghana and the factors that account for these differences.

## **THE CONCEPT OF SMALL BUSINESS PERFORMANCE**

Performance has been the subject of extensive and increasing empirical and conceptual investigation in the small business literature (Chandler & Hanks, 1993; Jarvis, Curran, Kitching, & Lightfoot, 2000; Lachman & Wolfe, 1997; March & Sutton, 1997; Murphy, Traylor, & Hill, 1996; Rodsutti & Swierczek, 2002; Watson, Newby, & Woodliff, 2000). Whilst it is generally agreed that performance should be viewed in relation to one or more goals (Etzioni, 1964) the issues that remain unresolved are the goals against which performance should be assessed and from whose perspective the goals should be established.

Organisational theories and the accounting literature, driven by classical economic theory emphasise profit maximisation as the central goal of the firm (Jarvis, Kitching, Curran, & Lightfoot, 1996). These theories, modelled on large enterprises, generalise the concept of performance and fail to take account of differences in goals between firms of varying sizes (LeCornu, McMahon, Forsaith, & Stanger, 1996). The separation of ownership and control from management in large firms and the agency relationship gives rise to profit maximisation as a performance goal, measured by indicators such as return on assets and return on investment (Jarvis et al., 2000).

The situation is different in small businesses where ownership and control as well as management of the firm are usually vested in one key person (the owner-manager). The owner-manager does not only dictate the goals of the firm but also exerts a powerful influence on the way the firm pursues these goals (Glancey, 1998; LeCornu et al., 1996; Verheul, Risseuw, & Bartelse, 2002; Watson et al., 2000). Consequently, researchers have challenged the application of the conventional goal of profit maximisation to the assessment of performance in small firms, advocating instead non-financial goals that portray the 'big picture' of the small firm (Ryan, 1995). The major goals of the small firm must be first understood before its performance can be assessed (Birley & Westhead, 1990; Jarvis et al., 1996; LeCornu et al., 1996; Watson et al., 2000).

Owner-managers pursue a range of goals, emphasizing in particular survival and stability of the firm (Jarvis et al., 2000; Tsai, MacMillan, & Low, 1991). Other goals pursued include efficiency, market share, liquidity, size, leverage, growth, customer satisfaction, quality of products, contribution to community development and employment of family members (Glancey, 1998; Murphy et al., 1996). Assessment of performance in small firms must therefore take account of a range of goals, both financial and non-financial. Since research interest in the small business sector derives from its contribution to economic development, performance of individual firms in the sector can be assessed by the extent to which they add value to the economy (Kotey & Meredith, 1997).

## **DETERMINANTS OF SMALL BUSINESS PERFORMANCE**

The factors that influence performance of small firms can be classified into two main areas – those that emanate from the firm's internal environment (labelled micro-level factors) and those associated with the external environment (ie the macro-level factors) (Kalleberg & Leicht, 1991; Keats & Bracker, 1988). The micro-level determinants include the psychology and demographics of the owner-manager, the resources of the firm, and the strategies adopted (Kalleberg & Leicht, 1991; Keats & Bracker, 1988), while the macro level determinants cover markets, economic, financial, technological, legal and political conditions as well as the socio-cultural context in which the firm operates (Kalleberg & Leicht, 1991; Keats & Bracker, 1988; Wiklund, 2003). Researchers have examined small business performance using various theories associated with these micro and macro level factors. The population ecology theory is the main macro-level theory whilst at the micro level, performance has been examined using the resource-based and strategic adaptation theories as well as in relation to the demographics and psychology of the owner-manager.

### **Population Ecology Theory**

The basic argument underlying the population ecology theory is that the environment largely determines the survival of organisations (Bruderl, Preisendorfer, & Ziegler, 1992; Schindehutte & Morris, 2001). Opponents of the population ecology theory argue that it proposes a relatively deterministic view of organizational design and performance outcomes and that by emphasising only the external constraints on a firm's performance the theory neglects those constraints that are internal to the firm and imposed by the owner-manager's motivations (Keats & Bracker, 1988).

Advocates of the micro level determinants of organisational performance argue that small business performance depends on their ability to adjust their internal structures to the contingencies imposed by their task environment (Iakovleva, n.d.; Kalleberg & Leicht, 1991). These researchers contend that, the better performing firms are those that best adapt to fit the opportunities provided and constraints imposed by their environments. This adaptation depends however, on the choices and actions of owner-managers and the resources at the firm's disposal (Lerner & Almor, 2002). These micro level factors have led to the resource-based and strategic adaptation theories of performance as well as theories based on owner-manager's psychology and demographics.

### **Psychology and Demographics of the Owner-manager**

Begley & Boyd (1986), Kalleberg & Leicht (1991) and Verheul et al., (2002) observed that differences among owner-managers in psychological traits, experiences and skills needed to accomplish their managerial tasks, explain differences in their performance. Traits found to be positively associated with performance in small firms include creativity, courage, aggressiveness, risk-taking (Stevenson & Gumpert, 1985), need for achievement (Kalleberg & Leicht, 1991), and internal locus of control (Brockhaus, 1980). In addition, Bauerschmidt & Hofer (1998) showed that the more skills and experience the owner-manager brings to the business the more successful the business is likely to be. Cooper (1998) cautioned that on their own these psychological and demographic characteristics do not directly influence performance but do so through other variables such as strategy and environmental characteristics.

## **Resource-Based Theory**

The resource-based theory of performance accentuates both the structural characteristics of the firm and the environment in explaining performance (Bruderl et al., 1992). Hadjimanolis (2000) noted that the resource-based view seeks to bridge the gap between the theories of internal capability of the firm on one hand and external competitive strategies on the other. It treats organisations as potential creators of valued capabilities and postulates that the assets and resources of the firm has to be viewed from a knowledge-based perspective (Caldeira & Ward, 2003).

Iakovleva (n.d.) criticised the resource-based theory on the basis that it is difficult to identify which of the several resources of a firm account for its success. In addition, she argued that the resource-based theory does not differentiate between performance factors associated with the resources of the firm and those related to the characteristics of the owner-manager. To overcome this limitation both the characteristics of the owner-manager and his/her resources should be examined separately in assessing small business performance.

## **Strategic Adaptation Theory**

The strategic adaptation theory postulates that the environment influences performance through the strategic choices of owner-managers (Covin & Slevin, 1989; Keats & Bracker, 1988). In emphasizing the role of strategic choice to business performance, the theory accentuates the influence of the owner-manager on the firm. It suggests that the key to business success lies in the decisions of the owner-manager who identifies opportunities, develops strategies, assembles resources and takes initiative (Lerner & Almor, 2002).

Since the major deficiency of each of the above theories is its neglect of the other determinants of performance, an inclusive theory is proposed that encompasses both macro-level factors (environmental factors) and micro-level variables (psychological and demographic characteristics of the owner-manager, the firm's resource and strategies). Figure 1 depicts the relationships between these factors and small firm performance and will form the basis of the conceptual framework developed for this paper.

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Figure 1 here

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Psychological and demographic characteristics of the owner-manager and the environment determine resources available to the firm and these three variables influence strategic choices, which then determine performance. Thus, the relationships between resources, the psychology and demographics of the owner manager, the environment and performance are mediated by the strategic choices made. The above conceptual framework is developed further to include the impact of gender.

## **GENDER AND SMALL BUSINESS PERFORMANCE**

Until more recently gender differences in small business performance remained largely unaddressed by social scientists (Greene, Hart, Gatewood, Brush, & Carter, 2003). The majority of studies either disregarded gender as a variable of interest or excluded female subjects from their design (Du Rietz & Henrekson, 2000). However, it is generally accepted that male and female owner-managers behave differently and that these behavioural

differences influence their performance (Brush, 1992), but these differences have been recognized but not fully explained (Brush & Hisrich 2000).

A comparison of performance of male and female owner-managers in Java, Indonesia showed that female-owned businesses tend to be less oriented towards growth compared to male-owned businesses (Singh, Reynolds, & Muhammad, 2001). Boden & Nucci (2000) investigated start-ups in the retail and service industries and found that the mean survival rate for male owned businesses was four to six percent higher than for female owned businesses. Loscocco, Robinson, Hall & Allen (1991) in their study of small businesses in the New England region of the USA found that both sales volume and income levels were lower for female- than for male-owned businesses. In a longitudinal study of 298 small firms in the United Kingdom (UK), of which 67 were female owned, Johnson & Storey (1994) observed that whilst female owner-managers had more stable enterprises than their male counterparts, on average the sales turnover for female owners were lower than for male owners. Brush (1992) suggests that women perform less on quantitative financial measures such as jobs created, sales turnover and profitability because they pursue intrinsic goals such as independence, and the flexibility to combine family and work commitments rather than financial gain.

In contrast to the above findings, Du Rietz and Henrekson (2000) reported that female-owned businesses were just as successful as their male counterparts when size and sector are controlled for. In his study of small and medium firms in Australia, Watson (2002), after controlling for the effect of industry sector, age of the business, and the number of days of operation, also reported no significant differences in performance between the male-controlled and female-controlled firms.

## **GENDER AND THE DETERMINANTS OF SMALL BUSINESS PERFORMANCE**

Performance differences between the genders have been ascribed to several factors (Lerner, Brush, & Hisrich, 1997). Various researchers have reported that gender influences business performance as a result of its close association with decision-making, business management, strategy formulation and the functional areas emphasised (Carter, Williams, & Reynolds, 1997; Fielden et al., 2003; Mukhtar, 2002). Two theoretical orientations have emerged that seek to explain performance differences between male and female owner-managers in terms of the determinants of performance presented above. They are the liberal feminist and social feminist theories (Liou & Aldrich, 1995).

Fischer et al., (1993) noted that the liberal feminist theory is rooted in liberal political philosophy which encompasses basic beliefs in the equality of all beings, and in human beings as essentially rational, self-interest-seeking agents. The liberal feminist theory attributes gender-based differences to the variations in power and opportunity accorded men and women in society (Beasley, 1999), that is the structural positions women and men occupy in society (Fischer et al., 1993). Thus, differences in the achievements of men and women are ascribed to the inability of women to realise their full potential because they are denied equal access to opportunities in the labour markets and to resources. This in turn has hindered women from acquiring the skills and capabilities necessary to compete on equal basis with men. According to the liberal feminist theory, once equal access to resources is ensured, gender differences in performance seemingly disappear (Carter et al., 1997).

In contrast to the liberal feminist theory, the social feminist theory, which emanates from the social learning theory and psychoanalysis, holds that differences between men and women exist from their earliest moments in life and result in fundamentally different ways of viewing the world (Beasley, 1999; Fischer et al., 1993; Kutanis & Bayraktaroglu, 2003). These differences are seen in the way women and men construct and interpret reality and how these influence the formation of their values and intentions (Carter et al., 1997). Men and women are inherently different because of differences in their socialisation, training and experiences encountered prior to entry into particular work positions. Differences in nurturing result in different self-perceptions, motivations and belief structures. As a consequence women adopt different approaches to work which may, or may not be as equally effective as those adopted by men (Fischer et al., 1993).

Drawing on these two feminist theories and research on the factors that influence performance of small firms, this paper proposes a conceptual framework to guide the examination of gender differences in small business performance in Ghana. In the next section the model is applied to the Ghanaian situation and propositions developed for testing.

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Figure 2 here

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## **APPLICATION OF THE THEORETICAL FRAMEWORK TO GHANA**

The Ghanaian society is an interrelated social system with the extended family system the hub around which the traditional social organization revolves (Federal Research Division, n.d.). Relationships are built around family membership, inherited status and ancestral beliefs. Traditional sex-role identification and living arrangements have established division of household responsibilities among various members of the family (Bortey and Dodoo, n.d.). Children internalize the gender specific roles assigned them and act in ways that conform to societal norms.

With no formal social security system in Ghana, men are perceived as the main source of livelihood for their families. They are nurtured to lead their households and to take responsibility for the welfare of all household members. In the process they are given control over the resources required to effectively discharge their responsibilities. The Ghanaian male is encouraged to be brave, even aggressive and not to display emotions openly. Values developed through this nurturing process include assertiveness, independence, achievement orientation, confidence and self-esteem (Bortey & Dodoo, n.d.). These values are recognized in the literature as entrepreneurial.

Ghanaian females, on the other hand, bear the responsibility for providing primary care for their families with duties such as child-rearing and various household chores (Dolphyne, 2000). Boys are selected over girls when the family allocates funds for the children's education. The subordinated position accorded the Ghanaian female is fuelled by a general perception that girls need not be as educated as boys as they are to be supported by and subservient to their husbands (Dolphyne, 2000). There is fear in most circles that a girl's marriage prospect is dimmed by extensive education. Consequently, on average Ghanaian women receive lesser education than their male counterparts (Tsikata, 2001). Although efforts are being made by various advocacy groups to minimize the disparities in nurturing and opportunities opened to the genders in Ghana traditional social values continue to endure. There is a general belief among the older generation that the Ghanaian race will be lost if its cultural values undergo changes and that Ghanaian traditions must be closely guarded in

order to preserve the Ghanaian race (Loth, 1999). Whilst modern lifestyles and Western influences have reduced the disparities in nurturing between the genders, particularly among the urban dwellers, Ghanaians are still bound through the kinship system to traditional social values that require them to assume the responsibilities that such associations entail (Bortey & Dodoo, n.d.; Federal Research Division, n.d.). The World Bank's (1999) report and the 2000 population and housing census by the Ghana Statistical Service (2002) revealed the following inequalities between the genders in Ghana –

- a. Girls receive less education than boys. In 1994, girls comprise 47 percent of primary school students, 35 percent of senior secondary school students, and only 26 percent of tertiary school students.
- b. Adult illiteracy rates were 47 percent for women in 1995 and 24 percent for men
- c. Women have less access to credit from formal channels than do men due to lack of collateral because of weak land tenure rights.
- d. Girls and women are pushed into female stereotyped careers such as teaching, tailoring, secretarial work, nursing and prevented pursuing careers in other areas such as the “hard” sciences, engineering, accounting and management

Parallel to the systematic discrimination that in general should leave Ghanaian women worse off in their ability to earn income, is a micro and small business sector dominated by women. With limited employment opportunities resulting from lack of education and experience, the majority of Ghanaian women engage in some form of micro or small enterprise, whether selling food items, clothing, and various other tradable commodities, or providing services such as hairdressing, tailoring, and cleaning. Many girls grow up helping their mothers in their commercial endeavors. They learn to haggle, budget, keep accounts, and to save early in life. In the process they develop the qualities required to survive in the commercial sector. Thus, in the effort to prevail in a society in which they are marginalized, Ghanaian women develop entrepreneurial qualities.

In contrast, small private enterprise does not fit well with the role expectations of Ghanaian men. Up until the 1980s, with the retrenchments that followed the implementation of the SAP, men were looked down on if they engaged in the micro or small business activities. Ghanaian men achieved social respect if employed in large multinational firms, the public sector, manage large manufacturing concerns or were self-employed in professional services. Men who engaged in commercial activities had bigger private concerns and employed workers (usually from their families). Although Ghanaian women have longer experiences as entrepreneurs than their male counterparts, their managerial skills are rudimentary, passed on through informal (on the job) training from mothers or other female relatives with little or no formal education. We draw the following propositions from the above observations.

**Proposition 1 Entrepreneurial values are similar for Ghanaian men and women small business owners.**

Women would have acquired entrepreneurial values from their involvement in private enterprise early in life whilst men are nurtured to develop these values in consonance with their role expectations.

**Proposition 2 On average Ghanaian women have more entrepreneurial experience than Ghanaian men.**

**Proposition 3 Ghanaian male small business owners have better managerial skills than their female counterparts.**

When it comes to resources Ghanaian female business owners are caught in a spiral web that makes it difficult for them to progress beyond their micro or small sized businesses.

Ghanaian female business owners lack access to resources particularly finance because - they have little or no assets for collateral security, their low educational backgrounds are barriers to processing the necessary paperwork, and they are intimidated by the male dominated staff in the banks and other organizations they have to deal with when accessing resources. Men are given priority over women in the allocation of scarce resources. Added to these setbacks are the constant pressures of household responsibilities and the common perception that it is not good for women in business to be more successful than their male counterparts (The World Bank Group, 1999). Whilst various networking and mentoring programs as well as assistance from non-government organizations (NGO) are being used to overcome some of the difficulties associated with accessing resources, the low educational backgrounds and managerial skills of female owner-managers in Ghana pose major barriers to equitable resource allocation. From the above observations and the model in Figure 2 we draw the following propositions about gender differences in business performance of male and female owner-managers in Ghana -

**Proposition 4 Female business owners in Ghana have less access to resources than their male counterparts.**

**Proposition 5 Ghanaian female owner-managers adopt less proactive strategies than the male owner-managers.**

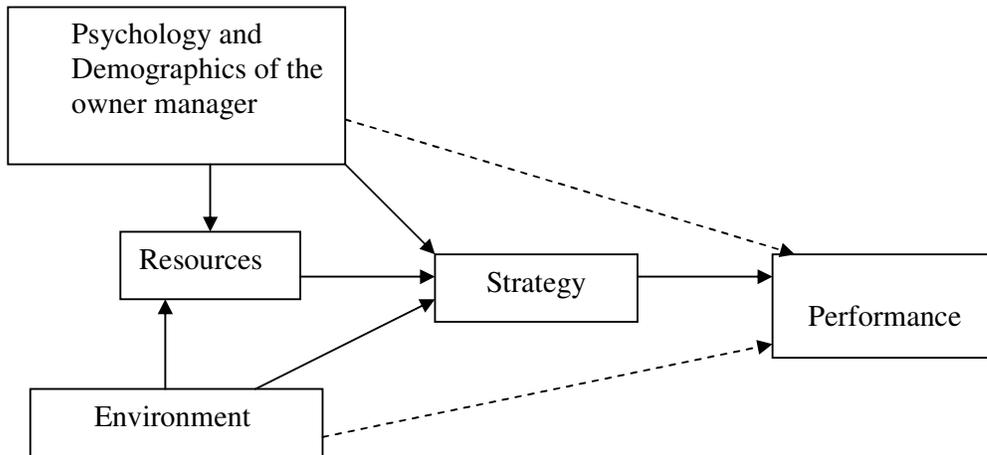
**Proposition 6 On the average Ghanaian women operate smaller businesses than their male counterparts.**

Confirmation of the above propositions by empirical analysis would imply that programs that enable temporal access to resources (such as networking and mentoring programs or access to informal sources of finance) would only provide short-term solutions to the gender inequalities in business performance. Long-term measures that equip Ghanaian women with the necessary education and managerial skills and place them on equal footing with the men should be more enduring in bridging the gender gap and assisting Ghanaian women to realize their full potential. These in turn require systematic education of Ghanaian parents about the potential of their female children.

Whilst the experiences of the Ghanaian woman bear some semblance to those of Western women, there are several areas of differences (e.g. predominance of women in micro and small enterprise, cultural influences) that would render direct implementation of some the programs used in the West to resolve gender differences in business performance ineffective (in the long-run) in Ghana.

If Ghanaian small business women have equal access to the capabilities, information and resources available to their male counterparts they should be able to adopt similar if not more proactive strategies than the male business owners and achieve equal or better performance.

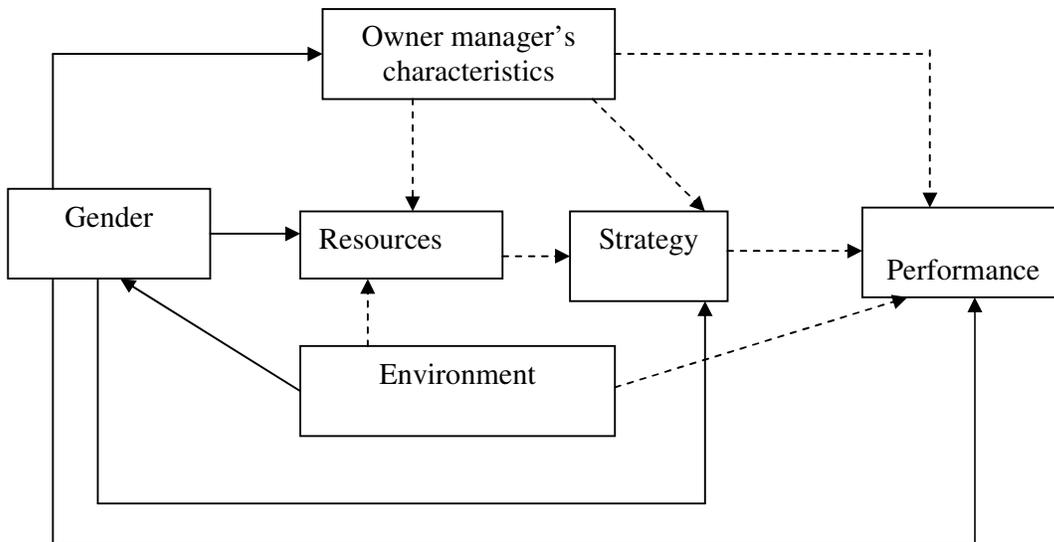
**Fig. 1 Factors that influence small business performance**



Source: Adapted and modified from Brush and Hisrich (2000 p. 21)

—————> Direct relationships  
 - - - - -> Indirect relationships

**Fig. 2 Proposed framework for the study of the relationship between gender, performance, owner manager’s characteristics, resources and strategy in Ghana.**



—————> Relationships of direct interest  
 - - - - -> Indirect relationships

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## VIRTUAL ENTERPRISE: ENGAGING RECENT U.S. IMMIGRANTS AND MINORITIES IN ENTREPRENEURSHIP EDUCATION

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### **Abstract**

At the City University of New York, recent immigrants and minorities are engaged in entrepreneurship education through a program called the Virtual Enterprise. Virtual Enterprise (VE) is a technology driven business simulation program in which students conceive, create and operate enterprises that utilize web-based and other technologies to trade products and services in a global, e-commerce network of more than 4,000 firms in 40 countries around the world. The Institute for Virtual Enterprise (IVE) is a CUNY Special Initiative whose mission is to bring the VE method of experiential learning to various student cohorts throughout the CUNY system.

This paper is an introduction to the Virtual Enterprise program and its effect on these student populations with regard to entrepreneurship education. The paper reports the results of the VE-CLIP program over the last three years since its implementation at CUNY. The data from qualitative and quantitative studies reveal that the recent immigrant/minority student becomes more engaged with learning because they see a link between academic and practical learning.

Most recent immigrants to the United States need to learn the American way of doing business. These students will, hopefully, eventually start their own businesses in the U.S. The VE program gives these students a taste of what it is like to do business in the U.S. without the risks associated with being a real entrepreneur and having to make payroll. Students learn the way of creating, owning and operating a business, and VE gives them the entrepreneurial tools to be successful.

## INTRODUCTION

*“Small business is the vehicle by which millions access the American Dream by creating opportunities for women, minorities and immigrants.”* (Acs, Tarpley and Phillips, 1998)

The above statement is a fact that many entrepreneurship educators have become quite familiar with. Correspondingly, academic curricula must be developed that attracts, retains, and ultimately provides those student groups with the entrepreneurial skills that allows them to achieve their financial dreams. Arguably, those students groups are among the most challenging student cohorts to educate in entrepreneurial activities. It's even more difficult to teach those student cohorts when they lack the English language skills that are necessary to be successful in academics or in entrepreneurial endeavors.

*“Sometimes the only thing standing between a foreigner and the American dream is the perplexing language, with its fast-changing slang and impossible pronunciations.”* (Huffman, 1997, 3). Entrepreneurship education is not limited to English speaking students in the United States. Arguably, college student populations in most large, U.S. cities are more diverse than in rural areas. How can entrepreneurship educators engage these student cohorts? To these student populations, at the City University of New York, (CUNY) entrepreneurship education is administered through the Virtual Enterprise method of instruction.

Virtual Enterprise (VE) is a technology driven business simulation program in which students conceive, create and operate enterprises that utilize web-based and other technologies to trade products and services in a global, e-commerce network of more than 4,000 firms in 40 countries around the world. The Institute for Virtual Enterprise (IVE) is a CUNY Special Initiative whose mission is to bring the VE method of experiential learning to college students throughout the United States.

Engaging English as a Second Language students (ESL) in college programs, let alone entrepreneurship courses, can be a very difficult task. More often than not, colleges do not allow ESL students to matriculate in credit bearing courses. ESL students are forced to pass their various ESL courses before being admitted into credit bearing courses. Kingsborough Community College, a CUNY school, and Shoreline Community College, in Washington State, have both utilized Virtual Enterprise methodology in ESL courses. Initial evidence shows that these students become more engaged with their studies because business is a “universal language,” and they can see the link between academics and financial success in the business-world. At Kingsborough Community College, (KCC) ESL students are enrolled in the VE-CUNY Language Immersion Program (VE-CLIP).

This paper studies the effects of Virtual Enterprise on ESL students with regard to entrepreneurship education. The paper has a three-pronged research methodology. First, it reports the qualitative results of a survey of students in the VE-CLIP program over the last two years since its implementation at KCC. Second, it reports the CUNY/ACT testing scores of VE-CLIP students who seek to become matriculated students. Finally, the paper reports the findings of an independent investigation by the Center for Advanced

Studies in Education. (CASE) CASE studied the Virtual Enterprise Program as a teaching methodology and assessed student outcomes with regard to the skill sets VE students received in entrepreneurship and other business-related skills.

## **History of Virtual Enterprise**

The original Virtual Enterprise (VE) concept was originated in Europe, where Virtual Enterprises are known as practice firms. The earliest practice firms were created "...to provide practical commercial education in the form of realistic exercises," (Korbmacher, 1989) and date back to at least the 17<sup>th</sup> century. In Vienna, a *Musterkonto*, an educational enterprise, or practice firm, was integrated into the curriculum of the Commercial College. These firms originated as a part of the apprenticeship movement in the German speaking countries of Europe. Educators of the time felt that it was better to have students apply their acquired academic knowledge before going out into the "real-world." (Borgese, p.3)

In the United States, the higher education VE was started by a FIPSIE grant that included various partners, one of which was the City University of New York (CUNY). Kingsborough Community College and their FIPSIE partners adopted this method of instruction, named it Virtual Enterprise, and added to the curriculum to provide a construct that offers an entrepreneurial business experience for college students.

## **How Virtual Enterprise Works**

The VE curriculum is not a simulation whereby you can put a CD into a computer and gain access to all components. VE is equivalent to open source code in computer programming; it is available for free to everyone. Once a college adopts the curriculum, students go to "work" to learn various entrepreneurial and business skills. The first steps in their new VE course are: learning about the VE global marketplace to identify entrepreneurial opportunities, creating an idea for an enterprise, naming the firm, creating its logo, and business plan. Subsequent lessons include: identifying and utilizing small business start-up resources, oral presentations for venture capital, creating budgets and other financial reports, marketing, pricing, payroll, understanding corporate tax structures, and business software and technology.

Every Virtual Enterprise firm and practice firm is assigned to a regional headquarters. In Europe, the regional headquarters for European practice firms is European. ([www.europen.de](http://www.europen.de)) In the United States, the Institute for Virtual Enterprise, a CUNY Special Initiative, ([www.ive.cuny.edu](http://www.ive.cuny.edu)) is the regional headquarters for U.S. based college VE firms. VE students must create and present a business plan to representatives of the regional headquarters in order to receive capital to start their businesses. The firms are awarded money, in virtual funds, based on their presentation and their ability to pay back the loan.

After each VE firm is provided with virtual money, they receive a bank account at the IVE Bank that forms the foundation to function within the simulation and carry out transactions. The IVE Bank is part of a major financial literacy program within the VE simulation known as the MarketMaker. VE curriculum designers feel that it is very important for immigrant entrepreneurs to understand the financing involved with business activities. In a report by Bates and Bradford, minority owned businesses outperformed the Standard and Poors 500 in 2003. (Bates and Bradford, 2003) This performance cannot occur without understanding the financial intricacies of a business. The MarketMaker provides that financial instruction to VE students. In addition to financial reports, the MarketMaker project includes a virtual stock market that matches the stock price of real corporations with similar VE firms. The MarketMaker also includes personal and corporate credit cards, whereby students learn the credit nuances of an entrepreneurial start-up.

One advantage of the Virtual Enterprise program is that it provides students with a worldwide, global, VE economy in which to try out ideas for their businesses. Implementation of their ideas comes from their own creativity and by performing in the VE course. The safety net provided by VE takes into account that if student business ideas fail, they have the luxury of making those mistakes within the simulation and not in the real world where the financial burden would have much greater costs. Other academic entrepreneurial simulations can only go so far and cannot offer the total package of entrepreneurial activities that Virtual Enterprise does.

### **Virtual Enterprise and the CUNY Language Immersion Program**

Virtual Enterprise started at Kingsborough Community College in 1997. The VE method of instruction has been used with various student cohorts including: at-risk students, honors students, students who have been academically dismissed from senior CUNY colleges and have been given a second chance, and workforce development students. In the 2002 academic year, CUNY decided to adopt VE methodology as part of the CUNY Language Immersion Program (CLIP) at KCC. (VE-CLIP)

The credit-bearing student population at Kingsborough Community College mirrors most large-city college populations. KCC has 17,000 students where 80% have immigrated to the United States within the past five years. The statistics for VE-CLIP students are, as one could imagine, comprised of 100% newly arrived immigrants into the United States. Additionally, they lack the English language skills necessary to be admitted to CUNY as matriculated students. It is the goal of the CLIP program to bring the English skills of these students to acceptable CUNY levels in order for these students to matriculate into CUNY colleges.

*“...the demand for training in business English will continue to grow as the population increases, immigrants settle in English speaking countries, and businesses become increasingly globalized.”* (Sarty and Gerdeman, 2004) Many college administrators believe that it is important to teach business skills to recently arrived immigrants. Also,

Gartner found that minorities with more education are more likely to start businesses. (Gartner, 2001) In addition to the matriculation of these students into CUNY colleges, CUNY administrators thought that the VE method of instruction would be a good intervention to teach English language skills, from a business perspective, in order to get these students to believe that there is not only academic success, but also financial success in learning English.

## **PROJECT DESIGN AND METHODOLOGY**

The research methodology of this paper is multifaceted, employing qualitative, quantitative and independent methodologies. First, the researcher reports the results of a qualitative study of a questionnaire administered to VE-CLIP students with regard to their own progress. The questionnaire the researchers utilized is a derivative of a questionnaire employed by Graziano in his doctoral dissertation. The questionnaire asked CLIP-VE students how they felt about their progress in a variety of entrepreneurial activities including: technology and software utilization, verbal and written communication, operations and teamwork, leadership and creativity, and other general business activities such as marketing.

The subjects in the quantitative piece are Kingsborough Community College VE-CLIP students who already have taken at least one semester of language instruction, but did not pass the CUNY/ACT entrance exams. The paper reports the results of the effects of VE on these VE-CLIP students after taking a VE course. The results take into consideration the students populations of women, minorities and immigrants.

Finally, the paper discusses the results of an outside investigation of the Virtual Enterprise methodology. The Center for Advanced Studies in Education (CASE) conducted an in-depth assessment of VE as a methodology in general. The CASE study did not focus on ESL students, but rather on Virtual Enterprise as a teaching methodology for various student cohorts.

### **Qualitative Results**

A questionnaire soliciting the opinions and feelings of VE-CLIP students was administered in the 2003/2004 academic year. The questionnaire was given to two VE-CLIP cohorts, one in fall 2003 and the other in spring 2004. The VE-CLIP courses had 15 students each for a total population of 30 students. Of the 30 students surveyed, 100% were recently arrived immigrants, all from identifiable minority groups. 100% listed English as their second language. 70% of the students surveyed were female, with 30% male.

The questionnaire asked 20 questions, on a Lickert-like scale, directly related to what IVE administrators believe students should be learning in a VE-CLIP course, specifically: technology and software utilization, verbal and written communication, business

operations and teamwork, leadership and creativity. These skills are similar to what the Consortium for Entrepreneurship Education has defined as some of the standards for entrepreneurship education. ([http://www.entre-ed.org/Standards\\_Toolkit/standards\\_summary.htm](http://www.entre-ed.org/Standards_Toolkit/standards_summary.htm)) Students were asked to identify if they made no, little, moderate great or very great progress in the above categories. The following are the results of the questionnaire in category and the percentage of respondents choosing moderate to very great progress:

| <u>Category</u>         | <u>Percentage</u> |
|-------------------------|-------------------|
| • Technology            | 65%               |
| • Software              | 58%               |
| • Verbal Communication  | 65%               |
| • Written Communication | 43%               |
| • Business Operations   | 86%               |
| • Teamwork              | 72%               |
| • Leadership            | 57%               |
| • Creativity            | 71%               |

In addition to the above questionnaire, there has been other qualitative research conducted on Virtual Enterprise students who are also within the women, minorities and immigrant categories. The previously mentioned dissertation of Graziano reasoned for VE methodology as a tool for teaching ESL. (Graziano, p155) Graziano’s dissertation discussed a focus group he convened with various VE students. One of the students from his focus group put VE methodology into perspective for students struggling with English.

*“I was always afraid to speak up because I thought I had an accent. I still have one. I had this feeling that whenever I began to speak, people would look at me differently, thinking, “Oh she must be from a different country.” So sometimes, even though I knew the answer, I was afraid to speak up. Coming to this class, for the first time it gave me the opportunity to express my opinions.”* (Graziano, p.154-155) While Graziano’s study was not specifically convened for ESL students, his findings speak directly to the Hunt quote mentioned previously about the importance of English to achieve the American Dream for foreigners/immigrants.

## **Quantitative Results**

The quantitative research for this paper is based on the scores of VE-CLIP students on the CUNY/ACT test. The CUNY/ACT test is a test that all students who desire to be full-time, matriculated, CUNY students have to take to assess their competency levels in, Reading, Writing, and Mathematics.

(<http://portal.cuny.edu/cms/id/cuny/documents/informationpage/002155.htm>)

The following results are based on VE-CLIP populations from the fall 2002 to fall 2004 semesters. All of these students are recent immigrants and minorities. The results are given in semester and percentage of students improving their scores on the CUNY/ACT. All students took the CUNY/ACT previously, and failed, and then retested after taking a Virtual Enterprise course.

| <u>Semester</u> | <u>Percentage of Students Improving their CUNY/ACT Scores</u> |
|-----------------|---|
| Fall 2002       | 79%   |
| Spring 2003     | 65%   |
| Fall 2003       | 65%   |
| Spring 2004     | 70%   |
| Fall 2004       | 93%   |

### **Center for Advanced Studies in Education (CASE) Assessment**

The Center for Advanced Studies in Education (CASE), an independent research institute of CUNY, conducted an assessment of the Virtual Enterprise Program at Kingsborough Community College as a teaching methodology. The CASE study was an in-depth study of the overall VE program at KCC, specifically with regard to student outcomes.

CASE compared the student learning outcomes in Virtual Enterprise with the 21<sup>st</sup> Century Core Skills. The 21<sup>st</sup> Century Core Skills were created in 2000 after research conducted with the aid of a Pew Charitable Trust grant. The following table shows the 21<sup>st</sup> Century Core Skills on the left and the VE Learning Outcomes on the right.

| <u>21<sup>st</sup> Century Core Skills</u>  | <u>VE Learning Outcome</u>  |
|---|---|
| <b>Communication Skills</b> (reading, writing, speaking and listening)  | <b>Communication Skills</b> (reading, writing, speaking and listening)  |
| <b>Community Skills</b> (citizenship; diversity/pluralism; local, community, global, environmental awareness)             | <b>Global Awareness</b> (understanding the global marketplace, culture and diversity)                                     |
| <b>Critical Thinking and Problem Solving Skills</b> (analysis, synthesis, evaluation, decision-making, creative thinking) | <b>Critical Thinking and Problem Solving Skills</b> (analysis, synthesis, evaluation, decision-making, creative thinking) |
| <b>Information Management Skills</b> (collecting, analyzing, and organizing information from a variety of sources)        | <b>Information Management Skills</b> (collecting, analyzing, and organizing information from a variety of sources)        |
| <b>Technology Skills</b> (computer literacy,  | <b>Technology Skills</b> (computer literacy,  |

|   |  |
|---|--|
| <p>Internet skills, retrieving and managing information via technology)</p> <p><b>Interpersonal Skills</b> (teamwork, relationship management, conflict resolution, workplace skills)</p> <p><b>Personal Skills</b> (ability to understand and manage self, management of change, learning to learn, personal responsibility, aesthetic responsiveness, wellness)</p> | <p>Internet skills, retrieving and managing information via technology)</p> <p><b>Interpersonal Skills</b> (teamwork, relationship management, conflict resolution)</p> <p><b>Intrapersonal Skills</b> (ability to understand and manage self, management of change, learning to learn, personal responsibility)</p> <p><b>Entrepreneurship/Business Knowledge</b> (developing business plans, developing marketing and sales strategies, financial literacy and accounting skills, etc.)</p> <p><b>Motivational Outcomes</b> (understanding the connection between academic skills and attainment of career goals, career self-efficacy expectations)</p> <p><b>Faculty Outcomes</b> (shifting roles from instructor to advisor-coach-facilitator, functioning in cross-disciplinary teams)</p> |
|---|--|

As indicated by the results, VE Learning Outcomes match up with the 21<sup>st</sup> Century Core Skills in various entrepreneurial activities such as: communication skills, global awareness, critical thinking and problem solving skills, and interpersonal skills. In addition, CASE found that VE student outcomes produce specific entrepreneurship and business skills such as: developing business plans, marketing strategies and financial literacy. CASE also found that VE students also gained motivational outcomes specifically within the area of linking academic skills to career goals. Upon completion of the program, VE students feel that they can take the skills they learned and become entrepreneurs.

### SUGGESTIONS FOR FURTHER RESEARCH

Due to the adaptability of Virtual Enterprise as a teaching methodology to various student populations, further research can occur in a variety of areas. First, the author believes that the most appropriate research should be conducted on the ESL students who are taking Virtual Enterprise at Shoreline Community College in Washington State. The VE program at Shoreline is in its infancy, but further research on their students should be conducted and compared to the research within this study to improve validation of VE as a method of entrepreneurship education that benefits non-English speaking immigrants.

Second, other student populations should be studied to see if the Virtual Enterprise method of instruction is providing benefits to those specific students with regard to entrepreneurship education. Limited research has already been conducted on academically challenged students who take Virtual Enterprise, but other student populations can, and should be studied. Specifically, women who take VE courses in order to gain entrepreneurial skills should be studied. Finally, minority students in, non-ESL populations should be studied as well. Although these student populations are part of this study, they were all grouped together. Academics could benefit from further, individual research on these student populations.

## SUMMARY AND CONCLUSION

Engaging recent United States immigrants and minorities in entrepreneurship education is not an easy task. For recent immigrants with a lack of English language skills the task is even harder. Most entrepreneurship academics agree that having a thorough understanding of English is the cornerstone to being a successful entrepreneur. It is up to college administrators and professors to devise curricula that meets the objectives of not only teaching English, but engaging immigrants to believe that they too can become entrepreneurs and achieve their American Dream.

Virtual Enterprise is a teaching methodology that personifies entrepreneurship education. VE has been used as a vehicle for teaching entrepreneurship education to various student populations, including ESL students. Accordingly, VE methodology has been scrutinized and assessed in a variety of ways. First, there is qualitative research that shows that VE students like the program and feel that they gain a variety of entrepreneurial and academic skills. Second, quantitative research, via the CUNY entrance exam testing results, indicates that CLIP-VE students improved their CUNY/ACT scores after taking a VE course. Finally, research conducted by an independent researcher shows that Virtual Enterprise gives students not only the 21<sup>st</sup> Century Core Skills, but motivational and entrepreneurship skills as well.

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## INVESTMENT OPPORTUNITIES IN WEST AFRICA

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In this research, the resources that make this region a great target not only for big international companies, but also for any small businesses, will be explained. The reasons why this relationship should increase not only with the United States, but also with the rest of the world, will also be explored. Most importantly reasons why, from the viewpoint of some foreign companies, investments in West Africa seem to be more profitable than in most other regions. The procedures for acquiring the investment loans, as well as barriers to the development of investments in West Africa will be studied. For instance, why, despite the apparent advantages is this part of the world not economically developed? Finally, in the last part of this research, some recommendations will be suggested to improve the economic climate.

For many investors in other parts of the world, the mention of Africa evokes images of civil unrest, war, poverty, disease, and mounting social problems. Even though it might be true and that these images might reflect the dire reality in some African countries, they are certainly not in all countries, nor is the entire continent plagued as it was reported during the United Nations Conference on Trade and Development that was held in New York in 1999. At this conference on trade and investment, a particular concern to help promote investment, domestic as well as foreign, as a means of strengthening the supply side of the African economy was discussed. The Secretary General of the United Nations, Mr. Kofi Aman, brought this topic to the conference and has recognized a disregard of the continent despite its potential. To achieve this investment promotion, Mr. Aman explained that it is essential to mobilize private capital flow, as well as to reverse the shameful decline in official development aid.

While the problems many African countries face are widely known and dominate the perceptions of the continent as a whole, there are a number of positive aspects that, although highly relevant for foreign investors, are little known. As in other continents, there are profitable investment opportunities to be found in most African countries that have a lot of resources that would greatly benefit any foreign companies.

Foreign direct investment (FDI) is welcomed and, indeed, actively sought by virtually all African countries. The contribution that FDI can make to their economic development and integration into the world economy is widely recognized. For this reason, African countries have made considerable efforts over the past decade to improve their investment climate. They have liberalized their investment regulations and have offered incentives to foreign investors. More importantly, the economic performance of the continent has substantially improved from the mid-1990s.

# PERCEIVED SUCCESS FACTORS IN START UP AND GROWTH STRATEGIES: A COMPARATIVE STUDY OF ENTREPRENEURS, MANAGERS, AND STUDENTS

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## ABSTRACT

This paper reports on a comparative quasi-experiment of how perceptions of entrepreneurial growth strategies differ between students, managers and technology entrepreneurs. The differences in perceptions as to what critical factors drive three strategies: no growth, market share growth and annual profit growth across to stages: start-up and take-off are measured. The ranks of the critical success factors are the dependent measures and the strategies and the phases the independent variables. Results show that experience impacts the ability to distinguish between strategies. Results also show that the perceptions of the critical success factors significantly differ between the groups. Hence even experience will yield quite different cognitive maps.

## INTRODUCTION

Recently it has been argued that management training alone will do little good if managers, or entrepreneurs, lack hands-on experience (Mintzberg, 2004). It has also been argued that technology entrepreneurs in particular, who may be excellent scientists and technologists, fail as entrepreneurs because they lack appropriate business management training and experience. Specifically it has been said that technology entrepreneurs do not understand the importance of their specific markets and how firm grow therefore failing to make appropriate managerial decisions with respect to appropriate critical success factors (CSFs) needed to implement pursued growth strategies. Recently Shane (2003) pointed out that we do not yet understand the relationship between the choice of entrepreneurial strategy and the opportunity exploited, which essentially points at this very same problem.

These claims are serious against the reality that entrepreneurial firms are expected to grow. Large firms dominate economically when measured by assets, but small firms undoubtedly dominate when measured by number. Most firms start small and if they can overcome the high failure rate, they are expected to grow. Technology firms in particular are perceived as high growth firms and the literature often provides Silicon Valley as the prime example of how technology firms grow rapidly and provide employment for large

amounts of people and therein generate regional wealth (Saxenian, 1994). Hence there is a notion of that growth means at least growth in employment. But, the growth concept is actually a highly complex cognitive framework based on several factors, and it is far from obvious what growth really means to the entrepreneur; is it annual profit growth; is it increased market share? Is sustainability or mere survival the entrepreneur's target? What kinds of growth strategies do entrepreneurs employ (Shane, 2003)? How are growth strategies conceptualized by entrepreneurs in terms of the critical success factors (CSFs) that drive them?

We have since the mid 1990's seen an exceptionally high rate of new technology-based firms, where the founder many times has had little if any prior business experience. Within the field of, for example, biotechnology the founder has often been a successful scientist and researcher holding a Ph.D. and within information technology (IT) the founder has many times had no degree at all. It has been shown that those scientists which work in close proximity to firms have a lower failure rate than those who do not (Zucker et al., 1998). Hence are there differences in perception of growth that can be related to prior experience (or absence thereof)?

Growth is by definition a dynamic concept and the life cycle concept has been used to describe how firms transcend different stages of growth, and that different sets of assets and skills or CSFs are needed at each stage in order to ensure success (Churchill and Lewis, 1983, Moore, 1995, Koberg et al, 1996). CSFs are perceived to be important and fundamental to business, but few studies exist where CSFs are analyzed across the stages in the life cycle of a firm. Additionally, few studies actually demonstrate the link between firm growth and entrepreneurial perceptions as conceptualized by CSFs. Finally, few studies show how prior experience impact the perception of growth. Therefore, we find it necessary to study CSFs and entrepreneurial growth in the context of dynamic business life cycle via a controlled quasi-experiment in order to deepen our understanding of the mental models of entrepreneurs in comparison with managers and students who lack managerial experience.

## **PREVIOUS RESEARCH AND HYPOTHESES**

Previous research show that CSFs are strategically important and a firm's competitive success depend on them. They are industry specific and even business unit specific and dependent on managerial perception and managerial experience (Daniel, 1961, Anthony et al, 1972, Rockart (1979).

H1: CFSs are different due to managerial experience

CSFs have implicitly been linked to the life cycle (LC) concept by concluding that CSFs will depend on the situation of the firm, i.e. in what stage the firm is and therefore change over time (Rockart, 1979). Similar conclusions regarding differences across stages have been found by other studies using the LC concept (Churchill and Lewis, 1983, Quinn and Cameron, 1983, Tushman and Nadler, 1986, Van de Ven, 1986, Walsh and Dewar, 1987, Kazanjian, 1988, Pinto and Prescott, 1988). Studies focusing on critical issues in one or two stages in relation to entrepreneurial growth have been extensively researched, often

focusing on foundation and growth (Katz and Gartner, 1988, Davidson, 1989, Covin, et al, 1990, Reynolds and Miller, 1992).

The cognitive framework of growth tends to be that of an S-form life cycle curve corresponding with Roger's (1962) model of diffusion of innovations describing consumer's perception and adoption of innovations. This curve was re-conceptualized into another cognitive framework for describing entrepreneurial growth over different stages. Churchill and Lewis (1983) identified five stages; (i) existence, (ii) survival, (iii) success, (iv) take-off, and (v) resource maturity. Kazanjian (1988) distinguished between four stages: conception, development and commercialization, growth, and stability. Later, Kazanjian and Drazin (1989) showed, although previously questioned by Miller and Friesen (1984), that firms progress sequentially across those stages and Moore (1995) showed that the shape (or steepness) of that curve may differ depending on chosen strategy.

H2: CSFs are different in different stages of the firm's life cycle

H3: CSFs are different depending on growth strategy

Finally, with respect to growth studies there appears to be two main categories, one concerned with large organizations and several products where growth is a sum of many. This has been labelled *corporate growth* whereas the other category has been concerned with small business growth labelled *entrepreneurial growth*. The difference between these two categories seems to come from the fact that growth in small companies can be attributed to one single product or innovation (Moore, 1995). A study by Sousa de Vasconcellos and Hambrick (1989) showed that CSFs could be deduced from knowledge of basic technology and market attributes.

H4: CSFs are different depending on product technology

## DESIGN

In order to acquire a deeper understanding of growth and CSFs and their relationship and how they are perceived we conducted a controlled experiment. A quasi-experimental design was chosen to control for the growth strategy, product technology, and the CSFs.

In this study we have taken the view by Drucker (1985) on entrepreneurship and thus entrepreneurial growth can mean anything from starting a brand new business, creating a new strategic business unit within a corporation, or launching a new product on existing markets or entirely new markets.

In order to study the role of experience in perceptions of growth strategies we had three groups of respondents:

- (i) management naïve undergraduates (Group 1) who were book-learned but lacked any business experience,

- (ii) experienced managers (Group 2) who were assumed to have some basic training but first and foremost business experience,
- (iii) experienced technology-based entrepreneurs (Group 3) who were assumed to have some basic training, technology-based experience, and business experience.

There were two kinds of products:

- (i) organic pasta (500g) sold at a 20% price premium (Product 1), and
- (ii) functional food pasta (500g) sold at a 20% price premium (Product 2).

These products can also be characterized as low technology (Product 1) and high technology (Product 2). For both, the element of technology, either its absence or its presence is used in the claim of the product's superiority. Functional food<sup>1</sup> is a sub-category of the life science sector. The third group of respondents possessed experience from another life science sector, biomaterials. Despite clear differences between functional foods and biomaterial, there are similarities in the fundamental science of these two sectors (e.g. biology, biochemistry, chemistry and medicine). Thus, it was assumed that Group 3 had technology-based experience that would enable them to understand the products and the markets in order to assess growth strategies. Group 2 consisted of managers who were all from the same food processing company, but from different business units although in such positions that they were judged as highly experienced. The company is a large food processing company, which has in recent years brought innovative products, functional foods, to the market. Recently, the company had launched a functional food pasta on the market and is market leader in several served target markets. Group 1 were business school students in their third year and had no managerial experience, but could be seen to have consumer experience of ordinary pasta.

Finally there were three different growth strategies:

- (i) no growth (control) (Strategy 1),
- (ii) 20% annual market share growth over a period of five years regardless of profitability (Strategy 2), and
- (iii) 20% annual profit growth over a period of five years (Strategy 3).

Each respondent was given a task based on *one* product and *one* strategy. Thus, we had six different growth scenarios. Each respondent was given a list of 21 CSFs based on Aaker's (1989) original list of 31 CSFs. These were based on application to the given products. To ensure randomness we listed the CSFs in alphabetic order as opposed to Aaker's list, which was based on perceived importance. The respondent was to choose five CSFs out of 21 and rank only these five factors in order of importance to their particular task scenario. To capture the cognitive framework of the life cycle the respondents were asked to repeat the choice in two phases:

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<sup>1</sup> Functional food contain an ingredient, a micro-nutrient or a natural chemical product for which we have scientific results either showing significant and beneficial interactions with the bodily functions or a reduced risk of developing certain diseases. Functional food must remain foods and must demonstrate their effects in amount that can normally be expected to be consumed in the diet: they are not pills or capsules, but part of a normal food pattern

- (i) start-up, and
- (ii) take-off.

The ranks were the dependent measures, and the strategy as well as the product the independent variables.

Table 1 about here

### **The CSFs**

CSFs have previously been empirically studied primarily in mature and large companies (Aaker, 1989, Sousa de Vasconcellos and Hambrick, 1989). Aaker conducted a study among 248 strategic business units covering service companies, high technology firms and manufacturing and raw materials firms in Northern California by Aaker (1989). He used the concept of assets and skills as those which are sources of sustainable competitive advantage (SCA), i.e. sources of success factors or CSFs. He concluded that there were on average of 4.65 factors which were critical. Daniel (1961) argued that they were between three and six and Anthony et al (1972) held six as a good rule of thumb. To ensure that there were real choices we wanted the respondents to choose from a list which also contained potential CSFs with no relevance what so ever. We did not include only obviously relevant CSFs. Hence as shown in Table 1 *reputation for quality* was #1 in our as well as in Aaker's study, but since 10 CSFs of Aaker's list were left out we have *enterprising/entrepreneurial* as #27 in Aaker's list and #19 in our list and *good distributor relations* as #31 in Aaker's list and #21 in our. Aaker's list reflects a relative measure of importance. Our ranks express the ordered rank of Aaker's list. Placed in an alphabetical order *continuing product innovation* is labelled CSF1, *customer orientation* CSF2, etc. These labels are used in the analysis and ultimately the respondents' ranks are compared with Aaker's rank.

### **The sample**

Initially 156 questionnaires were distributed, 88 undergraduate students, 41 experienced managers, and 24 technology entrepreneurs. Two student questionnaires had to be discarded giving a total of 86 participants and a response rate of 98% among students given the questionnaires in their classes in two business schools in Finland. In the company a call for volunteers was sent out and 41 managers expressed an interest in participating in the experiment. Thirty three (33) completed the task giving a response rate of 80% among managers. Twenty four (24) technology entrepreneurs were participating in a executive training course out of which 19 returned the questionnaire giving a response rate of 79%. Hence a total of 138 responses were used for the final analysis. The students completed the task as a class assignment.

Group 1 consisted of 86 undergraduate business school students and

Group 2 consisted of 33 experienced managers.

Group 3 consisted of 19 technology entrepreneurs

Table 2 about here

The respondents were randomly assigned a product and a strategy however we aimed at equal distribution of gender in the groups. However, due to the large number of female managers in Group 2 we were only able to ensure that each cell contained at least one male respondent and the low number of respondents in Group 3 made that aim impossible. Nevertheless, a test on the gender effect among students showed no significant effect ( $\chi^2_{(20)} = 26.43$   $p = 0.1522$ ). The distribution of respondents in each cell is shown in Table 2. The cells in Group 1 are almost equal size ranging from 13-16 persons. However, for Group 2 and 3 the cells are uneven. This bias is due to the fact that some of the volunteers did not complete the experiment. This is particularly problematic in Group 3 where one cell contains only one observation and impacts the interpretation of the results.

### **The Data Analysis**

The data was analyzed based on the *exploded logit model* (Allison and Christakis, 1994) using the rank order logit-procedure in the software package STATA 8.2. The model is a generalization of conditional logit regression. In the economics literature it has been named rank-order logit model. However, in the marketing literature it has been used as the exploded logit model. The model allows us to estimate and test for differences among items in respondents for them and the model allows for ties in the ranking. The exploded logit model offers several design and analysis possibilities. The model allows for ranking only the first few ranks treating the remaining ranks as ties or unordered. This may be preferred when there is reason to believe that the remaining ranks are “noisier”. Thus, one can, as we did, ask respondents to rank only the top five items. The model also allows for different choice sets for different respondents. The item that people are asked to rank may be sets of characteristics rather than named items. The CSFs that were asked to be ranked were such and in such a design the idea is to minimize collinearity and maximize variability. The model allows for subjective ratings of item dimensions, i.e. measured effects for each respondent’s perception of the item characteristics rather than some consensus rating. This analysis allowed participants to express their individual cognitive maps of CSFs for their respective scenario.

## **RESULTS**

Based on the literature we had reason to assume that there would be differences among the ranked CSFs across the different phases of the life cycle (Hypothesis 2). The differences between the factors was significant in each group (Group 1,  $\chi^2_{(40)} = 226.36$   $p = 0.000$ ; Group 2,  $\chi^2_{(33)} = 180000$   $p = 0.000$ ; Group 3  $\chi^2_{(33)} = 19103.18$   $p = 0.000$ ). Our conclusion is that hypothesis 2 was supported and at this point managerial experience did not seem to impact (hypothesis 1).

Hypothesis 3 assumed that strategy would impact the rankings of the CSFs. Here results were mixed. For the student group we found that the students were able to significantly distinguish between no growth strategy and market share growth strategy ( $\chi^2_{(20)} = 50.19$   $p = 0.000$ ). A lower significance was also found between no growth strategy and annual profit growth, i.e. it was only significant at the 5% level ( $\chi^2_{(20)} = 33.87$   $p = 0.027$ ).

Perhaps most interesting was that there was no significant difference in rankings by students between market share growth strategy and annual profit growth strategy ( $\chi^2_{(20)} = 30.04$   $p = 0.069$ ). For Group 2 the differences were significant in every respect (strategy 1 vs. 2  $\chi^2_{(19)} = 11990.22$   $p = 0.000$ ; strategy 1 vs. 3  $\chi^2_{(19)} = 9546.64$   $p = 0.000$ ; strategy 2 vs. 3  $\chi^2_{(20)} = 18240.72$ ). The same result was obtained from Group 3 (strategy 1 vs. 2  $\chi^2_{(16)} = 6354.63$   $p = 0.000$ ; strategy 1 vs. 3  $\chi^2_{(17)} = 10976.73$   $p = 0.000$ ; strategy 2 vs. 3  $\chi^2_{(17)} = 20090.96$   $p = 0.000$ ). The number of degrees of freedom is lower than the theoretical maximums due to the fact that some parameters were not estimable from the data. Given the fact that we have three groups out of which two were able to distinguish between strategy as reflected in ranking of CSFs we may conclude that Hypothesis 3 is supported. However, that fact that the student group was unable to make such a distinction supports Hypothesis 1, i.e. difference in perceptions relating to experience.

Table 3 about here

The support for hypothesis 4 was also mixed. The students were unable to distinguish between the products ( $\chi^2_{(20)} = 25.91$   $p = 0.1689$ ), whereas the managers were quite capable ( $\chi^2_{(19)} = 1990.45$   $p = 0.000$ ) as were the technology entrepreneurs ( $\chi^2_{(15)} = 387.51$   $p = 0.000$ ). This enforces the support for hypothesis 1, and it also supports the result from the study by Sousa de Vasconcellos and Hambrick (1989) and Covin et al, (1990). However, the factors that the technology entrepreneurs perceived as important show considerable differences in the cognitive maps of managers and technology entrepreneurs (Table 3). For the student group the products remain uncategorized as they were not able to distinguish between them.

## DISCUSSION AND CONCLUSIONS

Out of three hypotheses two provided support for the argument that prior experience will impact perceptions of what factors drives growth (Hypothesis 1). Hypothesis 3 specifically targeted growth, whereas Hypothesis 4 captured the issue with respect to a product technology. The results are initial, and it is important to note that both Group 2 and 3 should have been larger in order to allow for generalizations. Nevertheless, the results support the earlier mentioned observation by Shane (2004). Our results partially confirm findings in previous studies, but raise a number of issues, which are significant for entrepreneurship and perception of growth but also for marketing management, management education

### The Product

One of our fundamental assumptions was that the ranking of CSFs would be dependent on the product, i.e. there would be significant differences in rankings between the products with respect to group and strategy. The underlying rationale for this assumption is based on previous studies, which state that CSFs are contextual as well as firm-specific (Rockart, 1979, Sousa de Vasconcellos and Hambrick, 1989), which showed that CSFs could be deduced from knowledge of basic technology and market attributes. Moreover, a

study by Covin et al, (1990) shows that product related issues are very important in high technology industries.

While high technology attracts the attention of policy makers and investors because of the quite explicit assumption that success involves high growth, low technology is implicitly assumed to be the opposite to high technology and also associated with low or no growth. It is also apparent that low technology rarely involves product development but is mostly concerned with services and/or marketing.

In the experiment the choice of organic pasta on one end and functional food pasta on the other was *a priori* assumed to represent examples of low technology and high technology within a given product category. Since both product types exist on the market it was assumed that respondents were familiar with these products, especially our expert manager group. Frequently, in popular press organic foods are portrayed as non-technology foods and functional foods as high technology foods. Both product categories are positioned on the market based on this categorization, and the claims used in marketing carry these notions.

Although the managers and the technology entrepreneurs were able to distinguish between the products we find that the factors that drive growth are perceived to be very different, which will be discussed in more detail below. From a marketing perspective the results raise the question whether the concept of functional food is very well understood by others than those closely involved with the product. This point also raises issues of concern for market penetration and launching of new products.

### **Growth Strategy**

In our study the managers and the technology entrepreneurs were apparently better in envisioning the growth strategies as if they had already been accomplished, whereas they remained open-ended possibilities with no anchor or frame, i.e. reality based on hands-on experience (Russo and Schoemaker, 1989) for the students. Hence the students completed the task as if creating some, or any, order out there, whereas the task was aimed at creating a specific order relating to a growth strategy. This becomes particularly obvious through the fact that students had problems in distinguishing between no growth and annual profit growth strategy (it was significant on a 5% level but not on a 1% level) and could not at all distinguish between market share growth and annual profit growth. In other words, they cannot envision what impacts revenues and what profits.

In a seminar for Group 2 this issue was subject to a lengthy discussion, where it was pointed out that although the managers had been able to distinguish between the strategies this rationale does not reflect the reality of the managers' reasoning. We were told that when launching a product, annual profit growth is not the target – although admitting it ought to be so. The actual target is market share growth (regardless of profit target). Profits are monitored by senior executives and owners, not primarily by operating managers! For students there are thus apparent problems in conceptualising what generates revenues and profits (as if they are not necessarily different concepts). The

results raise some concerns with respect to nascent technology entrepreneurs and their perceptions of growth as it could be assumed that the students could represent proxies for nascent technology entrepreneurs. This perhaps reflects the fact that strategies become more useful with experience and that mere education alone will not prove sufficient. “Strategies that encourage rewriting and increase involvement are likely to be those strategies that call forth the most relevant experience. And those strategies most likely to do this are those whose outcomes can be envisioned most clearly (Weick, 1990, p. 8).”

## CSFs

Our study confirms that CSFs are different depending on which stage the firm is in currently. However, the cognitive framework, which links growth to life cycle stages, remains unclear as can be seen upon closer analysis. This is particularly visible in the student group, which lack managerial experience. This perhaps reflects the fact that cognitive maps become more useful from experience and that mere education alone will not prove sufficient. “Strategies that encourage rewriting and increase involvement are likely to be those strategies that call forth the most relevant experience. And those strategies most likely to do this are those whose outcomes can be envisioned most clearly (Weick, 1990, p. 8).” Clearly relative naïve students have not such maps to fall back on from their experience.

In ranking the factors the students chose every factor at least once whereas the managers group appears much more homogeneous in the rankings as there are three factors in each phase which are not ranked at all. In the start-up phase these are *location*, *market share*, and *size/location of distribution*. In the take-off phase these are *enterprising/entrepreneurial*, *location*, and *pioneer early entrant*. The technology entrepreneurs never ranked *low price/high value offering* and *market share* in the start-up phase and *location* in the take-off phase. It may seem surprising that enterprising/entrepreneurship was not a CSF for managers in the take off phase, but that could likewise be based on cognitive maps from their past experience. Moreover, the technology entrepreneurs ranked this factor for product 1 in all strategies very high in the start-up phase. Again it is somewhat surprising that this factor is not associated with the high technology version, i.e. product 2. But, there are more interesting features.

In the student group we find one factor which is ranked among the top five in all phases and all strategies; *good distributor relations* (factor 7). The manager’s include this factor in both phases for two strategies and both products; no growth and annual profit growth. In market share growth strategy it is only included in phase 1 and for product 1. The technology entrepreneurs are concerned with distribution in the take-off phase, for all strategies and both products. This factor was the last factor (least important) on Aaker’s list from his Northern California sample. The explanation for this can be found by the fact that the experiment was done in Finland, which is both a small domestic market and far away from any market, whereas Aaker’s study was conducted in California where 50% of the world market is right in front of you.

Another interesting observation is that factor 10, *low price/high value offering* places high among the students with the annual profit growth strategy in take-off phases. The managers ranked this product in both phases and for both products, but not very high. The technology entrepreneurs did not include this factor at all in the start-up phase. We have to recall that both products were described as selling at a 20% price premium. Generally, organic foods and functional foods are priced on the high end because they claim high value, i.e. they have never been regarded as low price products. This could, in the students' case, reflect the cognitive maps of in-experience where there is no prior experience on which to call (Weick, 1990). The text books teach that low price can lead to profit growth. That is, some prior experience exists, or as described by Weick (1985, p. 127): "The important feature of a cause map [or any map] is that it leads people to anticipate some order 'out there'. It matters less what particular order is portrayed than an order of *some* kind is portrayed." Yet, this does not explain the obvious contradiction with the announced price premium.

Overall marketing skills (factor 14) is seen as important by the managers in both phases in two strategies for both products; market share growth and annual profit growth. The technology entrepreneurs find this factor important only for functional foods and annual profit growth, whereas this factor is not at all found important by the students. The technology entrepreneurs rank *financial resources* (factor 6) as important in both phases for product 2 regardless of strategy, as well as for product 1 albeit no growth. Students also rate this factor as very important in the start-up phase regardless of strategy, whereas the managers find this important only in the start-up phase and no growth strategy for both products and for product 1 in the take-off phase of annual profit growth strategy (a complete mirror of the managers' perceptions). One would have expected to find financial resources important for high technology products instead.

Students and managers find *knowledge of business* as very important in the start-up phase. The technology entrepreneurs find this factor important only in the start-up phase and for no growth strategy and annual profit growth. The managers also consider it important through out the take-off phase and functional foods. Students find *name recognition/high profile* important in take-off, whereas the managers find it important only for organic pasta, and the technology entrepreneurs do not find the factor important. This factor was the third most important in Aaker's study. Students find *reputation for quality* important in the take-off phase for all strategies, whereas this factor is regarded as important by the managers in these phases but only for organic pasta and for functional foods only for a no growth strategy, and the technology entrepreneurs find it important only for market share growth strategy. This factor was perceived as the most important CSF in Aaker's study.

Interestingly, clusters of CSFs that one would expect do not appear. For example, to have a low price/high value offering (our CSF 10) would assume a low-cost production CSF (our CSF 11). This does not occur with our student or manager group. Perhaps groups use one CSF as a short-hand for all related CSFs within their cognitive maps. The technology entrepreneurs does rank low-cost production for product 1 for no growth strategy, when

one would have assumed it to appear in the annual profit growth strategy, as conventional wisdom holds that low cost production increases profits.

Finally, the technology entrepreneurs appear more goal-oriented, as they rank factor 21, *strategic goals*, as important in the start-up phase for both products in all strategies but annual profit growth. Also, factor 19, *short term planning* is ranked high in the start-up phase for product 1 in no growth and market share growth.

### **Managerial Experience and Perceptions of Growth**

In the introduction we argued that growth strategies are conceptualized and obviously perceived differently. We also argued that managerial experience is central in the perception of growth. Previous studies show that one particular concept of growth—the life cycle—appears to play an important role in relation to perceptions of growth. However, as our results show the function remains unclear in terms of what factors are critical to achieve growth. One of our key arguments here is that it reflects differences in cognitive maps, which themselves are reflections of experience. This is supported by Karl Weick (1990) who provides some insights into the role of entrepreneurial experience of management and the perceptions of growth.

“Clear outcomes are most likely to occur when the strategy is conceived in the future perfect tense as if it had already accomplished, rather than in the future tense where it is *visualized* simply an open-ended possibility, one of many possibilities. (italics added by authors).” Weick, 1990, p 8.

The managers in this study actually had experience with a science based functional food product and the two stages of start-up and take-off. Whereas, students experience with the products were simply as consumers of food products. Experienced life science entrepreneurs had experience with developing technology and bringing it to market rather than the specific product experience of the manager group. Thus we had naïve or un-experienced students, experienced technology entrepreneurs, and product-specific experienced large firm managers.

Our results indicate that education alone is not sufficient to develop an ability to purposefully coordinate actions. Experience appears to significantly impact perceptions of what results certain critical success factors or combination of factors may lead to. This is not to say that only experienced persons can become entrepreneurs or successful ones, as our results also show that there are differences in perceptions with respect to experience as such. Therefore, a mentor, network of advisors, advisory boards, etc. possessing a variety of experience and the cognitive maps, which a management naïve person lacks, can be instrumental in entrepreneurship.

Different kinds of industry or product experience produce different kinds of strategic decision making frameworks for future use. General industry experience and/or experience in developing technology do not translate well into specific product differentiation strategies. For example, technology experience may not generalize across

specific technology based products, which may explain why a manager with technology experience from one industry may not be able to utilize that experience in another related industry with different products, let alone entirely different unrelated industries. The study also suggests that these skills may not transfer perfectly to a different orientation. It also means that a manager may lack sufficient entrepreneurial experience needed to successfully start-up and grow a venture despite product or industry experience. Perhaps most interestingly managerial experience may not transfer effectively to entrepreneurs as often assumed. This may explain why successful managers in one industry may not succeed as entrepreneurs even in the same industry. It may also explain why successful entrepreneurs may not always be successful managers of firms once they are established. Next, there is the implication that simply providing would-be technology entrepreneurs with general management education will not provide the kind of perspectives needed by technology entrepreneurs who perceive CSFs very differently from experienced managers.

## CONCLUSIONS

Our study show that perception of growth and perceptions of what factors are critical to growth is connected to managerial experience. Our study also shows that managerial concepts become meaningful when practiced. From an entrepreneurial perspective this is important as entrepreneurship most often is connected to growth and technology entrepreneurs many times start without any or little formal business training. Although it is not possible to make far reaching generalization based on the experimental study it does call for additional studies around several topics, where perception of growth clearly is one. How do start-up entrepreneurs perceive growth and how are these perceptions different from, e.g. nascent entrepreneurs? How do these groups envision *rapid* growth? Is it understood what drives growth?

Furthermore, the results encourage studies on how consumers perceive high technology products. Finally, the results should prove useful for management educators with respect to enable students to conceptualise complex technological products as well as to conceptualise complex cognitive framework. Finally, it means we have to as educators; pay a good deal more attention to specific past experience or practicum experience of participants in management education. It is clear from this study that entrepreneurship is certainly different from management. It is a unique experience and phenomena of its own.

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Table 1. The rank order of CSFs comparing Aaker and ours for importance

| <b>No.</b> | <b>Critical Success Factor</b> | <b>Aaker's rank</b> | <b>Our rank</b> |
|------------|--------------------------------|---------------------|-----------------|
| 1          | continuing product innovation  | 13                  | 9               |
| 2          | customer orientation           | 7                   | 6               |
| 3          | customer service               | 2                   | 2               |
| 4          | efficient, flexible production | 19                  | 15              |
| 5          | enterprising/entrepreneurial   | 27                  | 19              |
| 6          | financial resources            | 6                   | 5               |
| 7          | good distributor relations     | 31                  | 21              |
| 8          | knowledge of business          | 17                  | 13              |
| 9          | location                       | 23                  | 18              |
| 10         | low price/high value offering  | 16                  | 12              |
| 11         | low-cost production            | 5                   | 4               |
| 12         | market share                   | 14                  | 10              |
| 13         | name recognition/high profile  | 3                   | 3               |
| 14         | overall marketing skills       | 21                  | 16              |
| 15         | pioneer/early entrant          | 18                  | 14              |
| 16         | product characteristics        | 12                  | 8               |
| 17         | reputation for quality         | 1                   | 1               |
| 18         | segmentation/focus             | 11                  | 7               |
| 19         | short-term planning            | 30                  | 20              |
| 20         | size/location of distribution  | 15                  | 11              |
| 21         | strategic goals                | 23                  | 17              |

Table 2 The distribution of respondents in each cell

| Product   | Growth strategy  | Student/company/total |          |               |           |
|-----------|------------------|-----------------------|----------|---------------|-----------|
|           |                  | Stud                  | Com-pany | Tech Entrep . | Total     |
| Product 1 | No growth        | <b>14</b>             | <b>4</b> | <b>3</b>      | <b>21</b> |
|           | Market Share gr. | <b>13</b>             | <b>4</b> | <b>3</b>      | <b>20</b> |
|           | Annual gr.       | <b>15</b>             | <b>8</b> | <b>5</b>      | <b>28</b> |
| Product 2 | No growth        | <b>13</b>             | <b>5</b> | <b>4</b>      | <b>22</b> |
|           | Market Share gr. | <b>15</b>             | <b>5</b> | <b>3</b>      | <b>23</b> |
|           | Annual gr        | <b>16</b>             | <b>7</b> | <b>1</b>      | <b>24</b> |

Table 3. Top five ranking of CSFs. The numbers in the cell are the same as in Table 1, e.g. No.2 = customer orientation

|   |           | Start-up    | Take-off      |
|---|-----------|-------------|---------------|
| <b>Group 1<br/>(students)</b>                   |           |             |               |
| No growth                                       |           | 6,2,8,18,7  | 17,2,7,13,4   |
| Market share gr.                                |           | 6,2,8,7,15  | 13,7,2,17,1   |
| Ann.prof.gr.                                    |           | 2,8,6,7,16  | 2,17,7,13,10  |
| <b>Group 2<br/>(managers)</b>                   |           |             |               |
| No growth                                       | Product 1 | 8,7,2,6,16  | 17,7,2,8,13   |
|   | Product 2 | 8,2,7,6,3   | 8,2,7,17,4    |
| Market share gr.                                | Product 1 | 16,8,14,3,2 | 14,16,13,17,3 |
|   | Product 2 | 8,16,14,3,2 | 8,14,2,4,3    |
| Ann. prof. gr.                                  | Product 1 | 14,2,8,16,7 | 14,7,2,6,17   |
|   | Product 2 | 14,8,2,7,15 | 2,14,4,7,8    |
| <b>Group 3<br/>(Life Science entrepreneurs)</b> |           |             |               |
| No growth                                       | Product 1 | 8,21,5,19,2 | 7,3,2,11,18   |
|   | Product 2 | 8,21,16,2,6 | 3,16,2,7,6    |
| Market share gr.                                | Product 1 | 2,5,6,21,19 | 4,2,17,6,7    |
|   | Product 2 | 2,6,9,21,1  | 1,17,2,6,7    |
| Ann. prof. gr                                   | Product 1 | 2,5,8,6,21  | 2,7,4,6,3     |
|   | Product 2 | 2,6,8,16,14 | 2,14,6,16,7   |

# A COMPARATIVE STUDY ON ENTREPRENEURIAL OPPORTUNITY RECOGNITION AND THE ROLE OF EDUCATION AMONG FINNISH BUSINESS SCHOOL STUDENTS

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## ABSTRACT

Is entrepreneurship seen as a viable opportunity? To understand what makes people recognize entrepreneurship as an opportunity is important for educators as well as policymakers. Perceptions of entrepreneurship and the impact of education is studied by identifying what factors drive perceptions of entrepreneurial intentionality, perceived personal desirability, and perceived personal feasibility among a sample from two Finnish business schools. Additionally, the role of education on differences in perceptions is analyzed. Results show that there is a clear difference between how the two groups perceive entrepreneurship. In both groups the probability of starting a firm is low, i.e. entrepreneurship is not attractive. However, the groups who had participated in entrepreneurship education had a clear opportunistic view whereas the other saw entrepreneurship as a necessary last alternative. Entrepreneurial lifestyle seemed to excite respondents in both groups, but again the excitement was generated by quite different factors

## INTRODUCTION

Finland has recently been rated the most competitive nation in the world. National investment in R&D in 2003 was 3.4% of GDP. Yet, entrepreneurial activity is low despite increasing efforts by policymakers to support and improve the situation for start-up entrepreneurs. Based on the GEM data from 2003 the total entrepreneurial activity was 6.9%. Of these, 5.8% are opportunistic and only 0.6% necessity entrepreneurs. Previous studies have also shown a low (10%) entrepreneurial activity among Finnish engineering students.

The measures taken by policymakers have mostly focused on helping entrepreneurs getting started, ranging from serious and quite extensive measures by the National Technology Agency (TEKES), the foundation of regional development centers for supporting regional development through support for starting firms to increasing public endorsement by policymakers that entrepreneurship is good for the economy and

something which is highly welcomed by society. Most of the measures have meant developing financial instruments, i.e. financial support, or the lack of financial support has been identified as the fundamental reason for low entrepreneurial activity. It is true, that starting a firm requires money. But, whether it requires some, more or a lot of it depends on the opportunity the entrepreneur decides to pursue. Moreover, actions have been taken to increase the entrepreneurial skills among start-up entrepreneurs taking the form of business plan writing courses, education on how to manage intellectual property, etc.

However, there is one step prior to stretching out the hand and ask for funding. That is when the would-be entrepreneur recognizes an opportunity and/or decides to become an entrepreneur. Very little has been done to improve opportunity recognition or to generate the spark that ignites entrepreneurial activity. This is odd, to say the least, as opportunity recognition is the most distinctive and fundamental entrepreneurial behavior (Bird, 1988, Katz and Gartner, 1988, Gaglio and Katz, 2001). The literature on opportunity recognition is extensive (Kirzner, 1997, Venkataraman, 1997, Krueger, 1998, Shane, 2000, 2003, Shane and Venkataraman, 2000, Gaglio and Katz, 2001, Eckhart and Shane, 2003). However, few studies have addressed the problem of seeing entrepreneurship as an opportunity in itself.

Entrepreneurial intentionality studies (Bird, 1988, Carsrud et al, 1987, Krueger and Carsrud, 1993, Krueger et al, 2000) have analyzed a variety of factors impacting intentions, drawing on Ajzen (1987) and Shapero (1982) among others. Attitudes, traits, mentors and networks have proved to impact entrepreneurial behavior, i.e. social norm plays a key role. Krueger (1998) argues for the necessity for individuals to perceive a prospective new course of action as a credible opportunity, which requires the opportunity to not just be viable, but to be perceived as viable.

We have conducted a study in two Finnish schools among under-graduate students. In A 237 questionnaires were distributed and 191 returned, i.e. 80.6% response rate. In B 74 questionnaires were distributed and 72 returned, i.e. 97% response rate. Based on the results we will argue that in addition to recognizing an opportunity it is important for the would-be entrepreneur to first and foremost perceive entrepreneurship as an opportunity in it self, i.e., as an alternative employment route that also can be understood as a life-style decision. We will argue that although society sees entrepreneurship as good both in the form of espoused values and supporting measures for starting entrepreneurs it is highly unlikely to lead to the actual increase of entrepreneurial activity if entrepreneurship is not seen as an opportunity or if, for example there is a social norm which encourages other type of behavior. Additionally, we will argue that the social norm may fertilize the development of a misperception of who would be most suitable as an entrepreneur, a mistaken role identity.

Our study seeks to provide insights to the following research questions: To what degree is entrepreneurship seen as an opportunity? To what degree does education impact the ability to regard entrepreneurship as an opportunity? Are there mental prototypes of what

being an entrepreneur entails? Does a mental model impact the students' ability to see entrepreneurship as an opportunity?

## **OPPORTUNITY RECOGNITION AND ENTREPRENEURIAL INTENT - HYPOTHESES**

Opportunity recognition as an area within entrepreneurship research has recently attracted much attention in fact there are already a number of schools of thought (Shane, 2000). The Equilibrium School assumes that everyone can recognize all entrepreneurial opportunities and that whether this actually takes place is dependent on fundamental attributes of people. In other words, it is possible to identify individuals who want to become entrepreneurs and that these are less risk averse than those who choose to become employees. Hence we can formulate our first hypothesis:

H1: It is possible to identify a mental prototype of who is more suitable to become an entrepreneur

The Psychological School argues that fundamental attributes of people, rather than information about opportunities determine who becomes an entrepreneur and this again depends on a person's willingness and ability to take action (Krueger et al, 2001). Much attention within this school of thought has been given entrepreneurial intentionality studies and it has been argued and shown that attitude towards behavior, social norm, and perceived behavioral control influence a person's intentions to act, although social norm has also been shown not to have a significant impact (Ajzen, 1987, Krueger et al, 2001). Intentions reflect critical underlying attitudes and manifest themselves in three perception: (i) perceived personally desirable, (ii) perceived supported by social norm, and (iii) perceived as feasible. Expected values are a prerequisite for what is perceived as personally desirable, normative beliefs for social norm, and self-efficacy for perceived feasibility.

H2: There is a significant relationship between perceived personal desirability and entrepreneurial intent

H3: There is a significant relationship between perceived personal feasibility and entrepreneurial intent

H4: Perceived supporting social norm will impact entrepreneurial intent

Moreover, studies have shown that perceived role identity impact on attitudes and intentions towards entrepreneurship and that they can be changed significantly through education (Fiet, 2000a, 2000b, Klofsten, 2000, Gibb, 2002). Role identity is here understood to be influenced by the perception of the existence of a particular educational basis and level of education that would be more suitable for an entrepreneur. It reflects the perception *who* becomes an entrepreneur and who does not. Role identity also includes the existence of role models either within the family or close friend(s).

H5: Role models in within the family will impact entrepreneurial intent

The Austrian School builds on the idea of information asymmetry as the driving force. People cannot recognize all entrepreneurial opportunities, and that information about opportunities will drive entrepreneurial opportunity recognition rather than a willingness to take action (Kirzner, 1997, Shane 2000). However, the Austrian school does not indicate what kind of information would generate a higher ability to opportunity recognition, but it does carry the notion of more information. Finally, this school of thought does not tie information asymmetry to success, i.e. if information is the trigger, will it result in more successful firms.

The idea of information asymmetry as the driving force is tempting in particular with respect to high technology entrepreneurship as it implicitly indicates that higher educated persons would be more prone to recognize entrepreneurial opportunities. To elaborate on that notion would mean that a country with a high proportion of the adult population having a university degree should show a high rate of entrepreneurial activity. Thus, in Finland, where 38,5% of the adult population aged 24-35 years having a university degree should show a high rate of entrepreneurial activity. The reality is quite the opposite with a total entrepreneurial activity of 6.9%, which gives a strong indication of that there are other factors than having knowledge and skills involved, e.g. willingness to act.

H6: There is a relationship between knowledge and skills and entrepreneurial intent

## **THE STUDY**

### **The sample**

The study was conducted in two Finnish business schools in the same city in the fall 2004. The questionnaire was constructed in accordance with previous studies (Krueger et al, 2001, Autio et al, 2001). What makes this study different from others is that we target business school students. The other interesting issue is that the two business school represent the two official languages in Finland; in A the teaching language is Finnish and the school recruits primarily from the Finnish speaking population; in B the teaching language is Swedish and recruits primarily its students from the country's 6% minority. Thus, the students have a different linguistic background, which also means that they have a different cultural background and they have different regional backgrounds. In this paper we have not analyzed further these issues, but let the two schools represent proxies for them.

Insert Table 1 about here

Initially 313 questionnaires were distributed, 237 in A and 74 in B, a total of 2263 were returned (total response rate 84%. Thus we had two groups:

A: 191 respondents and a response rate of 80.6%

B: 72 respondents and a response rate of 97%

The gender distribution for the total sample differs significantly ( $\chi^2=3.510$ ,  $p=.061$ ) (Table 1). In Table 1 the number of respondents differ ( $n=183$ ) from the real sample size as there were 8 persons who failed to indicate their gender.

## **Data and Measures**

### The dependent variables

Entrepreneurial intent: How probable is it that you will start a firm within 5 years? (scale 0-100)

Perceived personal desirability: How attractive would it be for you to start a firm? (scale 0-100)

Perceived personal feasibility: How easy would it be for you to start a firm? (scale 0-100)

### The independent variables

The respondents were then given a battery of 17 statements which they were to rank on a 5-point scale.

1. I would be more independent as an entrepreneur as an employee
2. I would be constantly overworked as an entrepreneur
3. I could reach my goal in life as an entrepreneur
4. I could earn more money as an entrepreneur than if an employee
5. It requires too much money to start a firm
6. I would be less appreciated as an entrepreneur
7. Only if I don't get a job will I become an entrepreneur
8. It would be the best way to benefit from my education
9. I'm precisely the kind of person who would become an entrepreneur
10. The lifestyle of an entrepreneur excites me
11. I know of a good market opportunity
12. I have a good business idea
13. I have skills and knowledge to become an entrepreneur
14. The example of family and relatives encourages me
15. The example of friends encourages me
16. I'd be interested to join with others as an owner/founder
17. Starting a firm is difficult for me

The role of family (parents and grand-parents, sisters) and friends were also controlled for. Finally, the respondents were asked to indicate what educational basis and level of education would be most suitable for becoming an entrepreneur.

The data was analyzed using step-wise regression analysis as well as the statistical significance of the strength of association through cross-tabulation was analyzed.

## **RESULTS**

### **Entrepreneurial Intent**

13.5% of the total sample regards the probability to become an entrepreneur higher than 50%, but only 4.6% (18 persons) give it an 80% or higher probability. In A the corresponding frequencies are 14.4% and 4.8% and in B 11.1% and 4.2%.

Our study confirms the results from previous studies and show that entrepreneurial intent ( $R^2=.45$ ) is significantly dependent on perceived personal desirability ( $\beta=.50$ ,  $p=.000$ ) and perceived personal feasibility ( $\beta=.26$ ,  $p=.000$ ). In a path analysis ( $R^2=.52$ ) results also show that there are two other factors directly linked to entrepreneurial intent, with the  $\beta$ -value lower for desirability ( $\beta=.27$ ,  $p=.001$ ) and feasibility ( $\beta=.34$ ,  $p=.000$ ). These factors are *the lifestyle of an entrepreneur excites me* ( $\beta=.22$ ,  $p=.004$ ) and *only if I don't get a job* ( $\beta=.13$ ,  $p=.014$ ).

There is a significant difference in perceived personal desirability ( $t=.015$ ) between A ( $n=191$ ; mean 49.37) and B ( $n=72$ ; mean 49.88) but not in perceived personal feasibility ( $t=.071$ ) between A ( $n=191$ ; mean 55.03) and B ( $n=72$ ; mean 49.29). There is a significant difference in perceived personal desirability ( $t=.006$ ) between women ( $n=132$ ; mean 47.12) and men ( $n=123$ ; mean 64.97) and in perceived personal feasibility ( $t=.001$ ) between women ( $n=132$ ; mean 48.79) and men ( $n=123$ ; mean 58.04).

When analyzing the groups separately we find that for A ( $R^2=.50$ ) entrepreneurial intent is dependent on perceived personal desirability ( $\beta=.24$ ,  $p=.016$ ), perceived personal feasibility ( $\beta=.26$ ,  $p=.001$ ), *I know of a market opportunity* ( $\beta=.16$ ,  $p=.04$ ), and *The lifestyle excites me* ( $\beta=.22$ ,  $p=.03$ ). For B ( $R^2=.68$ ) we find that entrepreneurial intent is dependent on perceived personal feasibility ( $\beta=.45$ ,  $p=.000$ ) and *Only if I don't get a job* ( $\beta=.42$ ,  $p=.000$ ). There is no significant link between perceived personal desirability and intent.

Hence we find a mixed support for Hypothesis 2, i.e. despite overall support we find that this is true only for group A whereas there is no significant link between perceived personal desirability and entrepreneurial intent in group B. However, Hypothesis 3 is fully supported. However, as we found we when studying the relationship of the 17 statements to entrepreneurial intent (Table 2), perceived personal desirability (Table 3), and perceived personal feasibility (Table 4) using step-wise regression analysis for the groups together and separately, we found that the groups have quite different mental maps of entrepreneurial intent, desirability and feasibility.

Insert Table 2 about here

Insert Table 3 about here

Insert Table 4 about here

### **Entrepreneurial mental prototype**

Research has for a long time tried to draw a picture of the typical entrepreneur with very little luck. As already indicated above we see that the cognitive maps of the two groups as to what drives entrepreneurial intent, perceived desirability, and feasibility are quite

different. A rough estimate would suggest that group A is far more opportunistic, whereas group B sees entrepreneurship in terms of necessity. Therefore, additional analysis was conducted by comparing the rating of the factors on a five-point scale of the 17 statements supplemented with questions concerning what kind of educational background and level of education would be suitable for entrepreneurs.

Out of 17 statements 12 showed a significant ( $p < .05$ ) difference between A and B (Table 5). As the respondents from both groups found the entrepreneurial lifestyle exciting it is possible to assume that some kind of mental prototype must exist despite the differences shown in Table 5. Thus, with lifestyle as dependent variable we ran a step-wise regression analysis through the statements and are able to draw the following picture (Table 6).

Insert Table 5 about here

Insert Table 6 about here

Finally, the respondents were asked what type of educational background and what level of education is most suitable for an entrepreneur. Both groups completely agreed that a business education on the college or polytechnic level is by far the best combination. Interestingly medical education, or law and technology were not perceived suitable. Not surprisingly arts, fine arts or crafts were considered very unsuitable, although reality is quite the opposite. In conclusion, we argue that it is not possible to identify a mental prototype of an entrepreneur, i.e. we do not find support for Hypothesis 1.

### **Role of family and friends and social norm**

Evidence from the impact of social norms on entrepreneurial intent is mixed. Krueger et al (2001) conducted a study in the US and found no significant link between social norm and entrepreneurial link whereas Grunsten (2004) conducted a study among Finnish technology entrepreneurs and found a weak but significant link between social norm and entrepreneurial intent and a somewhat stronger link to perceived personal desirability. Our study does not provide a significant direct link between social norms and entrepreneurial intent. However, as we have seen in the previous sections the role of family, relatives and friends appear to be linked to the perception of entrepreneurial lifestyle. Moreover, there seems to be in group A the understanding that one is less appreciated as an employee and this is why the entrepreneurial lifestyle seems exciting. However, we cannot claim that our results provide any support for Hypothesis 4 and 5.

### **The issue of information asymmetry**

The Austrian School assumes that opportunity recognition is tied to the fact that the potential entrepreneur has information, knowledge or skills that enables the person to recognize opportunities better than those who do not. We find that *I have skills and knowledge* is a significant factor in entrepreneurial intent and perceived personal desirability for the total sample and for group A in particular. The strongest link we find with respect to perceived personal feasibility for both groups. This would indicate that

perception of possessing skills and knowledge is important but at the same time we find that there are many other factors that play a significant role as well. Hence our results provide support for Hypothesis 6.

## **DISCUSSION**

We will discuss the results in terms of the research questions of this paper.

### **Entrepreneurship as an opportunity**

In the introduction we raised the concern that entrepreneurship is not seen as a viable opportunity in itself and that this may be a primary reason for the low entrepreneurial activity in Finland. Hence our first research question was to analyze to what degree entrepreneurship is seen as an opportunity.

Drawing on the extant research body of entrepreneurial intentionality studies the research question was operationalized with three questions: (i) what is the probability that you will start a firm in five years, (ii) how desirable would it be for you to start a firm, and (iii) how feasible would it be for you to start a firm? Furthermore two hypotheses were formulated (Hypothesis 2 and 3).

We find that there is a very small number of the respondents who rate the probability to become an entrepreneur greater than 50% and an even smaller number who indicate a high probability (<80%); 4.8% for A and 4.2% for B. Thus, entrepreneurship is not seen as an attractive opportunity.

Based on our survey we found for the total sample a direct link between entrepreneurial intent and perceived personal desirability and perceived personal feasibility. However, when analysing the two groups separately we found fundamental differences in perceptions of what factors contribute to entrepreneurial intent, perceived personal desirability and perceived personal feasibility, but also that there were other factors with direct links to entrepreneurial intentionality and that again these differed between the groups. Hypothesis 3 was fully supported, but the support for Hypothesis 2 was mixed. Thus, when we look at the factors which showed a significant link to the perceptions we see that the cognitive maps are very different for the two groups. Group A appears to have an opportunistic view, whereas B is very much tuned towards a necessity-based view. In fact, B seemed to have the impression that entrepreneurship is something one does when there is nothing better around and only if it does not require too much effort. There is at least one thing that the body of literature on entrepreneurship, whether academic studies or biographies, seem to fully agree upon, and that is that starting a firm, rarely if ever is perceived as *easy* by the entrepreneur.

### **The role of education**

The two groups have different background factors, which may partially explain the different cognitive maps. First, they represent two groups with a different linguistic and cultural background. This may be a partial explanation, but in this paper we did not delve

into this issue further since we think that the difference really is rooted in educational differences. Despite the fact that both groups are formed by business school students who also happen to be in the same city – in fact roughly 500 yards apart there are differences. School A has had compulsory courses in entrepreneurship since 1999, i.e. every student has to take two courses in entrepreneurship. In 2004 entrepreneurship became a major subject and furthermore, a Small Business Research and Development Center has existed within the school for over 10 years. In school B there has been one optional course given in the fall 2003 and 2004, with a total of 30 participants. Hence in A entrepreneurship is present and real, whereas in B it is to many non-existent or at least highly distant.

The data from group A was conducted during the exam from an entrepreneurship course whereas B filled in the questionnaires during a compulsory course in research methods. We argue, that part of the differences is due to education. As such, we find support for Shane's (2000) argument that the ability to recognize opportunities is due to information asymmetry. In this case, group A could be assumed to have a perception of entrepreneurship which was more likely to be based on facts, whereas group B was left to rely on facts that seem to be based more on myth.

We know from the entrepreneurial intentionality literature and cognitive science that attitudes are linked to action, and that education can influence attitudes. It is clear from our study that the two groups have different cognitive maps regarding entrepreneurship and the fact that education has been provided for one of the groups we argue that education makes a difference.

### **Mental prototype**

When we look at the factors we find that *entrepreneurial lifestyle excites me* is strongly present in group A but absent in B. Much to our surprise we then find that *I'm precisely the type to become an entrepreneur* as a significant factor for group B, but not A. Apparently, there seems to exist some kind of mental prototype of what an entrepreneur is, but it is far from clear what that is. As the factors perceived to be linked to intentionality, desirability and feasibility as so very different between the groups and since one of the groups has participated in entrepreneurship education and the other has not it is possible to argue that education will impact the mental prototype. However, there does not appear to be a link to how probable it will be that the student decides to become an entrepreneur since the probabilities are very low for both groups and the difference is not statistically significant.

In his criticism of the Equilibrium school, Shane (2000) questions the assumption that there exists a particular type of person who becomes an entrepreneur. Moreover, despite the large body of research it has yet not been possible to identify this *homo entrepreneuriens* (Brockhaus, 1982, Gartner, 1988, Baron, 1998, Hytti, 2003). Our study, shows that the two groups again have very different perceptions of what would be so exciting about the entrepreneurial lifestyle. In fact, when we look at the significant factors for both groups (Table 6), we find two factors: *starting a firm is the best way to benefit from my education* and *I know a good market opportunity* that perhaps not intuitively

would be regarded as lifestyle factors. However, assuming that they impact the perception of an exciting lifestyle, we may arrive at the notion that entrepreneurial intentionality is not necessarily just an opportunistic or a necessity decision, but a lifestyle decision.

### **Social norm and role of family and friends**

Research on whether social norm is linked to entrepreneurial intentionality is mixed. Krueger et al (2001) found no link, but Grunsten (2004) in a study conducted on a Finnish sample showed a link although a weak one. In our study the issue of social norm was addressed as how the respondents perceived themselves to be appreciated more, i.e. as an employee or an entrepreneur and how they perceived to benefit from their education. The perceived utility has a significant link to perceived personal desirability for the total sample (Table 3), but recalling that perceived personal desirability had no link to intentionality for group B it can be assumed that the link is next to none. Interestingly, the perceived appreciation is linked to lifestyle (group A). Hence, social norm understood in terms of appreciation does not have an impact on intentionality other than in terms of lifestyle.

The role of family and friends does not seem to be important in general. However, again these factors seem to be linked to entrepreneurial lifestyle. Thus, if there is a connection between social norm, family and friends it is indirect and embedded in other factors.

## **CONCLUSIONS AND ISSUES FOR FUTURE RESEARCH**

Our study has addressed the impact of education on perceptions of entrepreneurship. We have anchored our study into the conceptual framework of entrepreneurial intentionality used in numerous previous studies. The assumption has been that by understanding what factors drive - or the differences in perceptions of these factors - entrepreneurial intentionality, perceived personal desirability, and perceived personal feasibility we may draw important insights with implications for education and policy makers.

Our sample consisted of Finnish business school students and is therein different from previous studies. Krueger et al (2001) sampled US business students, and Autio et al (2001) sampled Scandinavian technology students and Grunsten (2004) sampled Finnish technology- students and start-up technology entrepreneurs. Our sample consisted of two groups where one had been participating in compulsory entrepreneurship education and the other group had not had any systematic entrepreneurship education.

Our results show that the cognitive maps of the two groups are very different. The groups that had participated in education seemed to have an opportunistic view whereas the other groups saw entrepreneurship as a necessary last alternative. Although the probability that the respondents would start a firm within five years was very low in both groups, it is possible to conclude that education will have an impact on how entrepreneurship as an opportunity in itself is perceived. Both groups shared the view that the lifestyle of an

entrepreneur seemed exciting. Yet, there seemed to be quite different aspects of lifestyle that excited them.

The impact of family and friends seems indirect and social norm was not found to significantly impact perceived personal desirability or perceived personal feasibility. It is not possible to say from our study at this stage to what degree education will increase the probability of starting a firm, only that education appears to impact the perception of entrepreneurship. However, since attitudes can be influenced via education it is likely that education can increase the probability. Therefore, the content of entrepreneurship education becomes critical. For students with academic education it would be important to provide more examples of successful academic entrepreneurs and to first and foremost demystify entrepreneurship.

Also, given the different perceptions of entrepreneurship it is obvious that there are other factors than financial means and knowledge and skills, which trigger personal perceived desirability and personal perceived feasibility and therein entrepreneurial intentionality. Policymakers should observe this, and take increasing measures in increasing the attractiveness of entrepreneurship. Entrepreneurship is not attractive at this moment.

Our results mandate additional research. In order to understand the role education, it would be necessary to collect data from students who are entering university, i.e. freshmen and then compare the data. This way we can understand how management studies impact perceptions of entrepreneurship, which in turn will enable us to a more targeted design of education. Also, it would be necessary to study the issues among graduated students, whereupon the role of experience would emerge.

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Table 1: Gender distribution of the sample

|          |     | Gender   |        | Total |
|----------|-----|----------|--------|-------|
|          |     | 1 female | 2 male |       |
| B-school | 1 A | 88       | 95     | 183   |
|          | 2 B | 44       | 28     | 72    |
| Total    |     | 132      | 123    | 255   |

Table 2. Factors with a significant link to entrepreneurial intent

| Total  | A  | B   |
|--|--|---|
| 1. Lifestyle of entrepreneur excites me ( $\beta=.36, p=.00$ ) | 1. Lifestyle of entrepreneur excites me ( $\beta=.40, p=.00$ ) | 1. Only if I don't get a job ( $\beta=.51, p=.00$ ) |
| 2. Only if it's easy ( $\beta=.19, p=.00$ )                    | 2. I have a good business idea ( $\beta=.21, p=.01$ )          | 2. Only if it's easy ( $\beta=.41, p=.00$ )         |
| 3. I have the skills and knowledge ( $\beta=.17, p=.01$ )      | 3. I have the skills and knowledge ( $\beta=.18, p=.03$ )      |   |
| 4. I know a market opportunity ( $\beta=.16, p=.01$ )          |  |   |
| 5. If it doesn't require too much money ( $\beta=.12, p=.05$ ) |  |   |
| <b><math>R^2=.44</math></b>                                    | <b><math>R^2=.43</math></b>                                    | <b><math>R^2=.61</math></b>                         |

Table 3. Factors with a significant link to perceived personal desirability

| Total  | A  | B  |
|--|--|--|
| 1. Lifestyle of entrepreneur excites me ( $\beta=.39, p=.00$ )             | 1. Lifestyle of entrepreneur excites me ( $\beta=.40, p=.00$ )       | 1. Lifestyle of entrepreneur excites me ( $\beta=.35, p=.00$ )             |
| 2. I'm precisely the type to become an entrepreneur ( $\beta=.19, p=.00$ ) | 2. I have the skills and knowledge ( $\beta=.18, p=.03$ )            | 2. I'm precisely the type to become an entrepreneur ( $\beta=.35, p=.00$ ) |
| 3. I have the skills and knowledge ( $\beta=.18, p=.00$ )                  | 3. I could earn more money as an entrepreneur ( $\beta=.19, p=.00$ ) | 3. Only if I don't get a job ( $\beta=.23, p=.03$ )                        |
| 4. It's the best way to benefit from my education ( $\beta=.14, p=.01$ )   |  | 4. I could join with others as an owner ( $\beta=.22, p=.03$ )             |
| 5. I could reach my goal in life ( $\beta=.15, p=.01$ )                    |  |  |
| <b><math>R^2=.61</math></b>  | <b><math>R^2=.60</math></b>  | <b><math>R^2=.64</math></b>  |

Table 4. Factors with a significant link to perceived personal feasibility

| <b>Total</b>  | <b>A</b>   | <b>B</b>   |
|---|--|--|
| 1. I have the skills and knowledge ( $\beta=.47, p=.00$ ) | 1. If it doesn't require too much money ( $\beta=.30, p=.00$ )           | 1. I have the skills and knowledge ( $\beta=.34, p=.00$ )                |
| 2. Only if it's easy ( $\beta=.43, p=.00$ )               | 2. I have the skills and knowledge ( $\beta=.26, p=.00$ )                | 2. If it doesn't require too much money ( $\beta=.30, p=.00$ )           |
|   | 3. I would be more independent as an entrepreneur ( $\beta=.20, p=.01$ ) | 3. Only if it's easy ( $\beta=.18, p=.01$ )                              |
|   | 4. Lifestyle of entrepreneur excites me ( $\beta=.19, p=.03$ )           | 4. I would be more independent as an entrepreneur ( $\beta=.15, p=.02$ ) |
| <b><math>R^2=.59</math></b>                               | <b><math>R^2=.41</math></b>  | <b><math>R^2=.45</math></b>  |

Table 5. The factors rated with significant difference between group A and B

| <b>Statement</b>  | <b>Measures</b>       |
|---|-----------------------|
| 1. As an entrepreneur I would be more independent                     | $\chi^2=30.37; p=.00$ |
| 2. As an entrepreneur I could reach my goals in life                  | $\chi^2=13.34; p=.01$ |
| 3. As an entrepreneur I could earn more money                         | $\chi^2=22.18; p=.00$ |
| 4. Starting a firm requires too much money                            | $\chi^2=15.50; p=.00$ |
| 5. As an employee I would be more appreciated than as an entrepreneur | $\chi^2=17.13; p=.00$ |
| 6. Only those who do not get a job become entrepreneurs               | $\chi^2=53.00; p=.00$ |
| 7. I have a good business idea  | $\chi^2=67.42; p=.00$ |
| 8. I know of a good market opportunity                                | $\chi^2=61.35; p=.00$ |
| 9. I have the skill and knowledge                                     | $\chi^2=11.38; p=.02$ |
| 10. The example of family/relatives encourages me                     | $\chi^2=19.37; p=.00$ |
| 11. The example of friends encourages me                              | $\chi^2=19.64; p=.00$ |
| 12. Starting a firm is easy to me                                     | $\chi^2=16.52; p=.00$ |

Table 6. Factors with a significant link to entrepreneurial lifestyle

| <b>Total</b>   | <b>A</b>  | <b>B</b>   |
|--|---|--|
| 1. I'm precisely the type to become an entrepreneur ( $\beta=.29, p=.00$ )               | 1. I'm precisely the type to become an entrepreneur ( $\beta=.40, p=.00$ )                          | 1. As an entrepreneur I would be more independent ( $\beta=.46, p=.00$ ) |
| 2. The example of family/relatives encourage me ( $\beta=.26, p=.00$ )                   | 2. The example of friends encourages me ( $\beta=.30, p=.00$ )                                      | 2. As an entrepreneur I could earn more money ( $\beta=.40, p=.00$ )     |
| 3. Starting a firm is the best way to benefit from my education ( $\beta=.19, p=.01$ )   | 3. As an entrepreneur I could reach my goals in life ( $\beta=.16, p=.01$ )                         |  |
| 4. I could earn more money as an entrepreneur than as an employee ( $\beta=.15, p=.02$ ) | 4. As an employee I would be <i>less</i> appreciated than as an entrepreneur ( $\beta=.15, p=.02$ ) |  |
| 5. I know of a good market opportunity ( $\beta=.12, p=.05$ )                            | 5. I could join with others as an owner ( $\beta=.14, p=.02$ )                                      |  |
| 6. As an entrepreneur I would be more independent ( $\beta=.12, p=.05$ )                 |   |  |
| <b>R<sup>2</sup>=.50</b>   | <b>R<sup>2</sup>=.63</b>  | <b>R<sup>2</sup>=.45</b>   |

**Title:** Disability and entrepreneurship dispelling the myth

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## **ABSTRACT**

Disability cuts across all socio-economic backgrounds, geographic areas and demographic characteristics. For too long it has been assumed that entrepreneurs with disabilities was an oxymoron. This paper will attempt to dispel such myths and assert instead that the experience of living with a disability may in fact actually contribute to business success. The experience of living with a disability may teach valuable skills and lessons which contribute positively to business success. This research paper seeks to question and explore the key barriers experienced by disabled entrepreneurs and influence policy makers in the promotion of alternative paradigms to embrace and embed an entrepreneurial ethos amongst the disabled .

The EU stated economic objective is to encourage **entrepreneurial activity** in Europe by helping to create favourable framework conditions for businesses. At the Lisbon European Council on 23 and 24 March 2000, the European Union set itself as its goal for the next decade to become the most competitive and dynamic knowledge-based economy in the world, which will be capable of developing sustainable economic growth with more and better jobs and greater social cohesion. Equally, the International Labour Office has promoted its stated objective of improving decent work and fostering and encouraging entrepreneurship in its most recent discussion paper on the global employment agenda.

This paper seeks to explore and question why so little progress and attention has been made to date in relation to entrepreneurial education and promotion for those with a disability.

According to the US Department of labor, entrepreneurship presents benefits and disadvantages for people with disabilities. Benefits of operating a small business include the freedom, flexibility and independence associated with self employment and freedom from access related obstacles such as transportation, fatigue, inaccessible work environments and the need for personal assistance. Potential disadvantages cited include the loss of cash benefits from Social Security or supplemental disability programmes inability to access venture capital due to poor credit ratings, and lack of assets to use as collateral. Surely, entrepreneurship can pose an attractive route to economic self sufficiency. Self employment may offer the individual unrivalled flexibility to work around a disabling condition. The effects of the condition may be mitigated without any loss in productivity when an individual has the latitude to work around medical routines. Equally, entrepreneurship may enable people with

disabilities to circumvent artificial barriers to career progression which may be prevalent in the labour market. To date disability research has not focused on this subject matter of entrepreneurship despite all the rhetoric from Europe and nationally to encourage and foster social inclusion and similarly an entrepreneurial ethos.

It is seldom seen that employment programmes tailored to people with disabilities often do not support entrepreneurship training. This paper will explore this phenomena and make recommendations for key supports for inclusion and mechanisms to enhance opportunity for this marginalized group. It has been noted in the literature (Schriner and Scotch 2001) that that the below than average educational attainment of people with disabilities may also make them more vulnerable to current trends in the labour market in particular in relation to the knowledge based economy which tend to prefer high levels of educational attainment and technical training. Equally the issue of assistive technologies, usability and human computer interaction (HCI) are significant areas worthy of research to promote and enhance technical expertise and educational attainment and ultimately labour market potential. This paper will explore these issues and identify mechanisms to tackle them at a policy level.

In spite of recent efforts to reduce unemployment amongst the disabled, labour market participation rates remain stubbornly high. In the United States for example, it is currently estimated that unemployment amongst the disabled hovers at around 70%. This is despite the fact that 67% of those with disabilities in the United States have expressed a desire to work. This begs the question that factors which impede economic participation need exploration. An equally related point is that income and earnings are chronically affected and linked by relatively low levels of labour market participation. In the past most attention has emphasized “getting back to work” rather than attempting to enhance entrepreneurial spirit and encourage those with disability to explore alternatives which may be more appropriate to their circumstances. This paper will focus on this dimension.

This research paper will seek to develop a new inclusive framework which values diversity and difference for entrepreneurs with disability and policy makers alike.

**Main Research Question(s):** This research paper will explore three questions:

1. What are the barriers to effective business development experienced by physically disabled entrepreneurs?
2. What types of business development support are required to facilitate disabled entrepreneurs?
3. How can policy development support greater diversity to encourage entrepreneurship amongst the physically disabled?

This paper will uniquely explore the issues associated with income adequacy, social inclusion and exclusion, education and training through the framework of entrepreneurship and disability. The overall aim of the paper is to promote a new issue in the entrepreneurial debate – disability and entrepreneurship. The paper will refer to research and fieldwork currently being carried out in Ireland by the authors.

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EU SERVICE DIRECTIVE: ENTER THE *EUROFEMMEPRENEUR*: NEW  
OPPORTUNITIES FOR FEMALE ENTREPRENEURS IN EUROPE AND IRELAND

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## **Abstract**

This paper seeks to highlight and discuss three related issues pertaining to European and Irish economic development policy and the impact on female entrepreneurs. The paper consists of three strands of related argument. The first strand of the argument seeks to critically evaluate the impact of European and Irish economic policy on female entrepreneurs. The central theme of this discussion is that both sets of policies, which are interrelated, impact negatively on female entrepreneurs based on the economic policy aspiration of becoming the most competitive and dynamic knowledge-based economy in the world within a decade. The stated aspiration of *moving up the value chain* involves the development of more technologically orientated industries with women minority stakeholders, clearly marginalising the participation of female entrepreneurs.

The second strand argues that the EU Directive on services in the Internal Market provides new opportunities for female entrepreneurs in Europe, with its emphasis on the provision and delivery of services across borders within Europe.

The third strand scopes the opportunities created by the EU Directive and argues these may produce a new business species in Europe – the *eurofemmepreneur*. This paper will define the *eurofemmepreneur* and draws on recent Irish and European research to develop *eurofemmepreneur* profile. The main conclusions drawn in the paper is that the business and growth opportunities available for the new *eurofemmepreneur* are significant.

## **Introduction**

This paper is based on three inter-related lines of argument, which explore the rationale for developing a business case for the promotion of the European Union's Draft Directive on Services with the potential of providing new opportunities for female entrepreneurs in Europe. The first section the paper argues that the Lisbon strategy which is the driver of current European Union economic policy, with its emphasis on the knowledge-based economy, risks marginalizing a significant group of entrepreneurs, e.g. females. The E.U. economic policy objective of 'becoming the most competitive and dynamic knowledge based economy in the world within a decade' is very ambitious with the implicit assumption that all E.U. economic participants will be in a position to participate and share in the achievement of this objective. The '*one size fits all*' approach risks marginalizing some groups. This paper argues that a significant proportion of female entrepreneurs operating in the E.U. risk becoming one such marginalized group.

A second line of argument explored in this paper is the benefits accruing from the introduction of the E.U. Draft Directive on Services as a vehicle for the promotion female entrepreneurs in Europe. This paper argues the Draft Directive provides the potential for creating new opportunities for female entrepreneurs in the E.U. and, when fully operational, could reverse the marginalization effects of the Lisbon strategy.

A third issue addressed in this paper introduces, for the first time, the concept of the *eurofempreneur* and argues that the draft Directive on Services will create new business opportunities for female entrepreneurs in Europe, through the removal of trade barriers and the simplification of business regulations. This paper predicts that the female entrepreneur profile will greatly improve with the delivery of services elevated to become the '*new ICT*' of Europe. The introduction of the 'eurofempreneur' as the child of the Directive on Services – or perhaps more accurately *the precarious toddler* - brings a new dimension to the European entrepreneurial narratives. International and European literature on entrepreneurship has placed female entrepreneurs firmly within the service sector, where low turnover, low profit margins and limited growth opportunities are the norm. This paper argues that the female entrepreneur profile will improve significantly

following the introduction of Service Directive. The birth of the *Eurofempreneur*, breathes new life and aspirations into services delivery with the prospect of high growth potential, and will contribute to Europe's economic vision of competitiveness.

### **The Lisbon Strategy**

The Lisbon Strategy (2000) is a commitment to bring about economic, social and environmental renewal in the EU. In March 2000 the European Council in Lisbon agreed a ten year plan, aiming to position Europe as *'the most competitive and dynamic knowledge-based economy in the world capable of sustaining economic growth with more and better jobs and greater social cohesion'*. The Council recognized the need for a radical transformation of the economy in order to create some 15 million new jobs by 2010. The Commission recognize the importance of entrepreneurship for the development of the European Union and it has recognized that entrepreneurship can deliver important benefits, both economically and socially. Not only is entrepreneurship a driving force for the creation of jobs, competitiveness and growth, it also contributes to personal fulfilment and the achievement of social objectives.

Evidence of the E.U's commitment to supports for women entrepreneurs is reflected in *'Challenges for Enterprise Policy in the Knowledge-Driven Economy' (2000)* which argues that "enterprise policy will aim at improving the start-up rate among women, young and unemployed, encouraging networks and customer orientation".

To further the aims of the Lisbon Charter, the EU Commission published an "Action Plan – the European Agenda for Entrepreneurship" (2003). The key priorities of the plan refer to:

- Fuelling entrepreneurial mindsets
- Encouraging more people to become entrepreneurs
- Gearing entrepreneurs for growth and competitiveness
- Improving the flow of finance
- Creating a more SME-friendly regulatory and administrative framework.

The OECD (1996) definition of the knowledge based economy refers to 'an economy in which the production, distribution and use of knowledge is the main driver of growth, wealth creation and employment across all industries – not only those industries classified as high tech or knowledge intensive'.

Reservations have been expressed regarding the knowledge based economy and its potential to create inequality, referred to by some as the digital divide. Cullen's (2001) review of a number of research and policy papers which address the issue of the digital divide, identifies specific groups of people as being especially disadvantaged in their uptake of ICTs. In particular Cullen identifies such groups as consisting of: underdeveloped areas, ethnic minorities, disabled, unemployed and women. According to Cullen such groups risk being disadvantaged with the advent of the digital divide in terms of equal participation as European citizens with regard to: access to information, access to business processes and access to on-line services. The digital divide also threatens to define a new economic order, where some groups are assigned and isolated within the lower rungs of the new economic order. This paper argues that female entrepreneurs currently operate within the lower economic groups. The Draft Directive on Services provides real and substantive opportunities to grow and expand beyond national boundaries through the provision and delivery of a variety of services across the European Union.

The Lisbon Council has highlighted the importance of services in the economy in the context of their potential for growth and employment creation. The importance of the services sector is justified by its sheer weight in the economy (around 70% of EU 15 GDP)

### **New Opportunities for Female Entrepreneurs: EU Draft Directive on Services**

In December 2000, in response to the Lisbon Summit, the Commission set out "An Internal Market Strategy for Services". The proposal for a directive on services is part of the process of economic reform launched by the Lisbon European Council, with a view to making the EU the most competitive and dynamic knowledge-based economy in the

world by 2010. The European Parliament and the Council have emphasized that the removal of legal barriers to the establishment of a genuine internal market is a matter of priority for achieving the goal set by the Lisbon Economic Strategy. The removal of internal barriers is recognized as an essential requirement for the rejuvenation and growth of the European economy.

This arrival of *eurofemmepreneur* has created a unique window of opportunity for female entrepreneurs in the services sector, and failure to respond positively may jeopardize the opportunity to escape from world of low turnover, low profit and limited growth potential. The objective of the proposed Directive on Services is to provide a legal framework that eliminates the obstacles to the freedom of establishment for service providers and the free movement of services between the Member States, giving both the providers and recipients of services the legal certainty they need in order to exercise these two fundamental freedoms enshrined in the Treaty. The proposed Directive offers significant opportunities for female entrepreneurs on two levels. In the first instance, the proposed Directive covers a wide variety of economic service activities - with some exceptions, such as financial services. Second the proposed Directive applies only to service providers established in a Member State.

A recent E.U. report (2004) identified the users of services within the EU as comprising mainly of consumers and SMEs and used the term “victims “ in referring to the lack of a genuine internal market in services. The report stresses that these groups cannot currently benefit from a wide variety of competitively priced services. They are deprived of the chance of a better quality of life which they might expect due to current restrictive barriers to the operation of a free internal market.

An underlying rationale of the Directive is that by creating the conditions and legal certainty necessary for the development of service activities between Member States, and extending the range of services available, the Directive will be of direct benefit to the recipients of services, including SMEs. Furthermore, when the Directive becomes operational in the E.U. it will guarantee better quality in the services by enabling ( at

European Community level), an increase in the efficiency of the supervision of service activities. This paper argues the new draft Directive offers unique business opportunities for entrepreneurs operating in the E.U. particularly for female entrepreneurs.

The current profile emerging from the research on female entrepreneurs locates them in the services sector, with low turnover, low profit margins, limited opportunities for growth, business networking and limited access to credit. This Draft Directive on services, offers significant business development opportunities for service sector participants to trade across national boundaries within the E.U., and provide opportunities to explore innovative strategic alliances with other EU partners. In addition, the Directive simplifies business processes within Europe, for example:

- Simplifies the administrative procedures and formalities to which service activities are subject (Sections 1 and 2 of Chapter II), particularly by means of single points of contact (Article 6), the use of electronic procedures (Article 8) and simplification of the authorisation procedures for access to and the exercise of service activities (Articles 10-13); it should be noted that the obligations to communicate information (Article 7) and to make available electronic procedures (Article 8) do not prevent Member States from maintaining other procedures and methods of communication in parallel;
- Eliminates from national legislation a number of requirements listed in the Directive that hamper access to and the exercise of service activities (Articles 14, 21, 29);
- Guarantees the free movement of services from other Member States and consequently adapt any rules that would hamper such movement (Articles 16, 20, 23 and 25);
- Evaluates the justification and proportionality of a number of requirements listed in the Directive which, where they exist in their regulations, may significantly restrict the development of service activities

### ***Enter the Eurofemmepreneur***

The new opportunities provided in the draft Directive on Services in the Internal Market have escaped the attention of European and national business women's networks. The lack of engagement with the potential gains from the Directive is disappointing. This paper argues that the proposed Directive will introduce a new genre and narrative to current entrepreneur discourse – the '*eurofemmepreneur*' defined as a female entrepreneur operating in the services sector on a trans European basis.

A wide variety of services are included in the draft Directive, most of which are mainly carried out by women. For example, included in the draft Directive are business services such as management consultancy, certification and testing; facilities management, including office maintenance and security; advertising; recruitment services, including employment agencies; and the services of commercial agents. The definition of services can be extended also to include services provided both to businesses and to consumers, such as legal or fiscal advice; real estate services such as estate agencies; construction, including the services of architects; transport; distributive trades; the organisation of trade fairs; car rental; travel agencies; and security services. Consumer services are also include, such as those in the field of tourism, including tour guides; audio-visual services; leisure services, sports centres and amusement parks; health and health care services; and household support services, such as help for the elderly. Those activities may involve services requiring the proximity of provider and recipient, services requiring travel by the recipient or the provider and services which may be provided at a distance, including via the Internet. The era of the *eurofemmepreneur* has arrived. Based on the list of potential services included under the new Directive, a new era of entrepreneurship is about to unfold for women. To fully gain from the opportunities offered by the Directive call for a proactive response from female entrepreneurs if they are to claim and inhabit the niche of the *eurofemmepreneurs*.

### **Evidence from Ireland**

Female self –employment is still predominantly located in the low-tech service sector. Of the working women in Europe, 73 per cent are employed in the service sector in part-time

and temporary employment. Marlow and Carter (2003:4) comment that even in the “new economy” sectors, initially believed to offer gender neutral opportunities for entrepreneurship, the number of firms owned by men significantly outnumber those owned by women and traditional patterns of gender representation and stereotyping would appear to persist (Wilkinson, 2001). Ireland boasts one of the fastest growth rates of women’s workplace participation in the EU over the last decade. CSO Labour market statistics for the period (March to May 2004) show that 49.4% of women participate in the labor force in Ireland.

From the Irish perspective, research conducted by the Gender Equality Unit (2003) concurs with the international findings and shows that those enterprises set up by women in Ireland tend to be in the services sector, are smaller, and their owner managers have fewer growth aspirations and are less often engaged in exports. Market saturation is a major problem for small and micro enterprises related to a lack of access to higher value markets and a lack of innovation (Dawson 1997; MacIsaac 1996). Many entrepreneurs, particularly women, are located in low value markets which tend to be crowded leading to saturated markets and little room for growth. Without innovation through new product development and access to higher value markets, the potential for success for small and micro enterprises in these sectors is low. This paper argues the Directive on Services presents Irish female entrepreneurs with the opportunity to participate and trade in a free European market for services. Not only does the draft Directive open up a vast new market in services, it also removes the barriers to trade. Doing business in the E.U. will be effortless and rewarding.

## **Conclusions**

This paper presents a broad overview of the new opportunities for female entrepreneurs through the operation of the Directive on Services, and introduces a new genre to the entrepreneur discourse – the new *eurofemmepreneur*. It should be noted, not everyone shares the vision presented in this paper regarding the positive spin offs from the Directive. There is evidence that the debate had become polarized, and ideological positions are now being formed. For example, some of the European trade unions are strongly opposed of the draft Directive on the basis that it is a direct threat to the

'European social model' without taking account of democratic rules. Some trade unions are convinced that the quality of public services will diminish if the Directive achieves its aim of removing as many regulations as possible. The European Commissioner for the Internal Market and Services, Commissioner McCreevy, responding to these concerns has assured Europeans that conditions and standards for workers will not be affected in any way and rebutted the prospect that 'social dumping' and the end to the Social Model could result from the introduction of the Directive.

To-date the European and national business women's networks have been slow to articulate a view regarding the Directive's potential for business development or otherwise. This view is awaited with interest. This paper commends the draft Directive on Services to female entrepreneurs in Europe and seeks to bring to their attention the considerable opportunities this Directive can deliver – from a business and citizenship perspective. We commend the *Eurofemmepreneur* – may she have a long, rewarding and fulfilling life.

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**PORTRAIT OF AN ARTIST AS ENTREPRENEUR: THE RELEVANCE OF  
SOCIAL EXCHANGE THEORY FOR THE VISUAL ARTIST**

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## **Abstract**

**Social exchange theory and the visual artist:** Network theory, or social exchange theory, contends that interdependent relationships, comprised of proactive social actors, are the appropriate organizational system for the entrepreneurial process. The use of network theory has been prominent in attempts to understand entrepreneurship within small and medium enterprises (SMEs) (Granovetter 1985; Johannisson, Alexanderson, and Senneseth 1994). Social exchange theory does not claim to have the key to understanding entrepreneurship, Johannisson (1998), for example, criticizes the theoretical models used to study entrepreneurial networking for using vague definitions of key constructs. He proposes that "social" networks would be more appropriately labelled "personal" networks, a category that he further divides into "social" and "business" (Johannisson 1998).

It is widely accepted anecdotally that the arts and crafts sector (like most of the cultural sector) relies heavily on alliances, networks, and networking. Commissions are the key to an artist's survival. There is limited empirical research to-date on this phenomenon, and limited scholarly attention has been paid to social exchange theory applied to the arts and crafts sector, in particular the visual artist. The aim of this paper is to critically evaluate the validity of social exchange theory applied to the visual artist in Ireland. This paper will argue that social action theory plays a major role in business promotion for the cultural sector. This paper will further argue that social exchange, when harnessed successfully can make a major contribution to the success of artist as entrepreneur. A further aim of the paper is to encourage debate on social action theory and its application to the artist as an entrepreneur and to advance knowledge and identify issues for further research.

### **Introduction: Social exchange theory and the visual artist**

Network theory, or social exchange theory, contends that interdependent relationships, comprised of proactive social actors, are the appropriate organizational system for the entrepreneurial process. The use of network theory has been prominent in attempts to understand entrepreneurship within small and medium enterprises (SMEs) (Granovetter 1985; Johannisson, Alexanderson, and Senneseth 1994). Social exchange theory does not claim to have the key to understanding entrepreneurship, Johannisson (1998), for example, criticizes the theoretical models used to study entrepreneurial networking for using vague definitions of key constructs. He proposes that "social" networks would be more appropriately labelled "personal" networks, a category that he further divides into "social" and "business" (Johannisson 1998).

It is widely accepted anecdotally that the arts and crafts sector (like most of the cultural sector) relies heavily on alliances, networks, and networking. Commissions are the key to an artist's survival. There is limited empirical research to-date on this phenomenon, and limited scholarly attention has been paid to social exchange theory applied to the arts and crafts sector, in particular the visual artist. The aim of this paper is to critically evaluate the validity of social exchange theory applied to the visual artist in Ireland. This paper will argue that social exchange theory plays a major role in business promotion for the cultural sector. This paper will further argue that social exchange, when harnessed successfully can make a major contribution to the success of artist as entrepreneur. A further aim of the paper is to encourage debate on social exchange theory and its application to the artist as an entrepreneur and to advance knowledge and identify issues for further research.

### **Entrepreneurship and enterprise policy**

In Ireland as in other EU countries, entrepreneurship and enterprise policy are informed by EU policy. Current EU enterprise policy, referred to as the Lisbon Strategy, has set itself the goal over the next decade of becoming the most competitive and dynamic

knowledge-based economy in the world, which will be capable of developing sustainable economic growth with more and better jobs and greater social cohesion. In order to achieve this goal, entrepreneurship and innovation need to be developed by small and medium-sized enterprises (SMEs) in particular. For Ireland, the technological and creative industries sectors are predicted to play a significant part in the next phase of Ireland's economic growth. The National Development Plan (NDP) is the blueprint for Ireland's continuing economic progress and provides for the investment of EUR57 billion over seven years in infrastructure, productive investment, education and training, regional development and social inclusion. Digital content in Ireland has been identified as a new economic sector with tremendous enterprise and creative potential. This new area of economic activity has been brought about through the convergence of previously distinct areas such as traditional content, media and entertainment, software and multimedia, and electronic hardware and telecommunications. Broadly, it encompasses the creation, design, management and distribution of digital products and services and the technologies that underpin them. Worldwide, the market was estimated at over \$178 billion in 2001 (PwC, 2002).

For Ireland a key economic vision expressed in the national economic strategy is “to develop a world-class Digital Content industry based on the targeted development of a number of ‘clusters’ at the ‘intellectual property’ end of the market, namely enabling technology and high-value content and applications.” This vision promotes creativity as a key skill requirement for this new emerging sector. The future for the visual artist in Ireland looks positive, based on the findings of the PwC report (2002).

This paper seeks to investigate the extent to which visual artists will participate in Ireland's economic vision and the extent to which social exchange theory will facilitate this participation.

Art is a global business. However in comparison to other products, limited effort is invested in promoting and developing the key business skills (enterprise, technology and creativity) and business acumen of artists. In particular there is limited evidence that

artists are encouraged to define their approach to business within an entrepreneurial frame of reference. Key business skills are rarely shared with artists as part of their professional practice development. Artists rarely define themselves as entrepreneurs.

**The research question:** The main research question this paper seeks to answer is: does social exchange theory contribute to the promotion and development of an artist's work more so than the artist individual output and peer review? The paper approaches the problem in three ways: First it deconstructs and analyses the value chain operating in this sector. Through studies of different visual artists within the creative industry in Ireland, it examines and evaluates how artists initially engage and negotiate with key stakeholders – public as well as patrons (corporate and private) to purchase, consume and seek further exposure and consumption of the cultural product.

Second, in evaluating this business model, it asks to what extent practicing artists engage with their potential customers and publics and whether they see their users as customers or as citizens, and to what extent do they see themselves, in the full sense of the word, as 'an artist' or as an entrepreneur. To what extent, if at all, is this related to the approach adopted by an artist in the promotion and sale of works of art. For the artist, what role does social exchange theory play, and what role does the entrepreneur play in identifying and exploiting a business opportunity. Finally, for the art educational policy makers: to what extent should art education and professional practice incorporate social exchange theory and entrepreneurial skills. How can an arts education syllabus be de-constructed and re-constructed to reflect social exchange theory and entrepreneurship.

### **The Business of Art and the Art of business**

The predominant approach adopted by artists in the promotion of their work and product emerging from the international literature (Bains and Robson, 200; Wilson and Stokes, 2004) suggests that social network theory is the dominant business promotion tool used by the creative sector and 'cultural entrepreneurs'. This research has attempted to investigate the extent to which practicing artists in Ireland rely on social network theory to promote and develop their business. A survey of 30 artists living and working in

Dublin, Ireland was undertaken for this purpose. The methodology consisted of both qualitative and quantitative research, based on the diverging views emerging from the current literature on methodology. A pre-coded questionnaire was used as well as in depth interviews with key informant practicing artists. The following tables provides interesting insights into the strategies used by artists in growing their business, and prompts interesting questions about the artist as entrepreneur.

**Table 1: Main source of income**

|                | Percent | Valid Percent | Cumulative Percent |
|----------------|---------|---------------|--------------------|
| Valid Business | 22.2    | 22.2          | 22.2               |
| Demonstrations | 5.6     | 5.6           | 27.8               |
| Commissions    | 50.0    | 50.0          | 77.8               |
| other          | 22.2    | 22.2          | 100.0              |
| Total          | 100.0   | 100.0         |                    |

Over half the survey respondents indicated their main source of income was generated through commissions (private and corporate). Reference to ‘business’ implies they use some form of retail outlet (gallery etc).

**Table 2: Social Networks and business.**

Respondents were invited to respond to a list of statements about networking. For each statement they were asked to indicate whether they ‘strongly agreed, ‘agreed’ ‘neither agreed nor disagreed’ ‘disagree’ or ‘strongly disagree’. The statements were developed from the international literature on key themes emerging.

*“People in my business rely on social networks to promote their business”*

|                            | Percent | Valid Percent | Cumulative Percent |
|----------------------------|---------|---------------|--------------------|
| Valid strongly agree       | 38.9    | 38.9          | 38.9               |
| agree                      | 44.4    | 44.4          | 83.3               |
| neither agree nor disagree | 16.7    | 16.7          | 100.0              |
| Total                      | 100.0   | 100.0         |                    |

Consistent with international literature in the field of cultural enterprise, survey respondents indicated they either strongly agreed or agreed (83.3%) that they rely on social networks to promote their business. The only surprising aspect of this finding is that nearly 17% did not hold a view on this matter. However, the finding supports the importance of social network theory for this group of self employed.

**Table 3: "Most of my business is generated by my own personal contacts"**

|                            | Percent | Valid Percent | Cumulative Percent |
|----------------------------|---------|---------------|--------------------|
| Valid strongly agree       | 27.8    | 27.8          | 27.8               |
| agree                      | 61.1    | 61.1          | 88.9               |
| neither agree nor disagree | 5.6     | 5.6           | 94.4               |
| disagree                   | 5.6     | 5.6           | 100.0              |
| Total                      | 100.0   | 100.0         |                    |

The above table further supports the international evidence that the creative sector, and artists in particular, are dependent on personal contacts to generate business. A similar finding was reported by Baines and Robson (2001) who reported in their survey of self employed in the media sector that usually their collaborators were with people they knew extremely well. The current study suggests that social networking is heavily relied on by artists to generate business. Baines and Robson describe this relationship as the 'colleague employers' relationships, and argue that they are the most likely to describe their selfemployment in terms of freedom and opportunity. However, they add that it is unclear how sustainable their way of working will be in the longer term, particularly in relation to the development of skills. This is an interesting point when we refer to the question raised in this paper: for the artist generating business, what role does the entrepreneur play in identifying and exploiting a business opportunity. The international literature implies this sector lacks the critical business acumen and their entrepreneurial talents have yet to be discovered.

Further evidence of their entrepreneurial ethos can be found from the following table.

**Table 4: "I rely totally on outside advice to promote and develop my business"**

|                            | Percent | Valid Percent | Cumulative Percent |
|----------------------------|---------|---------------|--------------------|
| Valid strongly agree       | 5.6     | 5.6           | 5.6                |
| agree                      | 16.7    | 16.7          | 22.2               |
| neither agree nor disagree | 16.7    | 16.7          | 38.9               |
| disagree                   | 55.6    | 55.6          | 94.4               |
| strongly disagree          | 5.6     | 5.6           | 100.0              |
| Total                      | 100.0   | 100.0         |                    |

Clearly, this group of respondents did not feel the need to consult with external agencies, e.g. enterprise support agencies to promote their business with almost a quarter of respondents expressing this view. This finding raised questions about the longer term viability of their businesses, as shared by Baines and Robson (2001) with respect how sustainable their way of working will be in the longer term, particularly in relation to the development of skills (in relation to the creative sector).

Evidence of the lack of business acumen amongst artists can be found in the following table. Clearly this finding illuminates the portrait of the artist as an entrepreneur as one who relies heavily on social networks to generate sales.

**Table 5: "I rely on my business plan rather than relying on social networks for sales"**

|                            | Percent | Valid Percent | Cumulative Percent |
|----------------------------|---------|---------------|--------------------|
| Valid agree                | 22.2    | 22.2          | 22.2               |
| neither agree nor disagree | 27.8    | 27.8          | 50.0               |
| disagree                   | 50.0    | 50.0          | 100.0              |
| Total                      | 100.0   | 100.0         |                    |

The above table shows that artist respondents indicated a preference for relying on social networks for sales rather than on a business plan, and prompts questions regarding the need for basic business skills in their professional development and training.

**Table 6: "My previous purchased work has been a great asset in generating business for me"**

|       |                            | Percent | Valid Percent | Cumulative Percent |
|-------|----------------------------|---------|---------------|--------------------|
| Valid | strongly agree             | 11.1    | 11.1          | 11.1               |
|       | agree                      | 55.6    | 55.6          | 66.7               |
|       | neither agree nor disagree | 16.7    | 16.7          | 83.3               |
|       | disagree                   | 11.1    | 11.1          | 94.4               |
|       | strongly disagree          | 5.6     | 5.6           | 100.0              |
|       | Total                      | 100.0   | 100.0         |                    |

The extent and importance in social network theory is evidenced in respondents' attitude to the importance of previous work in generating business., with almost 67% agreeing that their previous purchased work has been a great asset in generating further business.

### **Conclusions**

This paper set out to explore three questions in relation to portrait of an artist as entrepreneur: first, does social exchange theory contribute to the promotion and development of an artist' work more so than the artist individual output and peer review? Second, to what extent do they see themselves, in the full sense of the word, as 'an artist' or as an entrepreneur and third, to what extent should art education and professional practice incorporate social exchange theory and business entrepreneurial skills. From the current exploratory study, the following points emerge: first: social exchange theory is a major determinant in business development for artists. Second, in keeping with international literature findings, the current study suggests that artists do not see themselves as entrepreneurs despite the fact they use of social networks to promote obtain and promote business. They appear not to have made the link between social networking and entrepreneurship. Third, in the light of the latter finding, a strong case can be supported for the development and inclusion of appropriate business entrepreneurial modules and discourses within an artist's training. Further research is required in this area, to illuminate existing knowledge on the application of social exchange theory to the visual artist and its impact on the promotion of the artist as an entrepreneur.

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**MAKING *SUCCESSION* A *SUCCESS*:  
PERSPECTIVES FROM CANADIAN SMEs**

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## **ABSTRACT**

The emergence of an aging population in Canada and its impact on the economic growth and social policy development such as health care has been a focal point of public policy research. However, one key aspect that has been overlooked is the impact of an aging small and medium-sized enterprise (SME) sector in Canada. Given that the vast majority of Canada's business population is comprised of SMEs, there is a clear need for in-depth examination into the aging of SME owners and their preparedness for business succession. Using results from a 2004 survey of independent business owners, the paper reveals much insight into SME succession, both from the family and non-family business perspective, as well as from those SME owners who recently acquired their business through succession. There are four major research gaps in the current literature pertaining to succession planning: the motivation of business owners to plan ahead of time for succession; an analysis of the net overall impact of failed business succession in the Canadian economy; the role of government and the financial community in promoting and facilitating business succession; and lastly, there is remarkably little research on the perspective of future successors of businesses.

## INTRODUCTION

Significant research in recent years highlights the influence of Canada's aging demographic composition. The largest cohort in the population, the baby-boomers, will continue to exert influence on the economy as well as the direction of public policy. Next to health care issues, the decline in labour force participation, mainly due to retirements, is of growing concern. Governments, employers and educational institutions have studied the implications of the pending "exodus" from the labour force and the implications for public policy. Clearly, the concern of an aging population extends far beyond health care.

Despite efforts to examine the aging workforce in recent years, there is a lack of research with respect to the aging of small and medium-sized enterprise (SME) owners in Canada. Recent data suggest that most SME owners are between the ages of 45 and 70, creating considerable concern over the effects of their retirement on the economy, the survival of their businesses and the people they employ.<sup>i</sup> Minimizing uncertainties, however, can be achieved through adequate business transition planning.

Focus on SMEs is pivotal in assessing the effects of succession planning. Seventy-five per cent of all businesses in Canada employ fewer than 5 employees and almost 60 per cent of employed Canadians work in for a small or medium-sized business. Moreover, of the self-employed in Canada, 40 percent are businesses with employees.<sup>ii</sup> In addition, the SME sector contributes approximately 45 per cent of Canada's economic output and is the catalyst of innovative products and services.

Among large corporations, planning for the succession of senior officers is an integral component of their overall strategy. However, the very nature of small business and

entrepreneurship is often a constraint to adequate succession planning. Moreover, the additional dimension of operating a family business often exacerbates these obstacles.

## **THE SUCCESSION PLAN**

Succession is not a single event, but rather a process in which leadership and, eventually, ownership is transferred to the successor. The succession plan formally outlines this process. More importantly, it selects and puts in place the tools required to attain the goals and objectives of all parties involved.

The plan involves several steps that require time, often years, for it to be effective, which is why one must start planning well in advance. Moreover, the legal, tax, and financial aspects of the plan come to play at different stages of the transition and are the tools by which the business owner's goals and objectives are attained. Identifying these objectives, however, is a prerequisite to prescribing the appropriate tools.

According to Landsberg (1988), the failure to address business succession can be termed the "Succession Conspiracy". He cites four barriers to succession planning: the business founder, the family, the employees, and the business environment (see Box 1). Barriers to choosing a successor, according to a survey of business owners, include the intention to sell the business outright, the owner's children being too young, and the lack of trained candidates (see Figure 3).

### **Strategic Plan**

The strategic plan involves a long-term assessment and identification of the goals and objectives of the business owner and, in the case of a family business, the family's goals. In addition, it charts out a clear, and shared, vision for the business and may include a formal mission statement.

The process involves asking questions such as: Where do I/we want the business be in the future? Who will run the business? Should the business remain in the family? What is the role of the family in the business?

***“Developing a common vision for the future is vital to the long-term success of any plan. Otherwise there is not one plan but many plans that are probably in competition with each other – a sure recipe for failure”. (Barnett, 2000)***

Often, business owners do not have clearly defined goals and objectives. Barnett (2000) finds it effective to provide business owners with generic objectives that can be customized. Such objectives include, but are not limited to the following:

1. Provide for the family
2. Maintain the value of the business over the transition
3. Prepare for the future
4. Maintain family harmony
5. Minimize tax liability

The formal discussion and setting of goals and objectives is a prerequisite to succession planning. As will be illustrated below, a succession plan encompasses the tools to attain these goals and objectives.

The strategic plan allows the family, the business owner, and the successor(s) an opportunity to chart out the future course for the firm. Collectively setting the business goals will ensure that everyone has a clear picture within the business. The plan may consist of written policies that determine the entry and exit criteria of family members, or outsiders, into the business; or the

necessary criteria required to manage the business. A strategic plan will also assist in dealing with and avoiding conflicts regarding compensation, ownership, and management control.<sup>iii</sup>

### **Elements of a Succession Plan**

According to the European Federation of Accountants (FEE), a succession plan should contain the following ten elements:<sup>iv</sup>

1. A statement of the distribution of ownership
2. The identity of the new leader or leaders
3. How the new leaders are to be trained for their roles
4. A definition of the roles of other key members of the business during the transition
5. Mechanics for the purchase or sale of stakes in business
6. Taxation and legal considerations
7. Financial considerations
8. Retirement considerations
9. A procedure for monitoring the process and dealing with disputes and problems
10. A timetable.

In addition to the above ten elements, Upton-Bowman (1999) and Barnett (2000) recommend a formal process of finding a successor, as well as a formal financial valuation of the business.

Several steps are required in order to satisfy the above ten (or twelve in this case) elements. Listing out common steps for the average business, however, is a futile exercise. Every business has a unique structure; a unique relationship with family, suppliers, and customers; a unique history with the community; and, above all, unique goals and objectives of the current owners.

Simply put, there are too many uncommon factors involved in succession planning to formulate a common set of specific steps.

As a result, not surprisingly, the efforts of consultants, accountants, and researchers have focussed on a common framework to succession planning; emphasizing the need to discuss and formalize the goals and objectives of all stakeholders involved. Once accomplished, the common elements of a succession plan, as listed above, can be satisfied with the use of specific steps involving financial and legal tools. These steps are ultimately guided by the unique circumstances of each business as well as the established goals and objective.

### **Key to Successful Succession**

According to Morris (1996) there are three general categories of factors that play a vital role in effective business transitions (see Box 1). Assuming that the process of selecting the successor has occurred, the study cites the preparation level of the business heirs, the relationships among family and business members, and planning and control activities as the primary factors to successful business transitions.

The key finding of Morris' study is that successful heirs to businesses were reasonably well prepared, in both educational attainment and general work experience – the latter including the undertaking of various positions within the business. Moreover, successful transitions were apparent in those situations where there were shared vision and values among stakeholders involved and minimal rivalry. Finally, despite the extensive tax planning involved, the planning and control activities surrounding succession planning were informal.

## Box 1: Underlying determinants of successful transitions

### **Preparation level of heirs:**

- Formal education, training, and work experience (outside firm);
- Entry-level position
- Year(s) working within firm (and/or industry);
- Motivation to joining firm;
- Self-perception of preparation.

### **Relationships among family and business members:**

- Communication;
- Trust, commitment, and loyalty;
- Family turmoil and sibling rivalry;
- Jealousy/resentment;
- Conflict;
- Shared values and traditions.

### **Planning and control activities:**

- Succession planning;
- Tax planning;
- Use of outside board;
- Use of family business consultants/advisors;
- Creation of a family council.

Source: Morris et al. (1996)

At a higher level, however, the findings by Morris et al. (1996) demonstrate the importance of the steps preceding the actual succession plan. That is, appropriate strategic planning (family and/or business) well in advance of succession will enhance the success of any transition plan whether they are informal or not.

## **SURVEY FINDINGS**

To assess the risks and opportunities for Canada's economy, CFIB carried out an extensive survey focused on SME succession. The survey was completed by 4,311 CFIB members during the period May 1 to 26, 2004. Responses are accurate  $\pm 1.5$  percentage points, 19 times out of 20. The survey focused on several key issues including: when do owners expect to exit their business; how are they preparing for succession—if at all; and what barriers do they

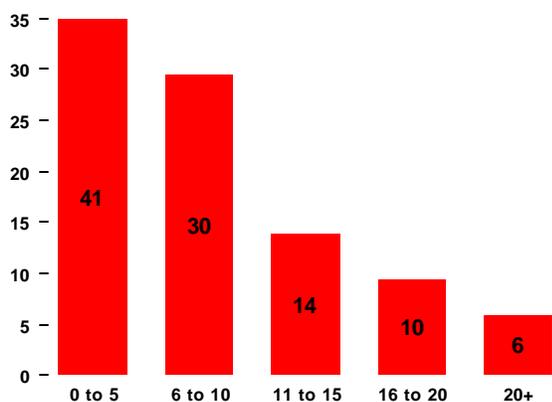
face in implementing their succession plans. To obtain another perspective unique to the CFIB survey, questions were asked of those owners who recently acquired a business through succession.

Major survey findings are as follows:

### **Business Exit Timeline**

The majority of business owners (71 per cent) plan to exit ownership or transfer control of their businesses within 10 years (Figure 1). These figures complement those found by the 1999 Deloitte and Touche study where 56 per cent of business owners expected to exit within 10 years<sup>1</sup>. Five years later the CFIB results clearly indicate that issues surrounding aging business owners have not dissipated. In fact the results justify greater concern on the issue as 41 per cent of SME owners surveyed intend to leave within the next five years.

Figure 1:  
When SME Owners Plan to Exit Business  
(% response, years)



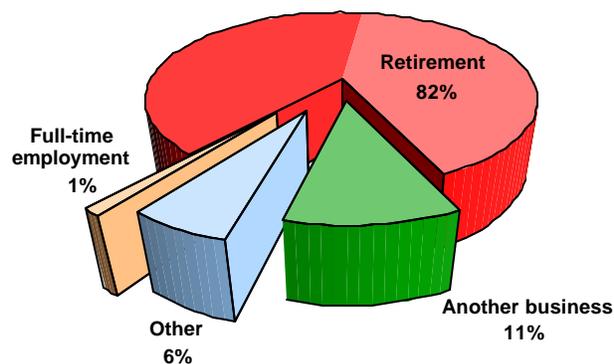
Retirement is the number one reason for business owners planning to exit their business, as indicated by 82 per cent of respondents (Figure 2). An interesting observation, however, is

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<sup>1</sup> "Are Canadian Family Businesses an Endangered Species?", Deloitte & Touche Centre for Tax Education and Research, University of Waterloo, 1999.

that 11 per cent of respondents indicated that they plan to move to another venture. Though small, this fact is particularly important as they represent the natural “churning” of businesses whereby business resources are shifted to more productive purposes. Returning to full-time employment, for the most part, is not a consideration for small business owners. This is likely due to the characteristics of entrepreneurs—most do not want full-time work after being self-employed.

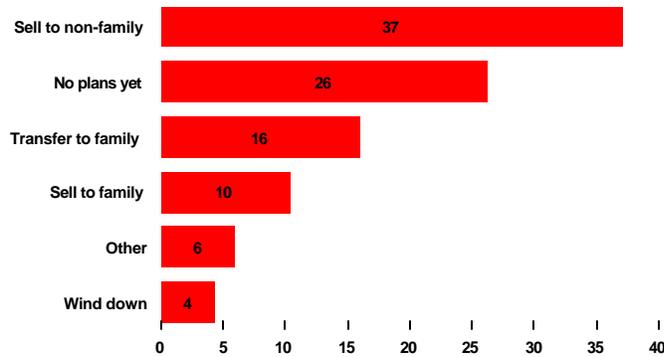
Figure 2:  
Reasons for Anticipated Exit from business  
(% response)



## Transition

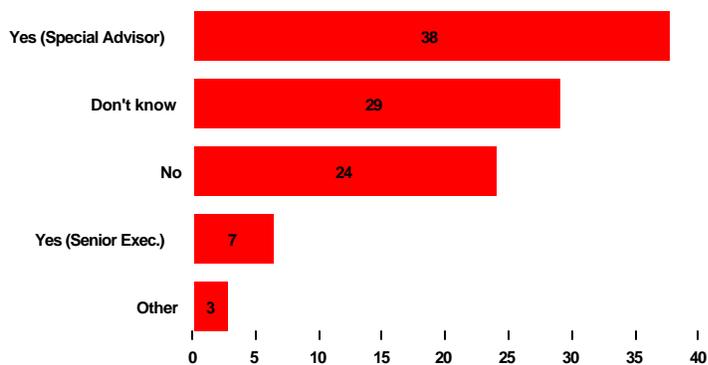
The most common method among SME owners of exiting their businesses is to sell outright to non-family members (37 per cent). This is surprising given the large presence of family businesses in the economy. One in four (26 per cent) business owners indicated that they intend to sell or transfer their businesses to a family member in the future, while a similar share do not currently have plans (Figure 3).

Figure 3:  
How SME Owners Plan to Exit Businesses  
(% response)



A significant portion of business owners intend to participate in the business after the transition of their business. This planned approach is very common among entrepreneurs, especially if preparing for succession proves to be a personal challenge for the owner. Thirty-eight per cent of owners plan to continue as special advisors (Figure 4). Seven per cent expect to remain as senior executives, while more than half (53 per cent) either don't know or plan to fully exit the business.

Figure 4:  
Planned role of Owner after Succession  
(% response)

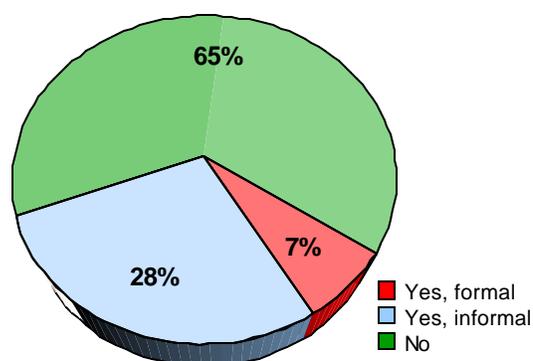


Owners of larger businesses are more likely to plan for a future role. In addition, the longer an entrepreneur is at the helm of their business the more likely they are to express a desire to have a role after succession—evidence of personal attachments between owners and their ventures. In fact, 44 per cent cited personal attachment as to why they plan to have a role after succession. The number one reason given (60 per cent), however, is to gradually reduce the business' dependence on the current owner.

### Succession Planning

Only one third (35 per cent) of SMEs have a plan to sell, transfer, or wind down their business in the future (Figure). Among these it is more likely to be an unwritten, informal plan (28 per cent) as opposed to one that is formal (7 per cent).

Figure 5:  
Existence of a Succession Plan  
(% respondents)



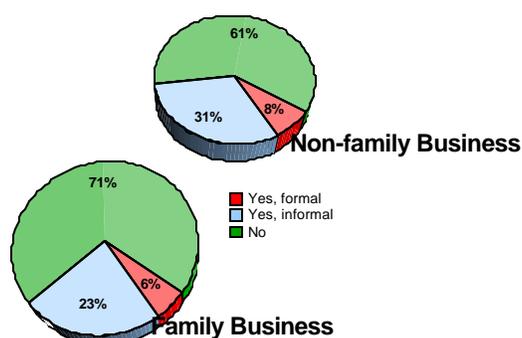
As Figure 6 illustrates, non-family businesses are slightly more likely to have a succession plan relative to family businesses (39 per cent vs. 29 per cent). However, these family

businesses are less likely to have a formal succession plan (23 per cent vs. 31 per cent). Lower formal plans in family businesses may occur as owners assume that they are “on the same page” as their successor.

Figure 6:

Existence of a Succession Plan: Family and Non-family Businesses

(% respondents)



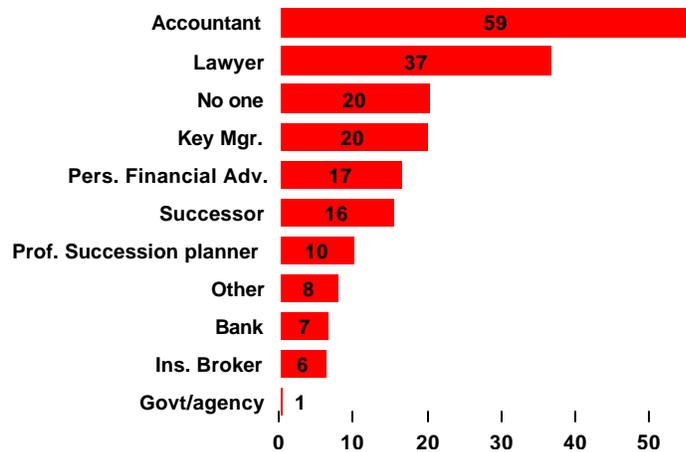
The earlier one expects to exit the business, the more likely that he or she will have a succession plan. Although this finding is intuitive, the issue is the degree at which owners are planning. Among those respondents planning to exit within 10 years, 41 per cent have a succession plan, while those planning to exit within 5 years, only 48 per cent have a succession plan.

### Succession Plan Development

The development of a succession plan often requires the input and services of various professionals such as accountants and lawyers; internal stakeholders in the business, such as key managers and employees; as well as family members and the successor(s) if already chosen.

The most common types of professional assistance used in developing a succession plan are accountants and lawyers (Figure 7). Use of other professional services is significantly lower.

Figure 7:  
Developing the Succession Plan: Who Helped?  
(% response)



Of particular concern is the fact that only 16 per cent of small business owners are seeking the input of their successors in the development of their plan. Those employing family are slightly more likely to have the input of successors (18 per cent) relative to those who don't employ family (11 per cent). Input from successors, however, is difficult if the owner has yet to choose one. Excluding owners who have not chosen a successor 28 per cent had the input of their heirs in the succession plan. Although higher than the figures presented above, the result illustrates a need for owners to develop and share their succession plans with family, key employees and their successors. Such input helps to minimize conflict among these stakeholders and to maintain stability within the business.

## **What is Being Planned?**

The most commonly cited components of a succession plan are considered to deal with “technical issues” and include: the legal transfer of business ownership, tax implications of disposing the business, the financing of the successor, and the division of future profits after the transition. However, seldom cited are “soft” issues, such as identifying long-term personal and family goals, the communication of each stakeholder’s vision for the business (employees, family, successor) and their anticipated role in the business after succession, as well as the processes foreseen for selecting and training their successor.

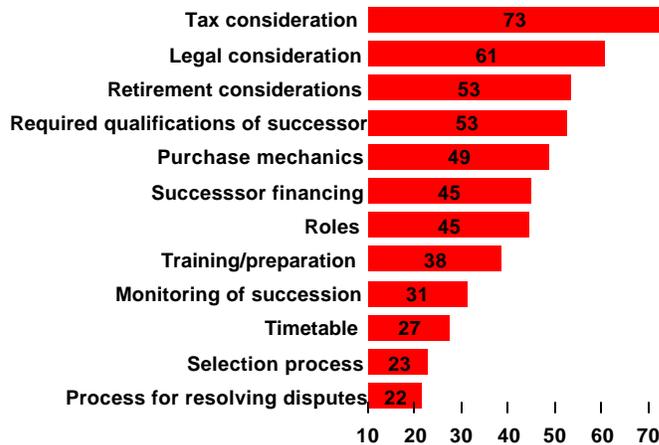
SME owners place significant emphasis on the technical components such as tax and legal considerations (73 and 61 percent respectively) when planning for succession. This is not surprising given that accountants and lawyers are the two main advisors in developing succession plans. The planning to deal with the “soft” issues lags behind (Figure 8).

Considerations for resolving disputes, for example, play a relatively minor role for most SME succession plans—only 22 per cent of respondents with a succession plan stated that such a process is in place. Moreover, only 27 per cent of succession plans state an official timeline for the transfer of ownership and/or control of the business. Finally, only 23 and 38 per cent, respectively, of succession plans incorporate processes for selecting and training successors.

Figure 8:

The Succession Plan: What's in it?

(% response)



Family businesses are less likely to incorporate a successor selection process in their succession plan than non-family (20 per cent for family businesses vs. 30 per cent for non-family). Conversely, family businesses are more likely to have the financing of their successors in their plans (48 vs. 39 per cent for non-family businesses). These findings, however, are intuitive in that many family business owners expect their heirs to take over the business. However, as indicated above, the majority of family-owned or operated businesses do not have the input of their successors in the succession plan. For a small business owner, to assume that a child, sibling, or relative wants to take over the business may be a serious risk with respect to planning succession.

### Succession Barriers

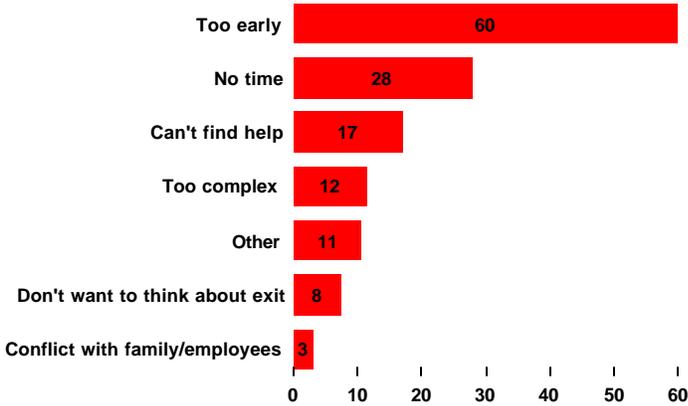
Most barriers identified by professional advisors are, as previously mentioned, commonly considered “soft” in nature. Such is the case when the owner avoids dealing with succession due to his or her strong personal sense of attachment with the business. In other instances, succession

is difficult due to conflict with family members or key employees. Technical barriers include legal, financial, and legislative restrictions to planning or executing a succession. The CFIB survey sought to identify both soft and technical barriers faced by current SMEs who are planning their succession as well as those who recently took over a business through succession. However, the single largest barrier to succession can be identified as those who do not have a succession plan altogether.

**No Succession Plan**

Among those business owners who do not have a succession plan, the majority (60 per cent) indicated that it is too early to plan (Figure 9). However, professional advisors indicate that it is never too early to start planning. The lack of adequate time to plan and execute succession is significant contributor to failed successions. The perception that succession can occur over a relatively short period of time is a significant barrier to overcome.

Figure 9:  
Why SMEs do not have Succession Plans  
(% respondents)



The lack of time on the part of small business owners (28 per cent) is another reason commonly cited for not planning. Small businesses operate in a very different environment than

their larger counterparts. Most owners are actively involved in all aspects of the business, making it difficult to dedicate significant time and attention towards planning for succession. In such cases, seeking professional advice may be the most appropriate course of action. However, 17 per cent of SME owners cite the lack of such assistance for not having a succession plan. Nonetheless, the largest barrier to successful small business succession is the perception that planning can wait.

### Barriers For Current Owners

According to current owners, the number one barrier to succession planning and execution (46 per cent) is the financing of their successors (Figure 10). Finding a suitable leader or buyer comes in a close second with 42 per cent of owners citing it as a barrier. Those businesses with at least one family member employed, however, are less likely to cite finding a successor as a barrier relative to those who do not employ family (35.1 vs. 57.9 per cent respectively). Among the “soft” issues, 39 per cent of owners indicated that the dependence of the business on their active involvement is an obstacle to succession.

Figure 10:  
Barriers to Succession: Current Owners  
(% respondents)



Although owners are often advised to seek professional assistance, 12 per cent identified the availability of cost-effective planning and professional advice as a barrier. This gap between service providers and business owners may be a primary cause to other barriers, which include the formal valuation of the business (32 per cent). The valuation of the business can also result from the dependence on the business owner's involvement, which accounts for "goodwill". Conflict among family members was ranked relatively low as a barrier and significantly differs in family and non-family businesses. Among family businesses 17 per cent of their owners cited conflict with family as a barrier; this compares to 4.3 per cent for non-family businesses.

Although the primary barriers identified by current SME owners are relate very little with the "soft" issues considerable care should be exerted in analyzing the above. As indicated, those SME owners who are planning for succession have placed relatively small importance on dealing with these "soft" issues in advance (transfer timeline, a family or successor dispute resolution process, a successor selection process, etc.). These issues easily become barriers to effective succession. As such, similar to those who do not have a succession plan, awareness is another key barrier—awareness that planning for "soft" issues is as important, if not more so than technical ones.

### **Barriers For Successors**

The most commonly identified barrier to succession, according to recent successors (44 per cent), is the financing of the purchase or transfer (Figure 11). Only 29 per cent of successors obtained business loans from any financial institution or bank; twenty-one per cent obtained personal loans from lenders (Figure 12). These figures are slightly higher from the expected sources of financing identified by current owners. Of greater contrast, however, is that half of successors actually invested their own personal equity to purchase their businesses. Nonetheless,

approximately 30 per cent still obtained financing from the previous owner and the majority, as expected, did not obtain funding from venture capital, government sponsored programs, or the Business Development Bank of Canada.

Figure 11  
 Barriers to Succession: Successors  
 (% respondents)

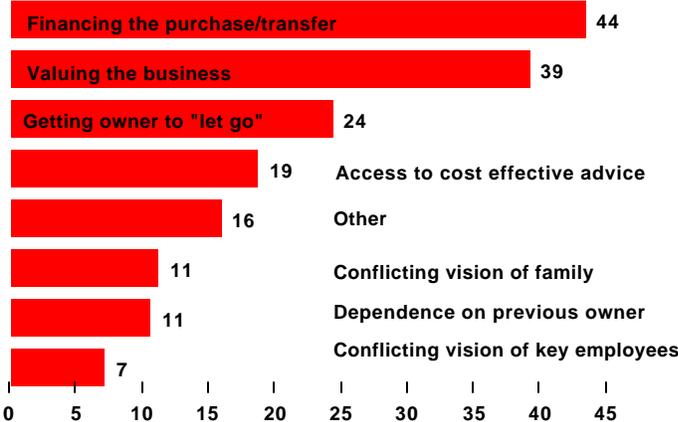
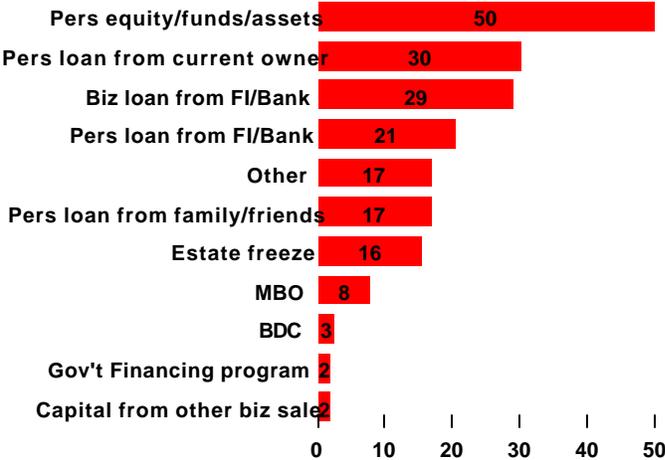


Figure 12:  
 Actual Sources of Financing for Successors  
 (% respondents)



Next to successor financing, the valuation of the business, according to successors, was a significant barrier (39 per cent). The difficulty in valuing a business is in itself a barrier to

obtaining adequate financing and in assessing future profitability. Nineteen per cent of recent SME successors indicated that this lack of professional advice was a significant barrier to their succession. Getting the previous owner to “let go” was cited by 24 per cent of successors as a barrier to their succession. Of those businesses where the previous owner remained actively involved after succession, 43 per cent, according to their successors, stayed on due to a personal sense of attachment. This barrier is the most significant “soft” issue identified by successors, relative to other issues such as family conflict.

### **RESEARCH GAPS**

There are four major research gaps in the current literature pertaining to succession planning. The first is a mapping of what motivates business owners to plan ahead of time for succession. The second is an analysis of the net overall impact of failed business succession in the Canadian economy. The third research gap is the role of government and the financial community in promoting and facilitating business succession in Canada. Lastly, there is remarkably little research on the perspective of future successors of businesses.

#### **Motivation to Planning**

As noted by many surveys, business owners in general are not planning for the succession of their businesses. There are many reasons why this may be the case: the psychological issues surrounding the thought of “letting-go”, the entrepreneurial characteristics of business owners as well as small business, or family related issues and tensions just to name a few.

Nevertheless, business owners should plan well in advance. What factors motivate them to plan, however, is a topic that has not been addressed. Flooding business owners with

succession related material, as has undoubtedly been done by professional service providers in the past, will yield little success if particular attention to the motivating factors is not addressed.

To promote effectively the issue to businesses and obtain the interest and the participation of other stakeholders, substantial research on the factors that motivate entrepreneurs to plan for succession is required.

### **Economic Impact of Failed Succession**

The economy as whole is a major stakeholder with respect to the successful transfer of businesses. Given the current demographics of business owners, a high failure rate of their businesses, post-succession, will exert great impact on employment, economic output, and business formation in the future.

Nevertheless, there exists very little research on the total economic impact of succession failure. Those who have addressed the consequences do so in a simplistic and myopic fashion. One cannot simply observe the loss of employment and business income that is lost. Rather, at the expense of using technical jargon, a general equilibrium approach is required. That is, evaluating the “net economic effect” on employment and income, as failed businesses also yield employment and business opportunities elsewhere.

The difficulty of performing such an analysis, however, is likely the cause of the research gap. Nevertheless, an attempt to measure net economic effect of failed successions will greatly promote the significance and importance of the issue.

### **Role of Governments and the Financial Community**

Given the complexities of succession planning, the large role of small businesses in the economy and the impacts of succession failure, there is a need to investigate what role

governments can play in facilitating succession planning. A significant role, not just by governments, but also by all stakeholders alike, is to promote the issue of planning in advance.

In addition, access to timely, useful information, special funding programs and tools should be explored. Whether governments are involved or not, financial institutions have a critical interest in fostering smooth business transitions. Failure of transitions may result in loan losses as well as lost business customers. Alternatively, those institutions that have traditionally distanced themselves from financing business successions may profit from better planning on the part of owners and the greater success rates of the transitions. The Baby Boomer *Owner* is currently an un-tapped market.

How governments and financial institutions can effectively promote succession planning, provide information and efficiently assist in transfer funding remains a research gap in Canada. Such research on initiatives in other countries and their effectiveness would be a good start.

### **Views of Successors and Potential Successors**

When referring to succession planning, there is a tendency to focus on the issues relevant to the business owner. However, given the structure of most business successions and the dependence of the current owner on the success of the business after succession, research on the issues faced by successors is pivotal. Nevertheless, little work has occurred in this domain apart from the study by Fiedgener (1996), who looked at the views of successors after the transition.

As noted above, a large issue faced by successors is the financing of the business acquisition. Sources of funding should be explored as well as the options available through private financial institutions.

## CONCLUSION

The message, it would seem, is relatively clear. Business owners are not planning, for the most part, for the future—and this is of no real surprise. Small businesses and entrepreneurs are unique in that their very nature serves as the ultimate barrier to succession planning. Nonetheless, succession planning must occur well in advance.

The main finding of this literature review is that the key issues related to succession planning are not the technical ones, such as tax, insurance, estate, and specific legislation. These are complicated issues that are all involved in a complete and effective succession plan. However, they are merely the tools required to achieve the goals and objectives of the business owner, his or her family, and successor(s). These goals and objectives are sorted, discussed, and shared in the steps preceding the actual succession plan. For the most part, business owners are not sharing a common vision for the business with all stakeholders. They are not sorting through the many “soft-issues” which are laid out in a complete strategic plan. As result, even those businesses with a succession plan seldom succeed because the soft issues were not addressed in advance.

Now the question remains: Where do we go from here? As expressed in the previous section there are four major research gaps. First, what factors motivate business owners to plan ahead? The key, it would seem, rests with the entrepreneurial characteristics of business owners. Second, what is the true economic impact of business succession failure? Such a study would greatly influence efforts by governments and financial institutions in addressing the issue. Third, what is the role of governments and financial institutions? Finally, what is the perspective of the successors of businesses?

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<sup>i</sup> Statistics Canada, *Labour Force Survey*, November 2000

<sup>ii</sup> Statistics Canada, *Labour Force Survey*, November 2000

<sup>iii</sup> See Bowman-Upton (1999)

<sup>iv</sup> “Keeping it in the Family: SME Family Business Succession,” European Federation of Accountants , 2002a.

**AN EXPLORATION OF FRANCHISING STRATEGY:  
INSIGHTS FROM NEW ZEALAND'S REAL ESTATE AGENCY SECTOR**

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**Abstract**

Business format franchising in the real estate agency sector (real estate brokerage industry) in New Zealand is a recent phenomenon. Beginning in the early 1990s, it has taken firm hold. This paper reports on an ongoing study, initially focusing on the franchisor perspective. It identifies elements for franchise growth and competitive advantage in the industry. These include market share; direct office ownership; novel notions of acculturation and parallelism and focus, as well as brand affiliation and internationalisation. These issues are discussed in the paper. The paper delineates progression through stages based on the tentative findings of New Zealand's real

estate franchises. Reporting on the internationalisation stage of growth includes mention of market penetration into emerging regional markets. Future phases of the study are detailed and new perspectives and issues signalled for future research.

## **INTRODUCTION**

In the real estate agency business (real estate brokerage industry) franchising, or more accurately, business format franchising, is becoming increasingly important. This is in line with the overall world-wide trend in the growth of franchising. Franchised businesses generate jobs for more than 18 million Americans or 8% of the private sector workforce (International Franchise Association [IFA] Report 2004). The latest franchising figures in New Zealand (NZ) indicate involvement by 5% or 40,195 of the private sector workforce (Lord, n.d). As a collaborative business alliance, franchising is an important entrepreneurial tool. It offers both a growth path for the franchisor and a small business opportunity, with apparent less risk for the franchisee (Knight, 1984, 1986; Kaufmann and Stanworth, 1995).

In NZ the advent of modern business format franchising is a relatively recent phenomenon which commenced in the early 1980s. Despite this late start, NZ now has the highest number of franchise systems per capita in the world. Franchising in the real estate agency sector in NZ is even more recent, having its beginnings in the late 1980's. Following a period of strong growth in the property market, there are now approximately 572 franchisee businesses accounting for around 29% of all real estate agency businesses.<sup>1</sup>

This paper aims to explore the reasons why franchising has been successful as a growth mechanism and source of competitive advantage for real estate organisations and to uncover some industry elements that affect its growth and operationalisation. It reports on an ongoing NZ study of the sector, with specific reference to the franchisor perspective. In examining franchisor motivations and strategies, the discussion centres on the application of extant theoretical arguments to the NZ context. Two novel notions of acculturation and parallelism are also hypothesized. These ideas are dealt with in dedicated sections of the paper to follow. The paper poses the question as to whether franchising growth follows distinct stages. Limitations of a stages approach are similarly highlighted. The paper concludes with an outline of the next phases of the study and signals new areas of interest for the future.

## **FRANCHISING IN THE NEW ZEALAND REAL ESTATE AGENCY INDUSTRY: BACKGROUND**

Real estate agency in New Zealand has traditionally been a small independent business often family owned and operated. Over the last twenty years there has been a growth of network groupings including franchising and now, in the 21<sup>st</sup> century these types of inter-organisational relationships and especially franchising are prominent in the sector. Network organisations like The Professionals Real Estate Group and First National are technically not franchises but co-operate or network under a recognised brand and build joint marketing systems. Regionally distributed offices are independently owned. If this network or ‘umbrella’ group is added to the franchise category in NZ, as is done in Australia by the Bureau of Statistics, there are effectively around 12 real estate franchise groups in NZ.

Most real estate franchises began with a single office and then developed a group of company owned units with employees as branch managers. Such a branch growth option was usually regionally concentrated. The development of franchise organisations became a further growth strategy for some of these companies. Thus for instance Barfoot and Thompson Ltd, the leading real estate agency in the Auckland region, has remained a family owned business with a branch network. This business currently retains an Auckland regional emphasis in line with family origins and the company's area of greatest brand awareness. By contrast, the Harcourts Group reached what appeared to be a critical mass of branches in its Wellington birthplace, but then chose franchising as a method of expanding its operations nationwide. Now the Group has moved beyond a purely NZ focus with the addition of franchisees and a full international corporate support structure in Australia, Indonesia and the Pacific Island region. The strategy for growth was essentially to divest the branch network by offering opportunity for suitably qualified<sup>2</sup> branch managers to convert to independently owned and operated franchises. Thus began a process of rationalisation with branch mergers and takeovers by franchisee operators, followed by new growth through a process of 'greenfielding'. The latter process involved the promotion of the brand and the franchisee concept to existing independent agencies or other group agencies. Greenfielding has become a standard mode of expansion for most franchisors and is applied in new geographic areas targeted for expansion.

## **ASPECTS OF FRANCHISING IN THE REAL ESTATE AGENCY INDUSTRY**

Franchising in the real estate agency industry can be advantageous for firms as well as consumers. Competitive advantage of real estate firms is enhanced through the franchise process of growing a large network of independently owned real estate offices in geographically diverse locations. The highly competitive nature of the industry, presents owners of small independent firms with many pressures. Real estate services are becoming increasingly specialised and delivered in differing, sophisticated modes. Advances in technology that allow industry participants to market property and company services, refer clients and instantly disseminate information via the Internet, are blurring national and international market boundaries. Up to date market information and analysis is an essential part of everyday real estate work and access to this material can present the independent real estate office owner with time consuming extra work. Lack of knowledge or ability in these areas can lead to business failure or at least only allow a business to achieve marginal profitability. In order to maintain competitive advantage and 'reinvent' themselves real estate businesses must develop a sophisticated web presence (Hamilton and Selen 2002: 2). Where there is a franchisor to drive technological advances, individual business owners will be less constrained by the need to gather the complex skills needed to adequately fulfil this challenge and more able to focus on core business competencies and profit generation.

Real estate franchise systems comprise a franchisor corporate structure that provides educational and training assistance, business development, personal development and all operational manuals, including office practice, sales and listing, management and motivational manuals.

Furthermore franchisee owners are offered assistance with sales staff recruitment and retention and corporate re locations and inter-city referral networks. Individual business owner are given access to proven business systems and ongoing service team assistance from the franchisor. The franchise group corporate events management plus active promotion of company pride and culture creates an atmosphere where teamwork and co-operation prevail. It is difficult for independent real estate businesses to compete on this level.

From the consumer perspective, buyers and sellers of property usually enter the market infrequently and face increasing complexity at transaction time. The cost of information is high and they are faced with difficulties in sourcing an appropriate property, understanding local market conditions, quantifying market value, ensuring resource compliance and structural soundness of the property, as well as negotiating a complex legal contract. In such circumstances the professional advice and assistance provided by real estate agents can be useful. Information asymmetry results in real estate agents often featuring as the 'gatekeepers' of critical market information. Additionally consumers may have difficulty evaluating the quality of information or the services offered by a multitude of different real estate agents. Given these circumstances, consumers may find the assurance of a franchise brand name particularly beneficial.

At a generalised level, theoretical support for franchising rests on two classic positions: the agency view and the resource scarcity view. The agency view suggests that franchising overcomes the need to closely monitor the work and standards of a chain of dispersed business units and that lowered monitoring costs are seen as an antecedent to franchising across industries. (see e.g. Rubin 1978). Although franchising does not totally remove the moral hazard

dilemma, it can be controlled by the franchise contract. Since franchisees invest their own capital and are residual claimants or owners of the business with the ability to profit from the reversionary sale, their business effort is better assured. The franchisor benefits as well and overall costs associated with this benefit are lower than those where corporate employees are used (Hoy & Stanworth, 2003). Jensen and Meckling (1976) point out that the moral hazard dilemma of shirking and prerequisite taking is more likely to occur amongst company owned units as managers have less to lose. In the real estate sector, however, there has been some disagreement with this view. It is claimed that franchising has a negative effect on efficiency (Anderson & Fok 1998). Although franchised real estate firms were found to be more efficient in allocating resources, non franchised firms achieved greater scale and technical efficiency. Conversely, Lewis and Anderson (1999) found that in competitive market conditions, franchised businesses are substantially more cost efficient than their independent counterparts.

The agency approach considers the possibility that the selection of non-owner managers could be sub optimal in terms of managerial talent and business acumen. Where there are problems between the parties, delays in contract renegotiation could impair profitability. Franchising serves to ease these possible problems because as the franchisee benefits from the residual profits of their businesses, they are provided with considerable incentive to work hard (Norton, 1988; Rubin, 1978). When the franchisee risks losing invested capital, he/she may be less cavalier in taking on the role in the first place, thus the quality of the management will be higher. Hold-up problems are reduced because the franchisee risks losing his/her contract for reasons of non compliance and thus risks losing a major investment. In this way franchising enables better alignment of the needs of both parties, even to the point where the co-dependent relationship has

been likened metaphorically to a symbiotic alliance (Dana et al., 2001). The profit stream anticipated by the franchisor depends on the performance of the franchisee and vice versa.

Other researchers examining agency theory have sought an answer to the effect of monitoring costs where there is wide geographical spread into unfamiliar markets (Carney & Gedajloviv, 1991) and where evaluation of local decision making presents a problem for the franchisor (Minkler, 1990). Both situations have relevance in the real estate context as systems spread domestically and then move to internationalise.

Hoy and Stanworth discuss 'post contractual opportunistic behaviour' (2003: 66). On the one hand franchisees are assumed to be subject to a risk that franchisors will not adequately promote the brand name. On the other hand, franchisors run the risk of franchisees cutting corners or letting the name down in some way. If potential franchisees perceive significant opportunism risk, it may be difficult to recruit them into the system. In real estate, franchisor risk is controlled by the quality support and training systems and franchisee risk is controlled by recruiting franchisee owners who have been acculturated. Similarly brand affiliation mitigates risk. (see later sections).

The resource scarcity view maintains franchising overcomes resource constraints to growth. These include human, financial and organisational capital. The latter may comprise management talent or trained management. Accessing resources, however, may be an antecedent to franchising. Dant et al. (1992) suggest that success of an organisation was dependent on human, intellectual, informational and financial resources but that these were hard to gather at an early

stage. Franchising therefore provides a ready and relatively quick means of obtaining these critical resources through the franchisee. Financial capital is required for a successful launch campaign and for underpinning start up costs and providing working capital. The franchise organisation also requires knowledge of specific desirable locations for the franchise businesses to be established, as well as access to available labour. Finally the franchisor needs site managers able to implement the proven business format in separate geographic locations. Well chosen franchisees fulfil these requirements by being added to the chain. In the real estate sector franchisees provide specialist, local knowledge to assist customers and enhance system effectiveness. In this way franchisee businesses are the local arm to the global brand – parallel and co-dependent businesses, as discussed later.

The resource scarcity model finds favour in some empirical evidence showing that immature franchisors (those less than 10 years old) are affected by commercial credit market conditions in establishing franchisee units (Martin and Justis 1993). Combs and Ketchen (1999) illustrate that financially strong franchise organisations were more likely to have company owned units. Thus the argument that financial resource scarcity underpins the move to franchise is contentious. Factors related to age, system size and the desire to grow rapidly found no support in the meta-analysis of Combs and Ketchen (2003). Furthermore, Hoy and Stanworth (2003) largely refute capital resources scarcity and in their emphasis on agency issues support the earlier work of Rubin (1978). The conclusion negating the lack of capital resources as an antecedent to franchising concurs with information gleaned from the real estate franchisors in this study.

Brickley and Dark (1987) broached the issue of informational resource scarcity amongst franchisors and found that where there was uncertainty about locations, there were more likely to be franchisee units established. In the real estate industry this can be seen when franchisors expanding nationally and internationally, take over outside agency groups. In this way local knowledge and locally trusted companies are added to the system. It has also been suggested that franchising enables managerial growth (Thompson, 1994; Shane, 1996). In real estate, there is a steady stream of entrepreneurial people who are ready to become managers and potential franchisees once they are professionally qualified. This is part of what we term the acculturation process as discussed later in the paper.

## **RESEARCH APPROACH**

The exploratory study reported in this paper draws on face-to-face in-depth interviews with key decision makers in six major NZ real estate franchise groups. These interviews were conducted over a period between November 2004 and early 2005, using a semi structured interview guide. The franchise organisations chosen had high value brand recognition yet had diverse origins. Three were organisations that originated in NZ, one in Australia and another in the USA. Eight people were interviewed from these six organisations, with three coming from a single organisation as it was the biggest franchise of NZ origin. This franchise is also intended to be the subject of a separate case study in the ongoing research.

The interviewees were encouraged to give their personal stories and experiences. Three of the interviewees had been with their organisations from the time the decision to follow the franchise

pathway was made and the others were also acquainted with the initial franchising or internationalisation decision process and were now in controlling managerial or ownership positions. All the interviews lasted for between 45 and 60 minutes. Each conversation was taped, transcribed and then analysed to reveal the main themes, using conversation analysis techniques (e.g. ten Have, 1998; Silverman, 2001).

## **RESEARCH FINDINGS AND DISCUSSION**

Initial analysis of the data collected in the interviews revealed broad elements of franchising strategy in the real estate agency industry. These issues related to market share; ownership; acculturation; focus and parallelism and brand affiliation and internalisation. They were considered to deliver competitive advantage in the highly competitive real estate industry sector and were often aligned to various stages of growth as discussed in the following sub-sections of the paper.

### **Market Share**

Franchising was seen as a way to increase market share because it enabled the growth of a widespread network of businesses, at first nationally and then outside the national borders. Once the brand was sufficiently recognisable, the developed business format could be cloned in independently owned agencies. One franchisor organisation stressed that the move to franchise was a natural development resulting from ownership changes in early years. The intention was to develop into a large single brand company different from any existing real estate operation in NZ at the time. Franchising allowed company managers to take ownership and develop their own

entrepreneurial ventures under the company brand. Financial backing was strong. Loyal, capable and experienced people were in place to take over franchised offices. The initial move was made possible by leveraging established brand awareness, developed through trading since 1888.

Consequently franchisees felt confident about ownership. The pre condition to franchising was company maturity and an established track record. Later at the internationalisation growth stage, the same brand awareness enabled further system expansion. The trust developed amongst consumers, plus quality systems ensured other groups were eager to join the system.

Strong links, both business and training related, built with individual company managers proved invaluable and have become the core values of this franchisor:

*... I suppose in our case because we've had such a large company owned operation we had very strong links with our business owners and I think we had a strong training ethic and those ethics those basic values have determined the type of company we are today.*

The aim of another franchise organisation was to be the biggest real estate franchise group in the Asian Pacific region. This meant a need to focus on rapid gains in market share with franchising a means to that end:

*...other reasons for expansion and looking into Asian markets were to see where these markets cross over with Australia, NZ and Indonesia. In the property market its only feasible for an agency to achieve 25% market share...there are no business models higher than that – so we work towards market share rather than actual office numbers...*

A director expressed a belief that quality was based on market share:

*...each office has a geographical area that is monitored for market share purposes...there are benchmarks for all offices, measured in the number of salespeople to cover the area. The...system as we call it is essentially...we have the number of salespeople to cover the area, the number of sales appropriate to the market place...we ask that each franchisee has that requirement in place...*

Reaching a level of administrative efficiency enabled geographical expansion across national boundaries. It was argued that a larger market share would also provide investment security for the franchisees and enable faster system expansion. As one director explained, in NZ, for example, there is still about 40% growth capacity and towards that end, during 2004 two new real estate offices per week joined the group. On the international scene, capacity was thought to be unlimited. Two franchisors had already made inroads into Indonesia. The emerging Chinese market has also been pinpointed as presenting vast potential for franchising growth.

## **Ownership**

Franchisee ownership was linked to resource access and mitigating moral hazard. One of the franchisors placed strong emphasis on growing and developing company people who had entrepreneurial abilities. Direct office ownership was perceived as offering extra incentive to a pool of managerial talent and was an instrument for ongoing growth. As one interviewee phrased it:

*... a share of the pie (creating independently owned offices) would increase the organisation greatly.*

He expressed an individual viewpoint in support of agency theory by relating:

*I think any company owned business when you've got a large number of outlets, the outlets are never going to do as well with paid employees running them as they are when the people running them actually having a share in the business, and their name on the bank account. My great, great granddad was a butcher and he always told my dad if you want to run a successful butcher shop you need to have the owner behind the counter because otherwise a kilo mince weighs more. So you have to have the person who is responsible for paying the bills running it. And equally if you don't give the people in your business the chance to expand and have ownership of what they're doing they will leave and go somewhere that they can.*

Overall it was clear from the interview data that the directors of the franchise groups saw ownership as a pull to franchising in real estate, rather than a push response to negative issues associated with moral hazard described in past research across industries.

Contrasting motivations for franchising emerged. For some interviewees franchising was a means of empowering people and prioritising individual growth. For others, a franchised empire was seen more as a way of ensuring ongoing company and market share expansion. In the latter case, the move to franchise was clearly profit driven. Franchising was regarded as being similar to a company public offering:

*...we looked at franchising a little bit like putting the company up for public offering without actually doing that per se ... giving people a vested interest in a name for their business – like a public offering but to people who are industry based...*

Creating a lifestyle was also seen as part of the ownership advantage, along with the challenge of running a successful business and creating an asset. Monitoring issues were generally not foremost in the motives of the franchisors because established systems had been designed to ensure quality. These involved groups of business advisors, educational and motivational programmes and regular monthly audits of business activities.

### **Acculturation**

Acculturation is central to the real estate franchise industry. It involves the process of adopting and adapting - assimilation into the culture of first the industry and then that of the franchisor. Individual franchisee business owners are usually drawn from industry ranks where they have operated as independently contracted salespeople and through undertaking further education, have attained Associate status. After experiencing sales contract work, and becoming acculturated within the industry and firm, suitable, potential franchisees are ready to operate their own franchisee businesses. They might also be brought into the system by conversion methods including mergers and takeovers ranging from greenfielding to group buyouts. With greenfielding, when acculturation is complete, the system brand is fully accepted into the new locality.

The franchised form is ready made to allow real estate franchisees who are experienced in the business to make substantial contribution to the franchise system. It is this supply of franchisees produced in the real estate agency business that ensures the franchise systems benefit from an ongoing flow of new blood. As a result of acculturation, the franchisor is confident in giving

franchisees considerable leeway in business operation and the entire system stands to benefit from the development of innovative practices that may result. The franchisors have mechanisms in place, mainly in the form of targeted meetings and discussion groups, to capture any innovative developments that might increase the competitive advantage of the system.

In real estate, the franchisor constantly grows franchisees by encouraging further education and providing in house training courses. For example, one franchisor has a real estate academy which trains suitable people, who are part of the organisation, to become franchisees. A director commented:

*(We have our training academy) ... to grow people into business ownership, that is a unique feature of franchising, growing to a degree that goes on. I think you need to grow your own people because if you don't they just leave, that's why we franchise and they become part of the culture, they are part of the culture. It is a lot easier having someone who's been with (our company) for some time in a variety of roles, you know a sales role, becoming a franchisee because they already are part of the culture. They know what (our company) stands for. If you get someone coming in from another brand it can be quite hard for them sometimes.*

Another organisation had a similar future leaders group. These people either start new offices or buy existing franchises where the owner is retiring or selling. Such internal acculturation means that real estate franchise systems have a constant source of new entrepreneurs ready and waiting to enter the system as business owners. Furthermore where the franchisor offers prospects like this salespeople have a clear career path to pursue if they are interested.

A further arm of acculturation reaches into the wider real estate environment outside the organisation when the franchisors seek to acquire or merge with other real estate groups. Here existing real estate industry companies, already part of the industry culture, are 'acculturated' into the new parent franchise system. The real estate acculturation process encourages the growth of franchising as a business form by providing an assured supply of qualified franchisee owners. The franchisee selection process is an integral part of this growth. A director explained:

*We will franchise to talented people who have one or two years experience in selling, the system is strong enough to support them through the transition to management, ownership and expansion, so we are always on the lookout for talent. We just focus on the Jim Collins idea of getting the right people on the bus and the wrong people off. So we are always looking for the right people to get on our bus.*

### **Parallelism and Focus**

At the heart of franchising lies an interlinked relationship, one that fundamentally changes the character of traditional small and medium enterprise (SME) ownership. Individuals involved in interlinked business forms, are partners in an entity bigger than 'self'. The franchisee business owner is a cog in a larger machine and an integral part of an organisation built on the concept of co-dependency. There is an inherent ability to learn and develop by drawing on and adding to the skills and competencies of others. Co-dependency, however does not dilute the separate identity of each of the parallel entrepreneurial ventures. We term this characteristic parallelism.

Parallelism describes two separate business identities that exist side by side in real estate franchise groups. The franchisor business endorses the service quality of a series of independently owned, locally bound franchisees, enabling them to tap into a client base by positioning themselves in the local market more quickly than they could do single-handedly. The franchisee endorses the brand. Thus two entrepreneurial ventures exist parallel to each other, operating in a co-dependent manner. For example a visible expression of this parallelism might be the retention of a franchisees original name but with the franchisor brand name added to it. Another illustration is with the international operations of real estate franchise groups where two brands are recognisable. Franchised businesses are able 'to draw on the strength of a globally recognised brand name, but are also faced with the challenge of managing two brands: the embraced global brand and the local one' (Yakhlef and Maubourguet, 2004: 193). Real estate franchises allow parallel business venturing, where the sum of the whole is greater than the parts.

'Focus' refers to the fact that the franchise relationship gives each party – franchisor and franchisee - the opportunity to concentrate on core individual competencies, thus each becomes expert in a separate set of skills. There is a clear belief held by all interviewees that the system success and growth is based on a need to divide responsibilities. The franchisors in the sample are focused on creating strong, value added franchise business systems and establishing the trade mark. They are in the business of franchising, not real estate. Both regard the quality of the system as paramount for growth because only a system of exceptional quality, that can deliver tangible advantage to franchisees in the form of a strong brand and proven business system, will attract outside agencies and new franchisee owners (Litz and Stewart, 1998). The franchisor shares computer systems, added products like insurance and mortgage facilities, and large

databases with the franchisees. The franchisees seek to manage their business risk by aligning with a strong named service, leaving them able to focus on increasing the turnover of their businesses through dealings in a range of property services. One director felt that to have company owned and franchise businesses in the same group would create competition that would be unfair:

*... that company owned offices could be seen as unfair and we are not competing with our business owners – we are not in the real estate business, rather in the business of franchising.*

Although division of responsibilities is a feature of franchising in general, the degree of separation in the real estate industry is particularly defined. Furthermore real estate franchisors rarely have any company owned franchise offices, for any length of time. The ability to focus on core activities is fundamental to real estate franchise systems because focus builds performance; assures quality; builds business assets; builds brand; ensures renewal through attracting others to join the group and enables inter firm learning to occur. Real estate companies can therefore achieve competitive advantage through creating a situation that allows for the parallel growth of businesses:

*We just keep working on the system that will develop our people and to do that we have to give them the best tools to do the job. So it just all goes round and round and round.*

### **Stages of Growth?**

Franchising strategies might be viewed within a stages of growth framework. We however, signal the caveat that application of a stages of growth theory can be considered too deterministic

and that an imperatives viewpoint may be more appropriate (Miller 1987). Miller's argument that an organisation's growth is determined by four basic imperatives found some resonance in our study. Thus the need to adapt to a changing environment has a powerful influence on strategy. We would argue that since the real estate industry is characterised by intense competition and uncertainty, small firms are particularly susceptible to the environmental imperative. Belonging to a franchise group can build critical mass, resources and stability. The environment imperative is a key influence during the early growth phase according to Miller (1987). In later growth and maturity stages, structural imperatives become important. Leadership and strategy are also important influences depending on the life cycle of an organisation.

While stressing that a standard sequencing of stages is not a prerequisite and stage skipping is a possibility, a stages approach does have validity when coupled with the imperatives perspective. Franchise systems in our study reach a pre condition to franchising stage where the franchisor expanded within a defined geographic region through several company owned offices to reach a point when it was believed franchising was the preferred strategy for continued growth. A transition stage follows when the company divests its offices to franchisee owners. The next stage involves further domestic market penetration through a process of acculturation. This involves bringing other real estate firms into the group as well as training future franchise business owners identified from within the company ranks. Finally the internationalisation stage is reached. For NZ companies, the move to internationalise meant establishing a corporate presence outside NZ, in the first instance in Australia – akin to Australian companies making their first move to New Zealand, and then replicating the business format in more diverse cultural settings such as Indonesia and China.

Oxenfeldt and Kelly (1968/69) argue that the value of franchising to franchisors is dynamic and changes over time. They consider franchising most advantageous in the early growth stages when the demand to achieve economies of scale requires rapid expansion, and progresses to being useful at later stages for the purpose of exploiting marginal locations. After a critical mass was achieved the firm's focus would shift to maximisation of each unit's profitability. The parent firm would then move to purchase the franchisee company so that ultimately a mature franchise system would return to a majority of company owned units. There is, however, no evidence of this reversionary process in the sample studied.

There is evidence that real estate firms in NZ see franchising as a means of expansion outside the original geographic area and then eventually outside the domestic market. Nevertheless, where geographic spread is contained and family value retention important, as is the case with Auckland's major real estate group, Barfoot and Thompson, company owned units currently remain the preferred organisational form.

Internationalisation and brand affiliation as a mode of internationalisation is another facet of franchise operations. Our interviewees indicated that international expansion had already taken place or was firmly on the agenda for the future. In all cases this internationalisation process was conceived as a mature stage growth strategy. Nevertheless, although internationalisation is more likely to occur once there is consolidation and growth in the domestic market, the stage of business growth when internationalisation occurs is not universal. Brand affiliation means that the offerings of a local business take on the global features associated with the global brand. The

global brand in effect vouches for the locally bound business, thereby providing it with recognition and reach (Yakhlef and Maubourguet, 2004). So it is in the interests of both parties to work efficiently and thereby to minimise risk.

## **CONCLUSION AND FUTURE RESEARCH**

This paper presents exploratory research on franchising from the perspective of franchisors in the NZ real estate agency sector. It is the first lens of focus on franchising in a specific industry context. Past research in franchising has been across industry sectors and largely quantitative in nature. In the current phase of the study, several elements emerged as important strands in the discussion. Of particular interest are new notions of acculturation and parallelism.

An overall objective of the ongoing study is to obtain and interpret fine-grained information in order to mitigate the research gap on franchising in the sector. Future phases of the study will include the franchisee perspective, an exploration of the creation of mini-chains within franchise groups and the internationalisation experience. The notion of psychic distance could be examined in relation to this experience. In depth, individual case studies of the organisations, archival documents, intranet material and observation will also supplement the semi-structured interviews material in the initial phase.

New issues are earmarked as areas for fruitful future research. These include issues of reputation, for example the individual agent's reputational career versus the firm's reputation. The interface between perceptions and beliefs of real estate market participants and the value of

a good name of the franchisor is another connected future research area. These issues are yet to be explored in the real estate agency sector. Likewise, departures from standard agency modes, especially involving brokerage fees and sales person remuneration also pose future research challenges.

## ENDNOTES

1. Statistics gathered from The Real Estate Institute of New Zealand [Inc], *List of Licensed Real Estate Agents*, August, 2004. These totals represent all agency businesses that are currently trading under a franchise group name and are on the Institute's records.
2. Directors or franchisee owners of real estate businesses are required to be associate members of the Real Estate Institute of New Zealand (A.R.E.I.N.Z.). In Australia people who attain the required education level set down in state legislature can become principal officers and owners of a real estate business.

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# CONFLICT OF TAKING CREDIT: THE BUREAUCRATIC CREATION OF ENTREPRENEURS

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## ABSTRACT

This paper provides an ethnographic account of the conflict of taking credit between the groups of Venture Growth<sup>1</sup>, Inc. (VGI - incubator) staff and entrepreneurs, where VGI seeks to increase its power through community recognition and control of resources and entrepreneurs try to run their companies independently but rely on VGI for space, counseling, contacts and services. Charles Perrow's (1986) concept of goal displacement and Alvin W. Gouldner's (1960) concept of reciprocity are combined to understand the conflicting, yet symbiotic relationship between the two groups. Exchanges between VGI staff and entrepreneurs are governed by the norm of reciprocity. These exchanges promote a number of subgoals that are different from the official goals of the VGI incubator.

## INTRODUCTION

The nurturing of entrepreneurs by an incubator is a complex process that involves a conflicting interaction of individuals with different motivations. The incubation process seeks to increase chances of new venture survival by maintaining favorable controlled conditions. This paper explores a specific case of one incubator's relationship with its entrepreneurs. VGI was established as a facility that offers a broad range of services to emerging companies and has a clearly identifiable organizational structure. VGI mainly relies on governmental grants and private donations for its existence and therefore must write frequent and extensive reports to maintain its financing. This organization is an established structure with roles, habits and routines, whereas entrepreneurs embody the destruction of previously existing structures. The conflict that arises from these disparate structures is maintained at a sustainable level by a form of integration called reciprocity. The relationship between the incubator and its entrepreneurs is maintained since each receives something in exchange for their participation in the arrangement. Based on these exchanged benefits, reciprocity replaces authority as a governing mechanism in the organization. The entrepreneur companies receive low cost space and services, while VGI receives increased visibility (e.g., the best incubator award), increased access to resources and consequently increased power.

## CONCEPTUAL FRAMEWORK

### Reciprocity

Gouldner (1960) defined reciprocity as “a generalized moral norm, which defines certain actions and obligations as repayments for benefits received” (p. 171). Gouldner argued that we owe other people because of what they have previously done for us and that reciprocity processes “mobilize egoistic motivations and channel them into the maintenance of the social system” (p. 173). Gouldner also indicated the disruptive potentialities of power differences. Given significant power differences, egoistic motivations may seek to get benefits without returning them. The norm of reciprocity, however, generates motives for returning benefits even when power differences might invite exploitation, because “emergence of exploitative relations would undermine the social system and the very power arrangements which had made exploitation possible” (Gouldner, 1960, p. 174). The problem with this and other conceptualizations of reciprocity is that they assume cooperative behavior and solidarity among actors. I argue that these reciprocal relationships are rather characterized by the conflict and instability, because obligations for repayment of benefits received mobilize egoistic motivations.

### Goal Displacement

The conflict between the individual and system was explored by Argyris (1957). To the extent that the requirements of the individual and of the formal organization are not congruent, the individual will tend to feel frustration, conflict and feelings of failure. There are instances in the organizational life, however, where individuals are able to further their personal interest using formal organization. Perrow (1961, 1986) conceptualized this phenomenon as goal displacement and challenged a number of assumptions about goals in organizations in previous theoretical approaches. One assumption was that organizations are oriented toward a specific goal. Perrow (1986) argued for multiplicity of conflicting goals that force firms to develop organizational mechanisms to deal with conflict.

## LITERATURE REVIEW

Since their initial development, there has been great interest in both concepts and a number of further conceptualizations and applications have been developed. Attewell and Gerstein (1979) explained the failures of government policy on methadone treatment for heroin addiction by applying a concept of goal displacement to understand the practices of local agencies, which were administering the directives of federal agencies. The dependence on the external financing shifted the focus of methadone clinics from therapeutic aims and toward an increasing concern with the self-presentation in order to look good to funding and regulatory agencies.

Yan (1996) examined the norm of reciprocity in the system of gift exchange in a north China village. Yan observed several incidents of conflict in gift exchange behavior, but he explained them as cases of ‘breaking the rules’ (p. 214). Von Reden (1998) defined reciprocity as “a local concept of order, peace, and social cohesion”. She argued that the confrontation of reciprocity and commodity exchange in Menander’s plays was “a metaphorical confrontation of order and disorder, civic community and its corrosion” (p. 255). While reciprocity is characterized by the

indeterminacy of both timing and value of the return, making it an element of social cohesion, the commodity exchange sets an end to this indeterminacy.

## **RESEARCH METHODOLOGY**

Over the period of five months I used structured and unstructured in-depth interviews as well as observation to collect data for the ethnographic study of the local incubator. At certain points I was also a participant observer: I had to evaluate business plans and discuss them with VGI staff. There were two very distinctive groups of actors in the field site: VGI staff and entrepreneurs of tenant companies.

Venture Growth Inc. was established in 1983 as one of the programs for turnaround of the economically troubled Midwestern city. In the beginning it only had two employees and was operating as an 'incubator without walls', providing a number of activities of classical incubator. Today, it performs several activities, which can be grouped into four categories: technology transfer, building public awareness, entrepreneurial education and client assistance; and it is now affiliated with a local university.

## **INTERPRETATION**

### **Control of Resources and Information**

In the previous section I have given a short description of VGI, whereas in this and the following sections I will try to interpret the nature of the relationship between VGI and entrepreneurs of tenant companies. An incubator is an organization, where traditional governance mechanisms may apply only to a limited extent. Even though VGI assumes the controlling position in the incubator, it has to deal with a number of organizations, whose primary motivation is independence. VGI is able to maintain a managing role in the incubator primarily through control of financial resources. It has access to those who make donations and has control over the systems for fund raising. Through financial control, they are able to impose the rules on the entrepreneurs; rules like entrance criteria, rules of conduct, the tenancy, and graduation terms.

VGI itself, on the other hand, is quite independent and without constraints from inside or outside of the organization. The president of VGI reports to the board of trustees, which is active primarily through its Incubator Committee. This committee meets on a quarterly basis to discuss strategic questions of incubator's operations. VGI makes an effort to diminish the role of the board of trustees. Caricatures of board members on the way to VGI offices are grotesque representations of individual's distinctive features with intent to ridicule the authority that they symbolize. Increasingly, VGI has been able to find alternative funding sources beyond the range of the current board thus reducing board's power. Additionally, VGI seems to be efficient in controlling the information flows among the actors in the organization. Due to their limited role in the incubator, members of the board rely on VGI's quarterly reports for the information about tenant companies. Under such conditions "trustees are likely to find that their legal power becomes nominal" (Perrow, 1961, p. 858).

External control from state or federal departments is at best unthorough. VGI reports about its incubator activities to State Department of Development (SDOD) through quarterly status reports. Copies of the report summary are also sent to the State Committee, which supervises operations of similar incubators statewide, and to governor's advisor for technology. These institutions do not have standards by which they could evaluate work of different incubators. As one of the VGI directors described: "*SDOD does not differentiate among incubators and it doesn't matter if incubator xyz did much better than incubator abc, funding would still be the same*".

Thus there is sufficient means for power by VGI and sufficient interest in power. Entrepreneurs, on the other hand, can undermine this power by simply choosing not to enter or remain in the incubator. One of the entrepreneurs in Biotechnology Incubator claimed that "*the only thing that VGI is helpful for them is space, which is somewhat oriented to more technical companies*", however "*it is not hard to find space somewhere else*".

### **Making Favors**

The precariousness of the relationship between VGI and entrepreneurs raises the question about the forces, which ensure minimum of consensus among these two groups. As discussed earlier, the three forms of integration are reciprocity, exchange and redistribution. To a certain extent the relationship between VGI and tenant companies can be seen as exchange relationship, since VGI sells some of the services and rents the space to entrepreneurs. However, most of the services for incubator companies are free or subsidized. For example, business consulting services and the majority of office services are free of charge. Rent is 25 percent below the comparable market prices for the same area. These privileges are attractive enough for entrepreneurs to seek admission to the incubator.

The process of initiation of entrepreneurs into the organization sets the basis for reciprocal relationship between VGI staff and entrepreneurs. Although entrance criteria, like high-technology/biotechnology orientation, high growth potential, and incorporation in State, are predetermined, there is still a great deal of arbitrariness in this process. It is at VGI's discretion, which companies will it allow to enter the incubator (usually one out of ten companies that apply). Sometimes these companies are admitted even if they do not match the entrance criteria. Melanie, a corporate history writer, admits that "*her connections with the University helped her to get into the VGI even though her business is not high-tech or biotech*". Additionally, VGI allows some companies to make modifications to facility. For example, Stanheath Inc. was able to break the wall to get a connection between their offices. Special cases aside, cheap rental space and free services are benefits for which many companies are grateful and feel that they are "*very lucky to be in*".

The norm of reciprocity generates motives for returning benefits over time and, according to Gouldner, maintains the social system through egoistic motivations. Entrepreneurs return favors in various ways. They frequently act as guest speakers at VGI's seminars and courses. More importantly, entrepreneurs willingly (and sometimes unwillingly) participate in promotional activities organized by VGI, which are intended to advertise young companies, but also to justify and recognize VGI's role in the 'incubation' process. There are several ways in which VGI

promotes itself and tenant companies. The quarterly Magazine features incubator success stories with a broad reach among local business community. VGI organizes and places its name on the awards endorsing regional fastest growing firms. In its quarterly report to SDOD and State's governor, VGI provides significant tenant news (mostly success stories). It also includes news about the companies that have graduated from incubator years ago. Through these and other activities VGI builds its own reputation on the achievements of other companies regardless of its contribution to the success of these companies. Entrepreneurs receive low cost space and services, while VGI receives increased visibility, increased access to resources and consequently increased power.

A characteristic not previously observed or discussed by the theorists of reciprocity in multi-group arrangements is that each group will observe and evaluate relationships among all other groups in the social system. This is even truer when these entities are supposed to have qualitatively similar reciprocal relationship with another entity. VGI claims that it will provide support to all tenant companies, but several entrepreneurs complained that they didn't receive the assistance that other companies did because "*there is nothing to brag about*" their companies or because their "*business is not exactly in line with VGI's preferences*". Although this observation does not oppose the quid pro quo nature of the relations in the incubator, it counters Gouldner's assumption of system stabilizing function of time period and comparative indeterminacy under the norm of reciprocity. Instead, as I will discuss in the following section, reciprocal relationships are characterized by the conflict and instability.

## **Conflict**

Gouldner argued that the norm of reciprocity mobilizes egoistic motivations, and channels them into the maintenance of the social system. However, I believe that these egoistic motivations focus on the fairness of the reciprocal exchange and whenever there are perceived inequalities, there is a potential for tension and conflict. The conflict between VGI and entrepreneurs is latent, but still quite easily observable. There were only a few open confrontations that subjects in my study referenced to or I was able to observe, but especially entrepreneurs were very eager to point out the deficiencies in the incubator. One source of conflict is that incubator companies do not get as much from VGI as they expect or as much as they are led to believe when they enter the incubator. Specifically, entrepreneurs complained about a lack of quality advice, a lack of networking, and a lack of financial sources from VGI. Several accounts from entrepreneurs make the point:

*"People (VGI) are nice but they do not take time to breathe with the new entrepreneur, to really know our problems and help us with them. Lack of business advice can be explained by the lack of hands-on experience. There are some people in VGI that were closely involved with small businesses but majority has worked for non-profits."* (Ruben, an entrepreneur)

*"Eight months ago I could have applied for an SBA loan, but I didn't know about it. So I was late. I lack the time to search for such information but the problem is that I can not get such information from VGI."* (Joe, tenant)

*"VGI organized this short seminar on financing. On that seminar they told me that it is very hard to get money from banks or angels, so my first source of financing should be my*

*rich relatives. I drove downtown to listen to somebody telling me that I should borrow money from my aunt or grandpa.” (Harry, former tenant)*

Another, more profound, conflict is the one of taking credit for the success of young companies. Entrepreneurs believe that they are solely responsible for the progress of their companies. They try to maintain their independence and hide details about their operations. Entrepreneurs fear the disclosure of sensitive data because of their vulnerability to competitor’s attacks. VGI, on the other hand, relies on governmental grants and private donations for its existence and therefore must write frequent and extensive reports to maintain this financing. For this reason VGI collects detailed data about the development and growth of incubator companies. The mandatory reporting of information by tenant companies is included as a stipulation in the Memo of Understanding. The information is then used for various promotional activities and publications in which VGI praises its own role in the incubation process. Comments from entrepreneurs are a good indication of this situation:

*“VGI likes to collect information for their newsletter and different reports. We provide them as little as possible. They want to know a little too much, so that they can claim credit for what our company does. I don’t really like this because it seems that VGI wants to feel that they have in a significant way contributed to the success of our company. They think of us, the companies, as being their children.” (Dave, an entrepreneur)*

*“If you succeed it is OK, if you fail so be it. They (VGI) should be more active: if you fail, we fail also.” (Mukul, a tenant)*

Another controversial issue in the incubator is the long-term success fee. It is designed to bring additional revenues to the incubator, but its introduction and implementation are frequently being disputed. The fee is initially mentioned in the Memorandum of Understanding, which is to be signed by an entrepreneur upon moving in the incubator. Memo only specifies a time period in which a long-term success fee agreement should be negotiated. A closer look at the fee formula shows that a company leaving the incubator would have to pay for the most, if not all, of the difference between the market and incubator rent, and for supposedly free services of consulting, conference rooms, and furniture for the whole ‘incubation’ period. VGI effectively changes ex post the nature of its relationship with entrepreneurs from reciprocal to exchange. The fact that companies have to negotiate to which extent the services and rent will be free of charge increases the visibility of VGI’s ‘favor’. Entrepreneurs view that these benefits are comparatively much smaller than what they give to VGI and therefore are very eager to voice their dissatisfaction with the incubator personnel and services.

VGI downplays the conflict. By the words of Linda, one of the incubator’s directors, VGI is a “benevolent landlord” and that “tenants also have to show some effort”. Clark, a project manager in VGI, described the relationship:

*“The prevailing philosophy in VGI is that companies (tenants) should come and ask VGI personnel for help. This is supposed to help them become independent. Some companies come and ask for help and others don’t. I don’t know if this approach is good. I am not sure if tenants know what are all the services that VGI offers.”*

This stands in a stark contrast to claims in the Annual Report and other publications where VGI is presented as a major contributor to the success of incubator companies. Conflict is maintained

at the sustainable level, because of the stipulation that companies have to leave the incubator in 24-48 months. Even though this may be an appropriate 'incubation' period, it also has a rather subtle function: it gives VGI the power to dismiss any of the companies that would complain too much and on the other hand, to regard any extension of tenancy as a reward to the companies that comply. The built-in high turnover of tenant companies prevents the conflict from growing out of proportion and helps VGI to maintain its role in the incubator.

The situation in the incubator is quite different from Gouldner's theoretical expectations about the norm of reciprocity and the disruptive potentialities of power differences. Gouldner claimed that the norm of reciprocity would keep off exploitative relations, because they would undermine the very social system that enabled them. VGI, however, uses its power not only to get benefits without returning them, but also to take back some of the favors it has supposedly given in the first place. By the institution of the limited tenancy, VGI is able to keep the conflict at the sustainable level.

Entrepreneurs react either by actively seeking benefits from VGI or by avoiding any contacts with VGI whatsoever. One example is the idea of an 'open space' incubator, where VGI tries to blur the boundaries between VGI office space and offices of tenant companies. Some entrepreneurs play along, while others introduce extreme security procedures. On one occasion when I helped a VGI employee deliver memos about a publicity event to tenant companies, I was able to observe that many of the companies had their doors open and were generally very welcoming. This was not the case with one of the tenant companies. Obeying the specific request of the president of the company, we had to knock on the closed door and wait until we were admitted into their offices. Several other companies were also reluctant to participate in the event that would praise VGI's role in the economic revival of the City. The widespread reluctance among entrepreneurs to participate in VGI rituals evokes frustration among VGI staff and focuses their attention to various unofficial goals.

### **Self-interest and Community Recognition**

All formal organizations are shaped by forces that are tangential to the official goals and procedures of these organizations (Selznick, 1949). As Perrow (1986) pointed out, the group conflict revolves around the question of conflict of goals in organizations. The official goal of VGI is to "*stimulate entrepreneurial activity and the creation and growth of early stage businesses*". In the absence of social supervision and constraint, many other unofficial goals are being pursued by VGI, such as community recognition (e.g., events/awards), extracurricular activities (e.g. golfing), and fringe benefits (e.g., free education at the university).

I discussed earlier the role of frequent and extensive reports that VGI has to write. The main purpose of these reports and publicity events is to obtain governmental grants and private donations, but also to gain community recognition. As one entrepreneur describes it: "*They (VGI staff) many times have to do things to look good for their financial supporters and that are not essential for early stage companies*". A large number of people in VGI are involved in the preparation of reports and organization of publicity events. Community recognition has become one of the unofficial goals of the organization, directly feeding into the ambitions of the senior vice president for operations, technology transfer and client assistance. On several occasions, she

talked about the development of a large technology park in the City area, where VGI would have a leading role.

The president and both senior vice presidents received the awards for the Entrepreneur of the Year in the past years. Some of the entrepreneurs see this as a “*bad joke*”, since none of these people “*has ever really started a company*”. The majority of the VGI staff only worked for non-profits or large organizations. The president had a business career for 27 years with a big steel company, where “*money went into drainage*”. He is the only one featured in the previously mentioned caricatures, where he wears a golfers outfit and is preparing to strike a ball. There is also a stack of books in the picture with clearly readable titles: *The Golfers’ Guide to Business*; *BMW Reparaturleitung*; *How to Manage Women in Business Vol. I.*; *Without Them Trying to Manage You Vol. II.* President and senior V. P. for recognition events and educational programs are frequently involved in golf outings, which are officially fund raising events, but unofficially a pleasant extracurricular activity.

Senior V. P. for recognition events is one of the founders of VGI. His attitude towards entrepreneurs can be sensed through jokes and quotes that are pasted on the visitor’s table in his office. The first one is a definition of an entrepreneur from Willey’s Dictionary (a comic strip): “a person who does everything he can think to keep from getting a job”. The second one is a quote from Prof. Abraham Zaleznich (Harvard Business School): “I think if we want to understand the entrepreneur, we should look at the juvenile delinquent”. This attitude does not seem to represent the broader culture in the organization, but rather an attitude of an individual that has become disinterested in the formal activities of the organization. He has no contacts with entrepreneurs and is “*just a name*” to many of them.

One member of the board of trustees maintained that “because salaries paid are usually lower, a president should have the ability to manage people that could make more money in other positions”. Instead, VGI allocated practically all the increase in the funds available in the previous year (15 percent increase) to the increase in salaries and related expenses. Free education at the university is the most important fringe benefit that employees of the incubator receive quite frequently. Motivation of VGI staff centers on their self-interest as manifested in extracurricular activities, community recognition, material gains, and long-term gains in power.

## CONCLUSION

VGI is an organization that was established to nurture and develop small companies, but has instead become a vehicle to pursue personal goals. The displacement of goals takes place because certain activities accrue increasing internal relevance, instead of having a direct relationship with the ultimate goals of the organization. VGI’s top administrators are able to pursue their self-interest, because there is no adequate system of control in existence. The external control is limited to a general type of supervision, which concentrates on the financial constraints and the internal control, exercised through board of trustees, is done routinely and with little interest.

The relationship between VGI staff and entrepreneurs is governed by the norm of reciprocity, despite some attempts from VGI to change this relationship retroactively into exchange

relationship. Previous researchers conceptualized the norm of reciprocity as “a local concept of order and peace” (Von Reden, 1998) with “system stabilizing function” (Gouldner, 1960), where conflict is only an instance of “breaking the rules” (Yan, 1996). Alternatively, I argue that reciprocal relationships are characterized by the conflict and instability. Two attributes of reciprocity (Gouldner), time period and comparative indeterminacy, do not perform their system-stabilizing functions.

The entrepreneur companies receive low cost space and services, while VGI receives increased visibility and access to resources. The central conflict in their reciprocal relationship is the one of taking credit for the success of young companies. VGI builds its own reputation on the achievements of incubator companies, while entrepreneurs believe that they are solely responsible for the success of their companies. As a result, the two groups of actors avoid each other and center their motivation on the self-interest.

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## Endnotes

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<sup>i</sup> Names of individuals and organizations have been modified to preserve the anonymity of participants in the study.

## **FAMILY BUSINESS SUCCESSION STRATEGIES**

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### **Introduction:**

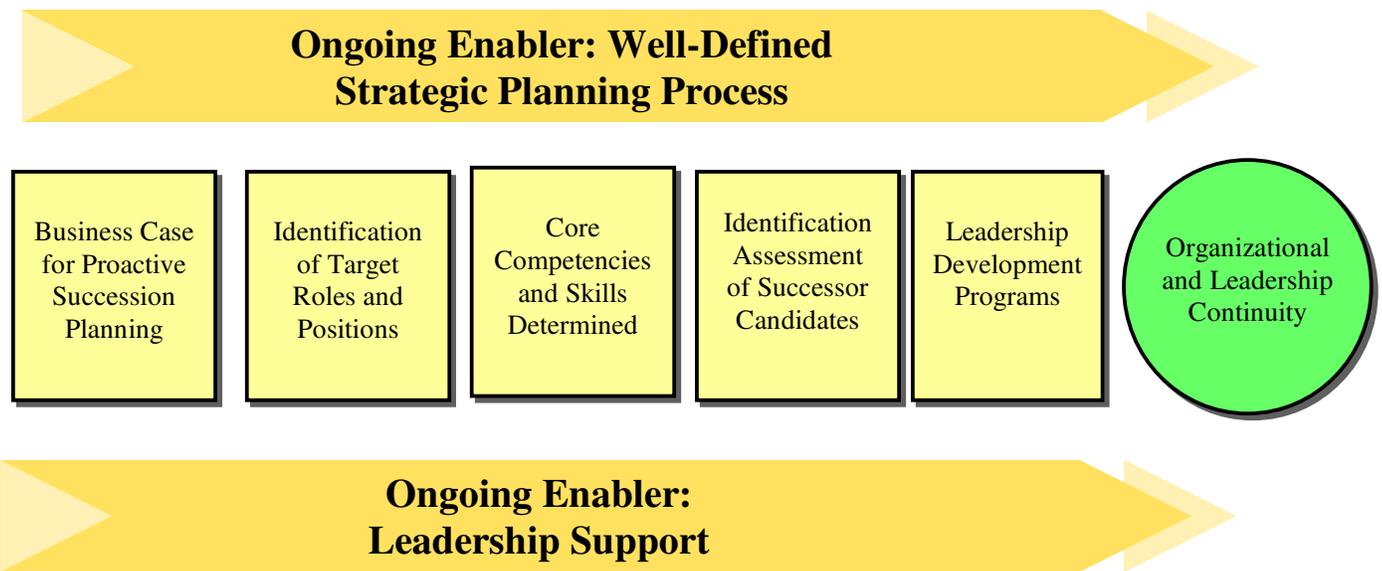
Many entrepreneurs view their business ventures as extensions of themselves, encompassing their vision and passions from both their personal and professional lives. For the most part, they welcome their children into the business based on trust and a belief that they have or will develop the same level of passion as they have. They believe the business will automatically transfer to their children when they are unable to carry on and so feel that planning this transition is not required. Perhaps it is the fear of facing that point in time when they are unable or unfit to carry on. Statistics indicate that less than half of viable small- and medium-sized businesses are able to survive past the first generation and, of these, very few are successfully passed on to the second and third generations, often due to a lack of an agreed upon strategic vision and ineffective succession planning.

There are many similarities in the way owners of large and small to medium size entrepreneurial organizations manage their companies effectively, primarily to pass them on to the next generation of family members. In fact, most of the large privately run companies were at one time, successful small businesses. By accepting and following an effective succession plan, these entrepreneurial owners will protect the company's culture and enable the implementation of a long-term business strategy that will smooth the transition phase necessary to pass control to the next generation.

The goal of this paper is to present a succession planning model that describes the key elements and challenges of an effective succession plan, focusing on the concerns of small family-run businesses. In addition, a well- defined succession plan must be supported by appropriate estate and tax planning.

## A SUCCESSION PLANNING MODEL

In the diagram below, the enclosed squares represent the five principal stages of a succession planning model. Above and below these are thick arrows showing ongoing enablers: a well-defined strategic planning process, and leadership support, which includes competitive compensation and access to high-level performance management tools and processes. The combination of these key enablers will drive organizational and leadership continuity—necessary elements of organizational success.



### Ongoing Enabler: Well-Defined Strategic Planning Process

The need for a formal strategic planning process and succession plan are integrated elements of family business success. Formalizing a mission statement is a key first step in order for the owners to clearly articulate and communicate the vision, culture and values desired throughout the organization. Many entrepreneurs will suggest that a written mission and value statement is not necessary; however, completing this task ultimately commits the entire organization, including family members, to accept and implement that vision. In the end, the strength of the strategic planning process has a direct impact on the future transition of the business to the next generation: assuming a healthy, structured, and analytical debate in the preparation of a business plan, the risk of family differences arising as to what direction the business strategy should go is either eliminated or, at worst, greatly reduced.

### **Stage One: Business Case for Proactive Succession Planning**

Stage one requires the entrepreneur to develop a business case that includes succession planning. This requires the entrepreneur to articulate the clear vision and company mission encompassing the business culture and values. The mission statement is the foundation for developing a strong strategic planning process that incorporates the development of a longer term business plan. Requiring the entrepreneur to envision where the business will be in the next five, ten, and twenty years requires decisions about organizational structure and effective leadership. In turn, this focuses creative debate around assessing the degree to which the owner's retirement and attrition issues will impact on the management of the controlling interests of the business in future, and leads, ultimately, to a decision to either carry on the business in perpetuity or to divest at a strategic time in order to obtain maximum value for the shareholders.

There are numerous considerations to take into account in developing a business case that works for each owner, but when including a succession plan, it is especially critical to fully understand the long-term impact of the following five factors:

1. Industry sector, market share, competition and barriers to growth
2. Long term business strategy for growth and required return on capital investments
3. Independent business valuation and the potential to increase brand equity over time
4. Timeframe for implementing a succession plan (relative ages of family members)
5. Commitment, ability, and leadership potential of family members

For successful organizations a formal strategic planning process is an ongoing business activity. Developing a business case is a total company effort, involving all family members and senior management who assist in identifying key roles, responsibilities and organizational structure. The business plan is reviewed annually, modified if necessary, and validated against the long term vision and values of the company's owners. The business case for succession planning differs from the ongoing planning activities in that it occurs at certain points in time when the family business has either reached a critical mass or family members become interested in working in the business and express a desire to develop their careers with the organization. These situations necessitate consideration of organizational and leadership continuity. Analysis of all aspects of the business plan strategy is necessary in order to develop a realistic business case for succession planning.

### **Stage Two: Identification of Target Roles and Positions**

The second stage of the model is aimed at identifying the critical workforce segments within the business. It is important to recognize that this should not be based on merely slotting people into specific roles or responsibilities (i.e., developing roles for current employees or family members), rather it is an assessment of the key positions required to achieve business targets at various stages of the business plan. This analysis serves to set priorities among the various key or “at risk” positions identified, as these are the positions that will support or drive growth initiatives which may or may not exist at the time of planning.

### **On-going Enabler: Role of the Board of Directors, and Other Advisors**

Developing and implementing a succession plan strategy generates a number of emotional issues in most family businesses, and the process is most effective when it is facilitated by independent counseling from a number of sources. The earlier external management expertise is introduced into the succession planning process, the more likely it will be that the plan will fit with the business vision. An independent viewpoint acts as a steering mechanism or “reality check” to ensure that the appropriate organizational structure is in place to enhance the likelihood that the business will survive through the transition phase. This independent viewpoint also reinforces the need for timely succession planning, and ensures that owners understand the significance of structured estate and tax planning.

### **Stage Three: Core Competencies and Skills**

Once key and “at risk” positions are identified in the business plan, core competencies and skill-sets for the target roles must be determined. This will provide a baseline for assessing performance that will identify gaps within the current workforce—including those in the owner and family members—and serve as a framework for recruiting the talent required to meet strategic goals and key objectives. By focusing on the broader organizational requirements of the business, it will become much clearer for the entrepreneur and family members to assess where developmental “gaps” exist and, if there is interest from family members, motivate them to gain the necessary skills and competencies required to fill those key positions.

### **On-going Enabler: Balancing Business and Personal needs within the Family Business**

A major element of the succession planning process is the identification of individual family members' outside/personal needs and activities in relation to those of the organization. In order for family members to be considered for key positions or as "successor candidates" there must be an inherent commitment to developing the necessary skills and competencies to meet future business needs. This is a complex area involving a number of interrelated issues, including trust and confidence in the ability of others to assume leadership roles, empowerment to make key decisions, delegation or resolution of conflicting duties and the ability to make ongoing personal sacrifices required in order to "learn the business."

Family members must be fully informed, involved, and have access to opportunities to best develop an effective succession strategy. They must be treated as equal employees in order to gain respect from non-family staff members; however, they have other responsibilities over and above executing the business vision: they must maintain the vision over time and changing circumstances. They must develop new and innovative ways of working together. They must transition into new and different roles in order to gain a broad business sense, and get involved in corporate policy and strategy as integral members of the board of directors or advisory team. In this way, they become acutely aware of the business needs and competencies required in the key positions.

### **Stage Four: Identification Assessment of Successor Candidates**

Stage four involves the development and implementation of a rigorous, competency-based performance-management process to identify high potential candidates within the organization. If internal candidates do not meet the set criteria, then a reliable and fair selection process for locating external qualified candidates may be necessary.

It is imperative that the family work with an outside expert during this stage in developing the business plan, as members will benefit greatly from the expertise of a communication facilitator who can control family emotions and act as a sounding board. Sharing information with all family members openly is important to ensure that they fully understand there is no "free pass" as the successor candidate, and that each must possess the necessary business and educational qualifications, just like any other applicant.

### **On-going Enabler: The Importance of a Positive Work Environment**

The culture of an organization must be well defined and consistently reinforced. It must recognize and reward employees and family members equally, train and promote from within while attracting new talent and knowledge to the organization based on an accepted business strategy. Determining whether one or any of the family members has the ability or interest to acquire the necessary skills and competencies to lead the organization is a key outcome of the succession plan. There is a strong argument that leaders are not born; rather, they develop over time by learning new skills and competencies. Family members can be given the opportunity to discover their “natural” management styles and understand the differences in their personalities and business philosophies. A family member may be identified as a potential successor candidate but may not want the responsibility, whereas another may desire to be the leader, but does not want to invest the time to develop the skills and competencies necessary in order to be effective.

### **Stage Five: Leadership Developmental Programs**

The final stage of the succession planning model consists of a review of current and required training and development practices. The objectives focus on ensuring that potential successors are receiving sufficient development opportunities on a regular basis. This training should involve a mentoring program, job development opportunities, special assignments and projects, and formal evaluations of progress, as well as independent feedback through external training.

As part of the ongoing training and development activities, the successor candidate should accept positions outside the family organization. A variety of practical, first hand experience is invaluable to the candidate who is able to develop business experiences outside the comforting environment of the family business. The identified successor can assess different cultures and values, new mentors and innovative ideas, and eventually incorporate those experiences back to the family organization.

### **Ongoing Enabler: Personal and Inter-personal Development**

In addition to in-house training, external team-building exercises and regularly scheduled “family retreats” become critical in developing a succession strategy. The knowledge gained from a retreat session can teach family members how to successfully manage the delicate relationship between family and business. The education and learning experiences should be very broad, ranging from

general management and leadership instruction, assessment of diversification opportunities and specific evaluation of business practices, to wealth management, family investment strategies and even parenting skills. Through these ongoing interactive sessions, participants understand better what their needs and desires are versus those of non-family employees and the business itself. They also have a better opportunity to identify the skills and competencies of a successor candidate and can evaluate whether that person is a qualified family member or if it would be in the best interests of the business to hire an external candidate.

### **The Desired Outcome: Organizational Continuity and Leadership Capability**

If the succession strategy suggests that control of the business should transfer to a chosen family member, this may necessitate a longer transition period before the leadership role is actually assumed. In many cases the outcome of stages two and three of the succession planning model will determine that key positions will be filled by external talented non-family executives, while allowing family members to develop and grow in the interim period. Therefore, the actual succession planning process is initiated well before the owner is contemplating retirement.

In other cases, the succession strategy process may determine that non-family members desire to remain actively involved in the business after the entrepreneur retires or begins to transition out of active leadership. This suggests a number of options, either to hire talented external management to run the operation on the family's behalf and generate ongoing income or dividend streams, or to divest of the business at a strategic time in order to obtain maximum value for the shareholders. It is best not to force family members to choose the family business as their vocation. They must make their own decisions. They must feel the passion for involvement and if they choose to enter the business after developing their own talents and exploring other business opportunities, then the company will greatly benefit from their outside perspective.

In either instance, the decision will have resulted from a well thought out business case that has considered all aspects of organizational continuity. Business ownership has always been about creating wealth and value for shareholders, and if this is accomplished without the transition of leadership to the next generation then the owner can be confident that the right decision has been made.

### **Concluding Remarks**

Succession planning is most likely one of the most complex and emotional issues family businesses will face. Involvement of all family members who are directly involved in the day-to-

day operations of the company, even at a minimum level, is critically important as the succession plan is implemented.

A successful strategy involves acceptance of an agreed upon process and effective board governance throughout the lifetime of the company. The underlying business strategy is determined through a formal vision and mission statement which is reinforced through a strong, well-defined culture and via organizational values. Each stage of the succession planning model must be fully analyzed and debated. The strategy must be developed in conjunction with an acceptable business case and needs to be balanced with constant, organization-wide planning. Input from independent sources, either board advisors or experienced facilitators, is absolutely necessary so that family members can gain an understanding of the necessary qualifications required of a successor candidate and share openly, to express their willingness and desire for continued involvement and commitment to the family business. The end result of this strategy setting is clear communication and the mobilization of all employees to create synergy and organizational continuity.

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# THE FIRST DEAL MIGHT BE THE LAST: BUILDING LONG TERM RELATIONSHIPS IN THE VENTURE CAPITAL COMMUNITY

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March 14, 2005

## Abstract

Previous analysis of venture capital activity in Silicon Valley has highlighted the role of venture capital syndication as a mechanism through which venture capitalists (VCs) build trusting relationships within the investment venture capital community. This paper analyzes the dynamics aspects of syndicated deals in technology sectors. The paper suggests the existence of 'persistence' in the patterns of collaboration among venture capitalists who participate in the same syndicated deal. VCs work more with those VCs with whom they have worked in the past, even after controlling for geography and investment activity effects. In order to honor the syndicate agreement, VCs must add new capital when required by the lead investor. It was found that those syndicate members who decide to 'stay' for the second round will collaborate, later on, more intensively among themselves (will participate together in more syndicated deals), than those who do not add new capital to the startup. The conditions under which the second round takes place are found to moderate the importance of honoring the syndicate agreement, and yield some insights into VCs' incentives to form syndicates.

## Introduction

The availability of capital has been shown to have strong effects on the intensity of innovation (Fazzari et al., [1988], Himmelberg et al. [1994], Lerner and Tsai [2002]). Young startups in innovative sectors, like IT and biotechnology, do not have the financial resources to bootstrap their growth, which exposes them to fluctuations in capital markets (Baker et al. [2003], Berk et al. [2004], Bhidé [1992], Carpenter and Petersen [1988], Davila et al. [2000], Hotz-Eakin et al. [1994]). The question that I aim to answer in this paper is: does the existence of VC syndication ensure the young technology startup a smoother 'ride' through the ups and downs of the capital market?

VC syndication has been a topic of active research in the last decade. Syndication has been considered a mechanism employed by VCs to achieve risk sharing and portfolio diversification. Lerner (1994) finds that, in earlier rounds, established VCs syndicate with each other, while in later rounds, they consider also syndication with less established players, which leads to 'improved-selection' as the main driver of VC syndication. By contrast, Brander et al. (2002) analyze a sample of Canadian biotechnology startups and conclude that the driver is the 'value added' by members of the syndicate (industry knowledge, experience with a particular type of security, etc.). For basic references and further discussion see also Bygrave (1988), Sorenson and Stuart (1999) or Manigart et al. (2002).

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<sup>1</sup> This research was partly funded by Caja de Ahorros y Pensiones de Barcelona Fellowship program.

Due to uncertainty, information asymmetry, and the possibility of opportunistic behavior by the entrepreneur, VCs stage their investments (Gompers [1995]). In the case of a syndicated investment, the members of the syndicate usually sign a legally binding document known as syndication agreement. The syndication agreement specifies (1) required information disclosures between syndicate members, (2) parties' rights, and (3) funding commitments in future rounds (Hopp and Rieder [2004]). However, as Wright and Lockett (2003) point out, it is not the threat of legal enforcement that legitimates the agreement. Rather, the agreement works because of the impact on reputation that results from infringement of some of its clauses.

Greif (1993) describes the existence of an economic institution, the coalition, which allowed Maghribi traders in the 11th century to employ overseas agents, despite extreme uncertainty and risk of opportunistic behavior. The coalition was 'an economic institution in which expectations, implicit contractual relations, and a specific information-transmission mechanism supported the operation of a reputation mechanism'.

When VCs sign a syndicate agreement, they know in advance that it will be challenging to legally enforce the terms of the agreement. In the same fashion that Maghribi traders in the 11<sup>th</sup> century relied on reputation as an enforcing mechanism, the venture capital community relies on members' incentives to keep reputation in order to facilitate collaboration with other members. If a VC signs a syndicate agreement and does not honor it, for example because she refuses to commit new funds when required by the syndicate lead member, then we should observe a decrease in the propensity to work with the member that infringed the agreement. In other words, the VC would suffer a disconnect from the 'deal flow'

This paper explores the temporal dynamic aspects of venture capital syndication to ascertain whether the logic behind the decision to repeatedly fund a startup is consistent with the value-added hypothesis, or whether the syndicate structure arises endogenously as an economic institution that incentivizes syndicate members to participate in multiple rounds of financing.

### **Hypothesis Development**

Previous analysis of the effects of VC syndicate properties on startup performance yielded two interesting results, only summarized here because of space constraints (Campo-Rembado [2004]). First, it was found that the size of the syndicated first round (number of members), has a positive and significant effect on the propensity to go through new VC rounds, but no effect on the propensity to go public (conditional on the occurrence of new VC funding rounds). Second, the continuity of syndicate members between first and second rounds, has negative effects on the propensity to go public, even after controlling for the size of the second syndicated round; furthermore, it has positive effects on the propensity to fail.

Assuming that the control variables effectively control for the startup intrinsic quality, these results are then not solely driven by startup intrinsic value; they are also driven by (1) the effects that VC activity has on the startup's intrinsic quality (the 'value-added' hypothesis), and (2) the effects that VC syndication has on the startup's ability to raise new capital.

The results are easily explained using the 'value-added' hypothesis. As Brander et al. (2002) suggest, the addition of members to a syndicate increases the pool of intangible capital that is

accessible by the startup. Therefore, syndicate size helps the young startup to build an organization and a technological project, helping it to attract future funding. Similarly, the addition of 'new' investors in second round (investors that did not participate in the first round) helps the startup to mature and build an IPO ready company.

Alternatively, this paper conjectures that the size of the syndicate increases the effectiveness of the syndicate as an economic institution and the threat of punishment in case of infringement, thus facilitating the occurrence of new rounds of financing. Participation of first round syndicate members in a second round of financing is driven not only by the attractiveness of the investment, but also by the threat of punishment by the other syndicate members. By contrast, new members in a second round are driven uniquely by investment attractiveness. Therefore, one could argue that the higher the continuity of syndicate members between first and second round, the worse the chances of the company to go public: if the company were attractive, new members would bid high to participate, and the first round lead member would waive first round members' commitment to participate in the second round.

In principle, both alternatives are possible. The second alternative, however, is based on building trust, social embeddedness, and reciprocation (Ferrary [2003]). Under this second alternative, a VC will have additional incentives to honor a syndicate agreement in order to build a trusting relationship with other VCs. If the participation of VCs in a second round helps them establish a reputation as trustable partners, then we should observe that the decision to honor the syndicate agreement should be positively correlated with the ex-post intensity of joint collaboration among those VC.

The importance of honoring the syndicate agreement will depend on the previously established reputation of the VC. For example, when two big VC partnerships work together, it should not matter too much whether they honor the syndicate agreement or not. Due to their size, none of the parties needs of the other party to run a profitable practice. A similar argument leads us to conclude that the importance of honoring the syndicate agreement between two small VC partnerships should not be decisive neither. Both parties lack the power to incentive the other party to do so. The following hypothesis follows

***H1: Size asymmetry among parties in a syndicate agreement will magnify the importance of honoring the syndicate agreement as a predictive factor of ex-post intensity of joint collaboration.***

When the number of second round participants is high enough, the importance of honoring the agreement should diminish. First, the VC partnership that did not honor the agreement can be easily 'forgiven' because its capital was not so urgently needed. Second, the allocation of trust and liabilities should become more and more complex as the number of syndicate members increase. Therefore:

***H2: The number of participants in the second round of financing should ameliorate the importance of honoring the syndicate agreement as a predictive factor of ex-post intensity of joint collaboration.***

## Methodology and Data

The sample population is the set of dyads of VC partnerships that satisfy the following conditions: (1) both VCs participate together in a first round syndicated deal in IT or biotechnology in the period 1976-2004; (2) the startup they fund in first round goes through a second round of financing. An example helps to illustrate. A given company CO goes through rounds 1 and 2. The size of the syndicate in first round is  $N_1$ . The  $N_1(N_1-1)/2$  possible different dyads formed by first round participants will be included in the sample population. Data on VC rounds is retrieved from SDC Platinum VentureXpert.

The dyad of VC partnerships is the unit of analysis. When the dyad F1/F2 of VC partnerships (or F2/F1) appears in different syndicated deals, only the ‘earliest deal’ is considered in the final sample population. Therefore, there are no repeated dyads. The ‘earliest deal’ is defined as the one with an earliest first round, but other criteria are also possible. One might argue, for example, that the ‘earliest deal’ is the one with the earliest second round, because it is the second round which defines the independent variable.

The dependent variable (INTENSITY OF JOINT SYNDICATION AFTER THE SECOND ROUND), is defined as the log ratio of the number of joint deals by the dyad members, and the time elapsed between second round and July 2004. The dependent variable captures the average number of joint deals per month, where a ‘joint deal’ is a syndicated deal in which the two members of the dyad participate.

The dichotomous independent variable (JOINT SECOND ROUND) registers the participation of the dyad members F1/F2 (or F2/F1) in the second round of the ‘earliest deal’. It takes the value of 1 when both members participate. The independent variable captures whether both dyad members ‘stay’ for the second round or not. The independent variable is intended to capture the decision of the dyad members to stay, but it also captures the decision of the lead syndicate member to invite the non-lead syndicate members in a second round, or the decision of the company to invite the non-lead syndicate members.

As control variables, I include (log) SYNDICATE SIZE in first and second rounds, SYNDICATE CONTINUITY, measured as the ratio of ‘repeaters’ in second round over the total number of unique participants between 1<sup>st</sup> and 2<sup>nd</sup> rounds; (log) AGGREGATE INVESTING INTENSITY, defined as the sum of the log investing intensity of both parties; (log) DIFFERENCE IN INVESTING INTENSITY, measured as the absolute log difference of investing intensities; FIRMS IN SAME STATE dummy; and FIRM AND COMPANY IN SAME STATE dummy, which takes the value 1 when at least one of the partnerships in the dyad F1/F2 is in the same state as the target portfolio company. Summary statistics and correlations are displayed in tables II and III below.

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Table II about here

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Table III about here

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The econometric specification is a random COMPANY effects, fixed YEAR effects, fixed SUBSECTOR effects model. For a given dyad of VC partnerships f1-f2 that has the earliest registered first joint round in company CO, the specification reads as

$$\begin{aligned}
 & [\text{INTENSITY OF JOINT SYNDICATION AFTER THE SECOND ROUND}]_{f1-f2} = \\
 & \alpha_1 [\text{JOINTT SECOND ROUND DUMMIE}]_{f1-f2} + \\
 & \alpha_2 [\text{SYNDICATE SIZE 1}^{\text{st}} \text{ round}]_{CO} + \\
 & \alpha_3 [\text{SYNDICATE SIZE 2}^{\text{nd}} \text{ round}]_{CO} + \\
 & \alpha_4 [\text{SYNDICATE CONTINUITY}]_{CO} + \\
 & \alpha_5 [\text{AGGREGATE INVESTING INTENSITY}]_{f1-f2} + \\
 & \alpha_6 [\text{DIFFERENCE IN INVESTING INTENSITY}]_{f1-f2} + \\
 & \alpha_7 [\text{FIRMS IN SAME STATE}]_{f1-f2} + \\
 & \alpha_8 [\text{FIRM AND COMPANY IN SAME STATE}]_{f1-f2} + \\
 & \alpha_9 [\text{COMPANY RANDOM EFFECT}]_{CO} + \\
 & \alpha_{10} [\text{YEAR FIXED EFFECT}]_{CO} + \\
 & \alpha_{11} [\text{SUBSECTOR FIXED EFFECT}]_{CO} + \varepsilon_{f1-f2}
 \end{aligned}$$

## Results

Results are displayed in table I

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Table I about here

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Model I is the baseline model without interaction terms. The baseline model shows the existence of a strong relationship between joint participation in the second round, and future collaboration. This result suggests that the formation of syndicate networks is characterized by structural ‘persistence’. Those VCs who have the chance to work together beyond the first round of financing show higher levels of cooperation among themselves than those VCs who do not commit further funds. The simplest story behind these result is that those VCs who commit beyond the first round are ‘deep pocket’ partnerships, and henceforth it is only natural that these VCs work more together. In this case, the relationship found would be spurious.

Model II and IV display the effect of the interaction terms. Model II suggests that both null hypotheses can be rejected. On the one hand, size asymmetry between VC partnerships magnifies the relevance of honoring the syndicate agreement. On the other hand, the size of the second syndicated round (number of syndicate members) diminishes the relevance of honoring the agreement. The analysis of the interaction terms yields a deeper level of complexity than the ‘deep pockets’ story above. In particular, we observe that participation in the second round of financing has the biggest effect when the interaction is between a ‘deep pockets’ VC and a small VC.

Model III suggest some industry heterogeneity. In particular, it must be remarked the difference between biotechnology and software (base case), being the importance of honoring the agreement less relevant in the former than in the later.

In addition to the main results, the control variables yield also interesting observations. In particular, Model III reveals that while the aggregate level of activity is positively correlated with the ex-post intensity of joint syndication, the difference in the level of activity is negatively correlated with ex-post intensity of joint syndication. The first result is trivial, the more deals the members of the dyad subscribe, the higher the average number of joint syndicated deals. The second result highlights the fact that homophily drives the structure of relations within the VC community. In conclusion, big VCs tend to work with big VCs (Lerner [1994]).

VC partnerships registered in the same state collaborate more; when at least one VC partnership and the company are registered (incorporated) in the same state, the intensity of ex-post joint collaboration diminishes. Again, the first result is trivial (Sorenson&Stuart [1999]). The second result is somewhat intriguing; it suggests that VC partnerships invest in out-of-state first round deals, but not necessarily in successive rounds.

Notably, from models I, II, III and IV, we can deduct a ‘regression to the mean’ phenomenon in the behavior of VC partnerships. A high level of investing activity during the time that elapses between 1<sup>st</sup> and 2<sup>nd</sup> round is related with a diminished level of ex-post joint collaboration.

### **Conclusions**

The decision to repeatedly participate in successive rounds of financing must consider a variety of factors, such as the attractiveness of the venture, the portfolio diversification disadvantage, the sequence and capitalization of funds raised by the VC partnership, the investment climate, etc. Even in the case in which the venture promises to yield above average risk adjusted returns, the VC might decide not to participate in new rounds of financing because of liquidity constraints. The VC might also be legally forbidden from participating if the VC’s investment memorandum specifies explicitly that successive funds cannot participate in the same company (otherwise VCs might be tempted to throw ‘good money after bad money’)

The results presented here suggest that, in order to decide whether to participate in a second round or not, VCs consider, also, the effect that their decision will have on the other VCs with whom they are trying to build a trusting relationship.

The implications derived from these results are ambiguous. On the one hand, if VCs consider other factors in addition to project profitability, then the aggregate level of investment may differ from the first best level of investment. On the other hand, if, once a first round is sunk, VCs have incentives to pour more capital into the company even if the project does not yield the required stand alone returns, then an unintended outcome could be that technology startups backed up by a syndicate grow faster than those startups supported by a single VC. The ‘value added’ by the VCs would be the value of assuring a network of future capital resources to the young company.

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**Table I: Intensity of Joint Syndication After 2nd Round**

The table displays coefficient estimates for five different specifications. t-ratios are shown in parenthesis. In the case of random effect variance estimates, Wald statistics is shown in parenthesis.

| <b>Dependent Variable: Intensity of Joint Syndication After 2nd Round</b> |                       |                       |                      |                       |                       |
|---|-----------------------|-----------------------|----------------------|-----------------------|-----------------------|
| <b>Independent Variables</b>  | <b>Model I</b>        | <b>Model II</b>       | <b>Model III</b>     | <b>Model IV</b>       | <b>Model V</b>        |
| Joint Second Round (2nd)  | 0.024 ***<br>(12.4)   | 0.038 ***<br>(6.8)    | 0.059 ***<br>(11.1)  | 0.033 ***<br>(9.3)    | 0.045 ***<br>(7.3)    |
| <b>Interaction terms</b>  |                       |                       |                      |                       |                       |
| 2nd * Difference in Investing Intensity (before 1st)                      |                       | 0.003 **<br>(-2.6)    | 0.004 **<br>(3.1)    |                       | 0.003 *<br>(2.2)      |
| 2nd * Syndicate Size (2nd round)  |                       | -0.01 ***<br>(-3.7)   | -0.016 ***<br>(-5.6) |                       | -0.010 ***<br>(-3.4)  |
| 2nd * Bio   |                       |                       |                      | -0.023 ***<br>(-3.8)  | -0.020 ***<br>(-3.3)  |
| 2nd * Internet  |                       |                       |                      | -0.013 **<br>(-2.6)   | -0.014 **<br>(-2.7)   |
| 2nd * Semiconductors  |                       |                       |                      | -0.017 **<br>(-2.9)   | -0.014 *<br>(-2.4)    |
| 2nd * Communications  |                       |                       |                      | 0.003<br>(0.5)        | 0.004<br>(0.9)        |
| 2nd * Hardware  |                       |                       |                      | -0.014 **<br>(-2.8)   | -0.011 *<br>(-2.1)    |
| 2nd * Software  |                       |                       |                      | -                     | -                     |
| <b>Controls</b>   |                       |                       |                      |                       |                       |
| Syndicate Size (1st round)  | 0.004<br>(1.2)        | 0.006<br>(1.8)        | 0.002<br>(0.5)       | 0.004<br>(1.2)        | 0.006<br>(1.7)        |
| Syndicate Size (2nd round)  | -0.008 ***<br>(-3.8)  | -0.006 **<br>(-3.0)   | -0.003<br>(-1.3)     | -0.008 ***<br>(-3.8)  | -0.006 **<br>(-2.9)   |
| Syndicate Continuity  | 0.027 ***<br>(5.5)    | 0.019 ***<br>(3.5)    |                      | 0.026 ***<br>(5.2)    | 0.018 ***<br>(3.4)    |
| (Aggregate) Investing Intensity (before 1st)                              | 0.000<br>(-0.3)       | 0.000<br>(-0.1)       | 0.012 ***<br>(23.8)  | 0.000<br>(-0.3)       | 0.000<br>(-0.2)       |
| (Aggregate) Investing Intensity (between 1st and 2nd)                     | -0.008 **<br>(-2.9)   | -0.008 **<br>(-2.9)   |                      | -0.008 **<br>(-2.8)   | -0.008 **<br>(-2.9)   |
| (Aggregate) Investing Intensity (after 2nd)                               | 0.184 ***<br>(44.5)   | 0.183 ***<br>(44.5)   |                      | 0.183 ***<br>(44.3)   | 0.183 ***<br>(44.3)   |
| (Difference in) Investing Intensity (before 1st)                          | 0.001<br>(0.8)        | -0.001<br>(-0.8)      | -0.006 ***<br>(-6.9) | 0.001<br>(0.9)        | 0.000<br>(-0.5)       |
| (Difference in) Investing Intensity (between 1st and 2nd)                 | -0.007 *<br>(-2.2)    | -0.007 *<br>(-2.0)    |                      | -0.007 *<br>(-2.2)    | -0.007 *<br>(-2.1)    |
| (Difference in) Investing Intensity (after 2nd)                           | -0.133 ***<br>(-26.2) | -0.133 ***<br>(-26.2) |                      | -0.133 ***<br>(-26.2) | -0.133 ***<br>(-26.2) |
| Firms in Same State   | 0.003<br>(1.9)        | 0.003<br>(1.9)        | 0.004 **<br>(2.5)    | 0.003<br>(1.9)        | 0.003<br>(1.8)        |

|  |                     |                     |                     |                     |                     |
|--|---------------------|---------------------|---------------------|---------------------|---------------------|
| Firm and Company in Same State                       | -0.003 *<br>(-2.1)  | -0.003 *<br>(-2.1)  | -0.002<br>(-1.3)    | -0.003 *<br>(-2.2)  | -0.003 *<br>(-2.1)  |
| Fixed Industry-Sector Effects                        | incl.               | incl.               | incl.               | incl.               | incl.               |
| Fixed Year Effects                                   | incl.               | incl.               | incl.               | incl.               | incl.               |
| Random Company Effect<br>(Variance, Scaled Identity) | 0.004 ***<br>(25.2) | 0.004 ***<br>(25.2) | 0.004 ***<br>(26.1) | 0.004 ***<br>(25.2) | 0.004 ***<br>(24.2) |
| Residual   | 0.004 ***<br>(67.3) | 0.004 ***<br>(67.3) | 0.004 ***<br>(67.7) | 0.004 ***<br>(67.3) | 0.004 ***<br>(67.3) |
| *** p<.01%; ** p<.1%; * p<.5%                        |                     |                     |                     |                     |                     |

**Table II. Summary statistics**

| Summary Statistics  |        |      |       |      |       |
|---|--------|------|-------|------|-------|
|   | Sample | Min  | Max   | Mean | StDev |
| Intensity of Joint Syndication After 2nd Round            | 12843  | 0.00 | 1.09  | 0.05 | 0.10  |
| Joint Second Round (2nd)                                  | 12843  | 0.00 | 1.00  | 0.41 | 0.49  |
| Syndicate Size (1st round)                                | 12843  | 0.69 | 2.83  | 1.56 | 0.53  |
| Syndicate Size (2nd round)                                | 12843  | 0.00 | 3.09  | 1.19 | 0.81  |
| Syndicate Continuity                                      | 12843  | 0.00 | 1.00  | 0.47 | 0.28  |
| (Aggregate) Investing Intensity (before 1st)              | 12843  | 1.39 | 10.42 | 4.09 | 1.83  |
| (Aggregate) Investing Intensity (between 1st and 2nd)     | 12796  | 0.00 | 4.00  | 0.62 | 0.53  |
| (Aggregate) Investing Intensity (after 2nd)               | 12843  | 0.00 | 2.48  | 0.36 | 0.34  |
| (Difference in) Investing Intensity (before 1st)          | 12843  | 0.00 | 5.40  | 1.22 | 1.03  |
| (Difference in) Investing Intensity (between 1st and 2nd) | 12796  | 0.00 | 2.76  | 0.29 | 0.31  |
| (Difference in) Investing Intensity (after 2nd)           | 12843  | 0.00 | 1.54  | 0.19 | 0.21  |
| Firms in Same State                                       | 12843  | 0.00 | 1.00  | 0.27 | 0.45  |
| Firm and Company in Same State                            | 12843  | 0.00 | 1.00  | 0.56 | 0.50  |

**Table III. Bivariate Correlatinons**

Level of significance is shown in below estimate.

| Pearson Correlation (Sig. (2-tailed)) |   | I     | II    | III   | IV    | V    | VI   | VII  | VIII  | IX    | X     | XI   | XII  |
|---------------------------------------|---|-------|-------|-------|-------|------|------|------|-------|-------|-------|------|------|
| I                                     | Joint Second Round (2nd)                                  | 1.00  |       |       |       |      |      |      |       |       |       |      |      |
| II                                    | Syndicate Size (1st round)                                | -0.11 | 1.00  |       |       |      |      |      |       |       |       |      |      |
| III                                   | Syndicate Size (2nd round)                                | 0.50  | 0.35  | 1.00  |       |      |      |      |       |       |       |      |      |
| IV                                    | Syndicate Continuity                                      | 0.64  | -0.12 | 0.41  | 1.00  |      |      |      |       |       |       |      |      |
| V                                     | (Aggregate) Investing Intensity (before 1st)              | 0.12  | -0.07 | -0.02 | 0.08  | 1.00 |      |      |       |       |       |      |      |
| VI                                    | (Aggregate) Investing Intensity (between 1st and 2nd)     | 0.20  | -0.08 | 0.08  | 0.12  | 0.58 | 1.00 |      |       |       |       |      |      |
| VII                                   | (Aggregate) Investing Intensity (after 2nd)               | 0.15  | -0.16 | 0.02  | 0.10  | 0.51 | 0.63 | 1.00 |       |       |       |      |      |
| VIII                                  | (Difference in) Investing Intensity (before 1st)          | -0.01 | -0.07 | -0.03 | 0.02  | 0.37 | 0.25 | 0.27 | 1.00  |       |       |      |      |
| IX                                    | (Difference in) Investing Intensity (between 1st and 2nd) | -0.10 | -0.02 | -0.04 | -0.05 | 0.34 | 0.61 | 0.42 | 0.46  | 1.00  |       |      |      |
| X                                     | (Difference in) Investing Intensity (after 2nd)           | 0.02  | -0.09 | 0.00  | 0.03  | 0.34 | 0.42 | 0.69 | 0.42  | 0.57  | 1.00  |      |      |
| XI                                    | Firms in Same State                                       | 0.05  | -0.11 | -0.01 | 0.03  | 0.01 | 0.01 | 0.02 | -0.02 | -0.04 | -0.02 | 1.00 |      |
| XII                                   | Firm and Company in Same State                            | 0.06  | -0.11 | 0.01  | 0.04  | 0.04 | 0.02 | 0.03 | 0.02  | -0.01 | 0.00  | 0.16 | 1.00 |

## **THE MULTI-FACETS OF FEMALE ENTREPRENEURSHIP: THEIR DREAMS AND THEIR REALITIES**

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### **ABSTRACT**

While females are starting businesses at an increasingly high level, many of the assistance programs have not kept pace. Yet women are finding alternative approaches to entrepreneurship and success. They are learning to balance multiple demands upon their time very well. They are learning that there is strength in numbers in collaboration efforts and they are becoming very successful in doing so.

We have surveyed more than 200 females who have started their own businesses and have asked them for the purposes in starting as well as their long term goals. We have also examined their drives, attitudes and cognitive styles.

We have determined that there are multiple levels of entrepreneurship and females predominantly make up the first level. Suggestions will be given as to how the females might advance to the higher levels and what practical solutions might result from public policy recognition of the potential for female entrepreneurs.

### **EXTENDED ABSTRACT**

Business women have been discriminated against in the workplace in terms of dollars as well as the potential for success. However, women made up 44.4% of the total civilian labor force over the age of 20 in 1986 (*Monthly Labor Review*, 1986) and in 1984, 31% of all women employed were in managerial or professional specialties (Mellor & Haugen, 1986). Further, 55.5% of women were working in 1986 (*Monthly Labor Review*, 1986). Women are clearly a significant force in business. These numbers are rising steadily as more women enter the job market from necessity, interest or desire.

In a study conducted by Robert Fairlie for the Small Business Administration in 2004, the rate of female business starts have risen significantly as compared to males. In his report Fairlie (2004) indicated that women have increased self-employment from 1,741,1000 in 1979 to 3,839,000 in 2003, a change rate of 5.1 to 6.8 percent.

While it has been argued that female owned firms have difficulty in finding funding, some from our sample started with owner financing which while small gives an opportunity for startup which might not otherwise exist in many rural areas or small urban areas.

Kalleberg and Leicht (1991) hypothesize that businesses owned and operated by women are less likely to survive and are less successful than those headed by men, yet they are unable to show that small firm survival rates are influenced by the gender of the proprietor. Rather they find that the key influences upon survival/non-survival are the age of the firm and the managerial confidence of the owner (Storey, 2000).

Brush (1992) concluded that business and family are closely knit together where the business owner is female and that in economic terms, the objective function of women business owners is much more likely to include striking a balance between family and work...rather than exceptional growth rates (Storey, 2000).

## **METHODOLOGY**

### **Instrumentation**

Three attributes from the literature were selected for study: the need for achievement, risk taking propensity, and preference for innovation. Although these factors clearly do not include all recognized or proposed characteristics of people who start businesses, they are among the most frequently encountered. To these factors we added a fourth attribute, entrepreneurial drive (Carland & Carland, 1984, 1988, 1997).

Questionnaires were developed which incorporated instruments to measure these attributes as well as obtaining demographic data about the respondent. The questionnaire also included questions about the motivations for founding the firm and questions about planning activities, goals and objectives, and the strategies employed in the management of the firm. In 1997, Carland and Carland proposed the following to distinguish between the various aspects of entrepreneurs. They suggested the points described in Table 1.

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Table 1 about here

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### **Sample**

Using a subset of fifty female business owners out of a sample of 291, female respondents were queried as to their purposes in starting their ventures as well as their long term goals. Also examined were their drives, attitudes and cognitive styles.

This is a convenience sample employing a survey developed for the purposes of ascertaining a profile of female entrepreneurs in the area. The sample is primarily from the Southeast and the majority are from small, rural, disadvantaged areas in the Mountains of North Carolina. Although there are a number of surveys from outside the region and state, the vast majority of the respondents come from areas designated as disadvantaged by the Regional Economic

Development Centers of the state. Most have lost any manufacturing which previously existed as well as farm income from the growth of tobacco. The profile of our respondents is found in Table 2.

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Table 2 about here

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Table 2 displays the demographic information about our sample subset. It indicates that most of our female entrepreneurs are involved in proprietorships (54%) or corporations (38%) and either in retail (42%) or service (50%) industries as one might expect. Fifty percent (50%) of the female entrepreneurs were in the smallest of businesses with ninety percent (90%) having fewer than 10 employees. Therefore, this sample subset included the smallest of the small and they were mostly in their middle age and undereducated

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Table 3 about here

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The ventures established in this sample go back to 1934 with one in the 1940s and two in the 1950s. These ventures were inherited (3) and bought (1) by the respondents. Seventy-four percent (74%) of the ventures have existed and continue to survive while the other twenty-six percent were established prior to 2004 so are somewhat untested.

As demonstrated in Table 3, most of the ventures, seventy-eight percent, were started by the respondent as opposed to purchase or inheritance, indicating the females are willing and able to begin ventures. Thirty-five of the respondents were nascent entrepreneurs, while 15 indicated that this was not their first venture.

As expected from the Brush(1992) article and the commentary by Storey (2000), the majority of the female respondents (68%) indicated that their principal reason for establishing their venture was to provide income for the family, while only thirty-two percent (32%) indicated profit and growth as their principal rationale.

Since only eight percent (8%) indicated that they had written plans to assist them in guiding their companies, and ninety-two percent (92%) indicated that they had no distinctive competency in their ventures, the researchers must conclude that from this subsample, the respondents may be undertrained and not as aware of resources needed for success.

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Table 4 about here

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The results in Table 4 indicate that our female respondents are just slightly above the mean in Innovation (11.6, expected mean 10) and well below the mean in risk taking propensity (6.8, expected mean 10). The respondents are well above the mean in the area of Need for Achievement (11.46, expected mean 8).

The entrepreneurial drive index was 14 on the average for the respondents with the expected mean of 16.5. This result was a bit of a surprise considering the profile expected and drawn by the data. The expectation was that considering the region from which most of the respondents were derived, that they would be predominantly microentrepreneurs, not entrepreneurs according to the definition espoused by Carland and Carland (1997).

## **CONCLUSIONS**

The sample subset because of its region of draw presents several unique possibilities. The needs, dreams and desires of this subset may well be different from that of the traditional female entrepreneur profile in that many of the businesses have been started and are continuing to be started out of necessity. The region is economically depressed and has no other future for those wishing to remain in the area. Education may be a solution to the issues of survival and success. More may be accomplished to create a better working environment for the nascent entrepreneurs as well as a source for the networks which can result in staying power. Perhaps further research could elucidate the disadvantaged entrepreneur or even the reluctant entrepreneur, regardless of gender.

Table 1  
Entrepreneurial Dreams as a Paradigm

| Classification    | Dreams   | Behavior    | Outcomes  | Consistency                                |
|-------------------|--|-------------|---|--|
| Macroentrepreneur | Dreams of revolutionary change                   | Innovative  | New markets, services, products and industries      | Never stops striving for dominance         |
| Entrepreneur      | Dreams of personal success, wealth and accolades | Ingenious   | Enhanced markets, services, products and industries | Shifts interest at perceived success level |
| Microentrepreneur | Dreams of personal freedom                       | Traditional | Small, stable, slowly changing, family businesses   | Shifts interest at perceived comfort level |

TABLE 2  
DEMOGRAPHIC DATA (N = 50)

|                        |     |
|------------------------|-----|
| Organization Type      |     |
| Proprietorship         | 27  |
| Partnership            | 3   |
| Corporation            | 19  |
| LLC                    | 1   |
| Type of Company        |     |
| Retail                 | 21  |
| Wholesale              | 0   |
| Manufacturing          | 1   |
| Construction           | 3   |
| Service                | 25  |
| Sales                  |     |
| Less than \$100K       | 25  |
| \$100K to \$500K       | 13  |
| \$500K to \$1M         | 7   |
| \$1M to \$5M           | 3   |
| \$5M to \$10M          | 0   |
| Over \$10M             | 2   |
| Employees              |     |
| Less than 10           | 45  |
| 10 to 50               | 4   |
| 51 to 100              | 1   |
| 101 to 250             | 0   |
| Over 250               | 0   |
| Age of the Owner       |     |
| 20 to 30               | 2   |
| 31 to 40               | 8   |
| 41 to 50               | 16  |
| 51 to 60               | 20  |
| Over 60                | 4   |
| Race of the Owner      |     |
| Majority               | 98% |
| Minority               | 2%  |
| Education of the Owner |     |
| Less than 12 years     | 1   |
| 12 years               | 16  |
| 14 years               | 13  |
| 16 years               | 9   |
| 18 years               | 4   |
| Over 20 years          | 7   |

TABLE 3  
PROFILE DATA (N = 50)

|  |    |
|--|----|
| Date Venture Established                   |    |
| Prior to 1970                              | 4  |
| 1970s                                      | 4  |
| 1980s                                      | 10 |
| 1990s                                      | 19 |
| 2000s                                      | 13 |
| Date of Ownership of Venture               |    |
| 1970s                                      | 6  |
| 1980s                                      | 10 |
| 1990s                                      | 21 |
| 2000s                                      | 13 |
| Method of Acquisition                      |    |
| Bought                                     | 8  |
| Inherited                                  | 3  |
| Started                                    | 39 |
| Number of Ventures                         |    |
| First (Nascent)                            | 35 |
| More than one (Serial)                     | 15 |
| Principal Reasons for Establishing Venture |    |
| Profit and Growth                          | 16 |
| Provide Family Income                      | 34 |
| Plans for Growth of Venture                |    |
| Written Plan                               | 4  |
| Unwritten Plan                             | 36 |
| No Plan                                    | 10 |
| Long Term Goals for the Venture            |    |
| Grow, expand, improve                      | 26 |
| Retire, sell                               | 2  |
| Not stated                                 | 22 |
| Distinctive Competency for Venture         |    |
| Different from Competitors                 | 4  |
| No Differentiation                         | 46 |

Table 4  
Profile Female Small Business Owners (N=50)

|                       | Number of Respondents | Range of Values | Mean  |
|-----------------------|-----------------------|-----------------|-------|
| Innovation            | 50                    | 1-20            | 11.6  |
| Risk Taking           | 50                    | 1-18            | 6.8   |
| Achievement           | 50                    | 6-16            | 11.46 |
| Entrepreneurial Drive | 50                    | 6-28            | 14    |
|                       | Macroentrepreneur     | 6               | 20-33 |
|                       | Entrepreneur          | 39              | 12-19 |
|                       | Microentrepreneur     | 15              | 1-11  |

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# **THE DARKSIDE OF ENTREPRENEURSHIP REVISITED: AMERICAN STYLE**

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## **ABSTRACT**

"Never underestimate the power of the Dark Side!" Luke Skywalker learned that lesson well in a galaxy far, far away and long, long ago, but modern entrepreneurship theorists may be less well informed than the characters in *Star Wars*. Like the "Force," Entrepreneurship is a tremendous power for good. But, like the "Force," Entrepreneurship does have a Dark Side and it is powerful, indeed.

With rare exceptions, the literature about entrepreneurship is positive and supportive and implies that uniform benefits accrue to the economy, to businesses, and to individuals as a result of entrepreneurship. This is only half the story. A small number of researchers have examined the dysfunctional aspects of entrepreneurship and pointed out that a dark side definitely exists.

This paper will look at those who turned to the darkside for their very existence. The authors have surveyed prisoners who have been convicted of a felony and who are serving sentences in a Federal Prison in the Midwest. The participants were enrolled in a continuing education course involving entrepreneurship and small business startup ideas and they all espoused a desire to "go straight" when their sentences had been served. How did they become criminals? Did they view their criminal activities as entrepreneurial ventures? Will they become legitimate entrepreneurs in the future? These were the questions which drove our research.

## **EXTENDED ABSTRACT**

Can criminal ventures be entrepreneurial in nature? Do criminals think of themselves as entrepreneurs? These issues have apparently not found wide acceptance in our literature. An extensive database study preformed for this paper found no articles involving criminal entrepreneurs, or entrepreneurial ventures classified as criminal enterprises in entrepreneurship or business journals or in the criminal justice literature. Our experience suggests that criminals do indeed frequently think of themselves as entrepreneurs. Drug dealers are comfortable talking about sources of supply, channels of distribution, the effect of supply and demand on price, market share, the impact of location, etc. In fact, we have seen that many organized drug dealers even understand the value of a brand identity and actively seek to establish that identity to obtain competitive advantage. They clearly understand first mover advantage and they have a firm grasp of the value of working capital.

It is equally clear that the organized crime families prevalent in the U.S. during the 1980s thought of themselves as businesses. Former FBI agents, Joseph O'Brien and Andris Kurins (1991) reported that many of these families were diversified in their holdings and activities and engaged in strategic planning to enhance the growth potential of their enterprises.

In our view, individuals who establish and manage ventures providing illegal or illegitimate products or services are entrepreneurs in every sense of the word. They are dark side entrepreneurs and their activities are destructive to the fabric of our society in direct proportion to the success of their ventures. What makes them turn to the dark side? If they have the skill and ability to launch and grow an illegitimate venture, why can't they focus their energies on legitimate businesses? How are they different from the entrepreneurs who are so beneficial to the economic well being of our society? Before we can tackle these issues, we need to explore entrepreneurial personality traits.

### **PERSONALITY TRAITS**

Personality traits of entrepreneurs have been examined by many researchers citing such attributes as a need for power (Peay & Dyer, 1989); the pursuit of freedom of expression and of spirit (Cole, 1989). Entrepreneurs have been characterized as confident, optimistic, not prone to take great risks or to be reckless, unwilling to have their performance judged by others, especially willing to be independent and self-reliant, and, as more than non-conformist, in fact, mildly sociopathic (Solomon & Winslow, 1988; Winslow & Solomon, 1987; 1989). At least one author has posited that entrepreneurship can be hazardous to one's health (Buttner, 1988).

Many characteristics of entrepreneurs such as risk taking propensity (Mill, 1848; McClelland, 1961; Mancuso, 1975; Timmons, 1978; Brockhaus, 1982; Watts, 1989; Carland & Carland, 1991) have been explored. Innovation has also oft been cited as a central characteristic of the entrepreneurial endeavor (Schumpeter, 1934; McClelland, 1961; Williams, 1981; Martin, 1982; Drucker, 1985; Carland & Carland, 1991). Other researchers have studied the need for achievement in entrepreneurs (Hornaday & Aboud, 1971; Liles, 1974; DeCarlo & Lyons, 1978; Carland & Carland, 1991) and cognitive influences have been examined as well (Carland & Carland, 1983, 1987, 1991, 1992; Barbato & Durlabhji, 1989). In most of the literature in which a portrait of the entrepreneur is drawn, only the positive aspects are vigorously outlined; and yet for every burst of brilliance, there is a negative or dark aspect.

Few have examined the aspects of the dark side of entrepreneurship. Osbourne (1991) identified the dark side as the "corrupting power of ownership" and cited examples of situations in which the power of ownership corrupted the organization. Cole (1989) described the entrepreneurial self and alluded to the reality that often entrepreneurs are 'displaced persons' who are entering the pursuit of ownership for less than sterling goals.

From whence does this dark side emanate? What is its source and can it be understood? For answers to these questions, many have turned to a study of cognitive temperament.

Keirsey and Bates (1984) felt that different types of cognition could be explained in a more straight-forward fashion than the 16 different groupings of typology which result from the better known Myers-Briggs Type Indicator (Myers & Briggs, 1962). Their conclusions are based on the works of Jung, Kretschmer, Freud, Adler, Sullivan, Maslow, and Spranger as well as Isabel Briggs Myers and Katherine Briggs (Keirsey & Bates, 1984). They modified Jung's theory dramatically by postulating that temperament emerges by way of differentiation rather than as a combination of attitudes, preferences, types or functions. That is, an individual displays a particular temperament rather than integrating Jung's attitudes.

They identify four major cognitive temperaments which can be described in MBTI terms as: SP or sensation-perceptive; SJ or sensation-judging; NF or intuitive-feeling; and, NT or intuitive-thinking. They stressed that temperament is not the result of a combination of the various MBTI functions. Rather, Keirsey and Bates (1984) observed the temperaments in individuals, classified and built up portraits of the temperaments and their potential for explaining individual behavior and used MBTI terminology to describe the result. Primary characteristics of the four temperaments are described in Table 1.

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Table 1 about here

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The four temperaments may be identified by use of the Keirsey Temperament Sorter which is presented and explained in *Please Understand Me* (Keirsey & Bates, 1984), or, the temperament may be identified by administering the MBTI (Myers & Briggs, 1962) and choosing the classification by comparing scores on the Sensing versus iNtuition scale, the Thinking versus Feeling scale, and the Judging versus Perceiving scale.

As Table 1 makes clear, each of the four temperaments has strengths, but each also has weaknesses. In fact, these weaknesses, when exacerbated by the pressures of business ownership can blossom into dysfunctional behavior. Carland and Carland (1992) examined these temperaments in a study involving more than 650 owners of businesses classified as small according to the U.S. Small Business Administration criteria. They also administered the Carland Entrepreneurship Index to the participants (Carland, Carland & Hoy, 1992) to determine the strength of their entrepreneurial drive.

SPs are individuals who have a lust for action with no thought for the consequences. While they are excellent problem solvers, they become quickly bored with routine and must perforce change directions. Since they are not goal-oriented, they tend to skip from task to task without completion. Carland and Carland (1993) found them under represented in their study, when compared to the general population, but they found that SPs displayed the highest tendency for launching multiple businesses. An interesting observation and one which begs the question of whether the serial SP entrepreneur was driven by a loss of interest in the existing business, or because their ventures tended to fail as a result of a lack of attention to detail.

In the SJ typology, one finds individuals who work very well with details and are most

comfortable with routine, however, they tend to resist change and may have problems in anticipating the shifts of the industry in which they find themselves. Carland and Carland (1993) found them over represented in their study, when compared to the general population, suggesting that they tended to be content in small business environments and successful, at least with regard to their own definition of success.

NFs are strongly people oriented and do not like stress. Carland and Carland (1993) found them present in their study at their normal level in the population, but, interestingly, they displayed higher entrepreneurial drive than SPs or SJs. This strong drive, coupled with a natural aversion to stress, could bode ill for personal health and mental well being.

NTs are the non-conformists, individualistic, seemingly arrogant group of people who seem to have the drive to start businesses based on growth and profit motives (Carland, Hoy, Boulton & Carland, 1984). They tend to pursue goals after others have lost sight of the possibilities and are always aware of the future implications of their actions and those of others. Their vision and creativity are strong supports for the growth and success of their ventures. However, their single-mindedness is often seen as a negative. Their dislike for routine and their pursuit of their own individual goals often make them pariahs in their own businesses. Coupled with the fact that they are harsh task masters, these problems can result in problems with Boards of Directors who prefer the stabilization of the management SJ types. Carland and Carland (1993) found NTs to be over represented in their study, in comparison to their distribution in the normal population. They also found them to display the highest entrepreneurial drive among the temperaments.

## **CRIMINAL ENTREPRENEURS**

Are dark side entrepreneurs different? To explore this question, we administered the MBTI (Myers & Briggs, 1962) and the Carland Entrepreneurship Index (Carland, Carland & Hoy, 1992) to a convenience sample of convicted felons incarcerated in a Federal Prison in the Midwest. All of the participants were male, and all were participating in a continuing education course involving entrepreneurship. Every participant in the course, 34 men, agreed to participate in the study. The instrumentation included demographic questions dealing with the traditional data, but including questions about the participant's criminal activities and criminal history. We also wanted to know whether any of the participants was actually involved in ownership of a legitimate business prior to incarceration, and we specifically addressed whether the participant considered his criminal activities to be a business.

We examined the personality temperaments of the participants, as classified by the MBTI and the entrepreneurial drive, as measured by the CEI. The results of our study and the conclusions which we drew from this exploratory research are described in the full version of our paper, copies of which are available from the authors.

**TABLE 1**  
**THE FOUR TEMPERAMENTS**

SP

The SP negotiates well; is good in a crisis; is a trouble-shooter and good in situations where one company takes over another; goes into everything at full speed; has a sharp nose for opportunity and feels that everything is negotiable and nothing sacred; can get cooperation from warring factions, is flexible, excited, open-minded, enthusiastic; is a risk taker; is practical, has acute observation powers; causes things to happen with an economy of motion; is flexible; is a good decision maker; but, does not like theory or routine and lives for the moment.

SJ

The SJ is a traditionalist or stabilizer; likes to establish policies, rules, schedules, and standards and create company rituals; is patient, thorough, steady, reliable, orderly; has a strong sense of social responsibility; has a need to serve, to be needed, and to do one's duty; is resistant to change; is decisive; has common sense; is a hard and steady worker; is thorough and loyal; but, is known to be pessimistic, may preserve useless rules and be critical of others.

NF

The NF is personal and personable; draws out the best in people; focuses on individuals; is naturally democratic and participative; has verbal fluency; can subordinate personal wishes to those of others; is idealistic, empathic, and charismatic; has a silver tongue; sees possibilities; works well with people; can turn liabilities into assets; shows appreciation; but, is generous with time to others so may neglect obligations; makes decisions based on personal likes and dislikes and feels responsible for others.

NT

The NT is visionary and an architect of change; takes pride in technical knowledge; demands a high level of personal performance; is skeptical; avoids redundancy and stating the obvious; hungers for competency, knowledge and mastery; sees both long and short term interactions and implications; focuses on possibility and is technologically ingenious; but, does not communicate well; may lose interest in a task before completion; be insensitive and may appear arrogant.

Source: Keirsey, D. & M. Bates (1984). *Please Understand Me*. Del Mar, CA: Prometheus Nemesis Books.

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**Customer Service-Orientation of Small Retail Business Owners in Austria, Hungary,  
Slovenia, Ukraine, and the United States of America**

Submitted to the ICSB Jan. 2005.

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## **Customer Service-Orientation of Small Retail Business Owners in Austria, Hungary, Slovenia, Ukraine, and the United States of America**

### **Abstract**

Hogan, Hogan, and Busch (1984) defined service-orientation as "the disposition to be helpful, thoughtful, considerate, and cooperative" (p. 167). The purpose of this study was to test whether or not a biodata inventory could be used to measure the service-orientation construct across cultures with samples of small business owners from Austria, Hungary, Slovenia, Ukraine, and the United States of America. Subjects were given the inventory in order to predict their on-the-job service-oriented performance. Within the samples, the service-orientation ratings were highly correlated with Extroversion and Openness to Experience in all five countries, and Agreeableness & Conscientiousness in four countries. The correlations of these scales with service-orientation were as high or higher than those generally obtained with measures of service-orientation with customer service representatives. Thus, it has been concluded that service-orientation may be effectively measured by biodata within small organizations across multiple cultures.

## INTRODUCTION/LITERATURE REVIEW

To the extent that an organization's success depends on effective customer relations, the customer service employees play a vital boundary spanning role for the organization (Robertson, 1995).

Consistent with this, firms often attempt to shape their image with customers by managing the types of behaviors employees display (Becherer & Maurer, 1999; Hipkin, 2000; Martin, 2000; O'Gorman & Doran, 1999). This is especially important in small and medium sized businesses where nearly all employees have contact with both external and internal customers on a daily basis (O'Gorman & Doran, 1999; Parnell, Carraher, & Odom, 2000; Zinger, LeBrasseur, & Zanibbi, 2001). For instance, Wright, Pearce, and Busbin (1997) found that firms which emphasize customer service report higher profitability, return on sales, return on investments, return on assets, and profit growth than those reporting less of an emphasis on customer service by the individual employees - - outcomes desirable by organizations both small and large.

### Service-Orientation

Among the most significant works to date in the area of service-orientation have been those of Hogan, Hogan, and Busch (1984). To measure the traits from their definition of service-orientation, they developed the Service-orientation Index (SOI). The SOI consisted of 87 true-false items covering issues of agreeableness, adjustment, conscientiousness, and sociability. Validation of the SOI on a group of healthcare workers revealed a correlation of  $r = .31$ , ( $p < .05$ ) between SOI scores and service-orientation ratings (Hogan & Hogan, 1992; Hogan et al., 1984).

Since Hogan et al. (1984) performed their work, several consulting companies such as Personnel Decisions, Questar Data Systems, and CORE Corporation have developed their own instruments to measure service-orientation. These instruments are based on measures of attitudes and/or behaviorally-based personality questions, but research published in peer refereed journals performed by individuals not employed by the consulting companies has yet to be presented on the efficacy of these instruments. Bowen, Siehl, & Schneider (1989), on the other hand, have recommended the use of more "behaviorally based selection procedures" (p. 83) - such as biographical information blanks – also called biodata (Schneider, 1997).

### Biographical Data

Credit for the first use of biographical information in employee selection dates back to 1894 when T. L. Peters used biographical information for the selection of insurance agents (Ferguson, 1962). Research using biographical questionnaires in multiple-choice formats blossomed during World War II, and much research was performed demonstrating that biodata could predict success in the military (Parish & Drucker, 1957). Reviews of further work support the empirical validity of biographical data in predicting various criteria including job placement success (Harvey-Cook & Taffler, 2000), turnover (Brush & Owens, 1979), and performance for service employees in large organizations (Allworth & Hesketh, 2000).

Biodata typically differ from measures of values, attitudes, moods, interests, personality, and abilities but can seek to assess constructs in all of these domains (Stokes, 1999). Biodata questions are often presented in a standardized self-report questionnaire with a multiple choice format that asks individuals to describe their past experiences, behaviors, and/or attitudes (Gatewood & Feild, 2001).

For example “in high school, how easy were your math classes?” and “in comparison with most people you know, how often do your friends come to you for advice or guidance” are biodata questions which could be reflections of perceived cognitive abilities and the personality construct of agreeableness, respectively (Stokes, 1999). Researchers use biodata with the assumption that often the best predictor of future behavior is past and present behaviors, attitudes, interests, and intentions (Owens, 1976; Stokes, 1999).

Based upon the work of Hogan et al. (1984), Parasuraman, Zeithaml, and Berry (1985), and Schoenfeldt (1999), McBride (1988, 1997, McBride, Mendoza, & Carraher, 1997) used samples of students in order to create a parsimonious biodata inventory purported to measure constructs related to service-orientation. He developed a 39-item biodata inventory hypothesized to contain the following seven topical scales: Life Satisfaction, Sociability, Agreeableness, Resistance to Stress, Responsibility, Need for Achievement, and desire to make Good Impressions on others. It was found that the Sociability and Good Impressions scales were significantly related to estimates of service-orientation.

Carraher, Mendoza, Buckley, Schoenfeldt, and Carraher (1998) used four samples with a combined sample size of 861 in order to examine whether or not a modified version of the 39 item biodata instrument developed by McBride (1988, 1997; McBride et al., 1997) could be used to measure the service-orientation construct. Using limited information factor analysis, Carraher et al (1998) found support for an eight-factor solution (Agreeableness split in to two factors - Helpfulness and Agreeableness) as well as finding that service-orientation ratings were consistently related with three of the scales: Good Impression, Sociability, and Helpfulness.

Two years later, Chait, Carraher, and Buckley (2000) used 605 job applicants to reexamine the relationship the biodata measure. Using principal components analysis, they found support for a five-

factor model with McBride's biodata instrument and further found that this five-factor model was similar to the Big Five Personality Factors of Extroversion, Conscientiousness, Emotional Stability, Agreeableness, and Openness to Experience. Interestingly, the results from this five-factor model had a similar multiple R (.46) to that from the originally hypothesized seven-factor solution suggested by McBride (1988, 1997; McBride et al., 1997).

Carraher, Buckley, Scott, Parnell, and Carraher (2002) used samples of 704 job applicants from three countries (the USA, Canada, and United Kingdom) in order to extend the work of Chait et al. (2000) across borders and 50 American students in order to examine the test-retest reliabilities for the biodata instrument. They found that across countries the service-orientation ratings were significantly correlated with Extroversion, Openness to Experience and Agreeableness, and they were also significantly correlated with Conscientiousness in both non-American samples but not in the American sample. The six-month, test-retest reliability estimates were found to range from .73 (Openness to Experience) to .84 (Extroversion).

In this study, we seek to extend the work of Carraher et al. (2002) and examine if McBride's biodata instrument is useful within small organizations in non-English and English-speaking countries. Specifically, the 39-item inventory developed by McBride (1988, 1997; McBride et al., 1997) is utilized in order to assess individuals' levels of service-orientation and compare these assessments to those determined through actual on-the-job performance.

## METHOD

### Subjects

Subjects included 321 small retail business owners in Austria, 183 in Hungary, 222 in Slovenia, 173 in Ukraine, and 202 in the USA. The gender composition of the samples was 51 to 60% males for the samples. There were no noticeable differences in service-orientation levels.

### Instruments

The primary instrument was the biodata inventory developed by McBride (1988, 1997; McBride et al., 1997) [all items are listed by McBride et al.]. Using full-profile principal components analysis (as was used by Chait et al., 2000), we found support for the five-factor models so we are going them with scales calculated using regressed factor scores. Due to problems with the use of coefficient alpha reliability estimates (Sethi & Carraher, 1993) and the admonition that commonly used internal consistency estimations of reliabilities are "generally inappropriate for biodata" (p. 492, Mitchell, 1994), we did not calculate them but supported the internal consistency of the scales using limited information factor analysis as suggested by Schoenfeldt and Mendoza (1994) and Mitchell (1994). Carraher et al. (2002) found the 6-month, test-retest reliability estimates to range from .73 (Openness to Experience) to .84 (Extroversion).

In terms of item content, in addition to covering basic demographics (age, sex, etc.), many of the questions contained in the inventory consisted of experiential, attitudinal, and behaviorally-based items (e.g. "When you were a member of a small group, how much do you participate?" and "How comfortable are you in new places and situations?"). The response formats for all questions except for age and gender had five response categories.

### Customer Interaction

The customer service interactions took place at the work sites of the small business owners. All

were self-employed business people in large cities within each country. Previous research has shown that business ventures in Central and Eastern Europe are often operated in a different manner than how they are run in the West. However, the motivations of the entrepreneurs tend to be similar and it is expected that this would be true as well in the Far East (Abetti, 1995; Abetti, Hirvensalo, & Kapij, 2001). Thus, this environment allows a variation in the organization system in terms of organization – but with similar underlying motivations. It is interesting to note that the individual business people were multi-lingual with each speaking at least two languages – with four or five languages being more typical. The actual customer interactions were observed over the course of two weekends in each location.

#### Criterion: Ratings of Service

Three observers rated the performance of the subjects in order to allow a comparison in the ratings. Each of the raters had been trained in order to accurately and consistently identify differing levels of service-orientation. After observing 6-30 actual customer service interactions, raters would rate each of the subjects. Service-orientation was measured using a 17-item rater evaluation form designed by Schoenfeldt (1999).

#### Results

Pearson product-moment correlations between the criterion (the average composite measure of service-orientation from the raters) and each of the scales are presented in Table 1. The multiple  $R$ 's regressing all five of the scales on the criterion are also presented in Table 1. Turning to the results of the correlations, we see that Extroversion, Agreeableness, and Openness to Experience have the highest correlations with ratings on service-orientation for the American sample. In the Ukrainian, Hungarian, and Austrian samples, Extroversion, Agreeableness, Openness to Experience, and Conscientiousness are the four that are consistently correlated with service-orientation ratings. In Slovenia, Extraversion,

Openness to Experience, and Conscientiousness were related to the service-orientation ratings for the small business owners. It is interesting to note that while all of the relationships are similar to or higher than those typically received with other service-orientation instruments, we were able to explain about half of the variance in service-orientation in Hungary and Austria than in Ukraine, with the American and Slovenian samples being in the middle range. Thus, while an instrument such as this one could potentially provide great utility for organizations seeking to use a questionnaire for selection or developmental purposes, we strongly suggest that additional cross cultural research be performed on the construct of service-orientation itself in order to ascertain its meaning between, within, and across cultures.

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Insert Table 1 about here

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## CONCLUSIONS

These findings suggest that service-orientation can be effectively identified using a biodata inventory such as the one used in this study. It should be noted that the coefficients found here are similar to those found by Hogan et al. (1984), Personnel Decisions, (Paajanen, 1995), and CORE Corporation (Fogli, 1995) with other measures of service-orientation. For example, CORE Corporation reports that their measures of service-orientation have validity coefficients in the range of .19 to .36 for the service-oriented performance of tellers in the banking industry (undated), and Personnel Decisions reports validity coefficients in the range of .19 to .32 across a variety of occupations for their measure of service-orientation (McLellan & Paajanen, 1994). These findings are

also consistent with those found by previous researchers (Carragher et al. 1998; 2002) with this instrument for job applicants in the United States, United Kingdom, and Canada suggesting that this instrument may be useful for developmental purposes in order to provide feedback to small business owners across cultures so that they may seek to increase their service oriented behaviors. In fact, O’Gorman and Doran (1999) have reported that it is through the focus on serving the customer well that small and medium sized businesses may more effectively compete with larger organizations that may have a cost advantage.

The results of the current study clearly show service-orientation to be reflective of extroverted individuals who make a conscious effort to actively help others and seek out new ways to satisfy the needs of customers. As a consequence, it does appear that inventories such as the one developed by McBride may be useful for identifying individuals with the tendency to exhibit strong service-oriented behaviors for both developmental and selection purposes. We suggest that additional research be performed in order to confirm our findings.

While the identification of proactive, considerate employees may be important to any organization, it is especially crucial in ones in which customer service may be a major part of the job for most of the positions within the organization as is increasingly becoming the case in the United States and around much of the world. This is especially important in small businesses where most employees may be called upon on a consistent basis to interact with both internal and external customers. Moreover, the generalizability of the instruments used to tap the construct are enhanced by the concept of service-orientation itself in that it is not occupation specific and as shown here may be used across all levels of an organization.

This research has served to shed light on those areas of service-orientation that may be most important in the identification of individuals likely to behave in a service-oriented manner within small businesses. Therefore, we believe that this type of an instrument can make an important contribution in the identification of individuals across cultures likely to exhibit high levels of service-oriented behaviors and that additional cross cultural research be performed on the construct of service-orientation.

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TABLE 1

Correlations and Regression of Service-Orientation with  
Biodata Scales

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| Scales   | Correlation (r)<br>with Criterion |                   |                   |                                     |
|--|-----------------------------------|-------------------|-------------------|-------------------------------------|
|  | Aus                               | Hun               | Slo               | Ukr                                 |
| USA  |                                   |                   |                   |                                     |
| Extroversion   | .261 <sup>c</sup>                 | .275 <sup>c</sup> | .354 <sup>c</sup> | .514 <sup>c</sup> .291 <sup>c</sup> |
| Agreeableness  | .194 <sup>c</sup>                 | .189 <sup>b</sup> | .024              | .176 <sup>a</sup> .221 <sup>b</sup> |
| Emotional Stability  | .016                              | -.055             | -.040             | .008-.024                           |
| Conscientiousness  | .212 <sup>c</sup>                 | .221 <sup>b</sup> | .254 <sup>c</sup> | .249 <sup>c</sup> .134              |
| Openness to Experience   | .226 <sup>c</sup>                 | .203 <sup>b</sup> | .297 <sup>c</sup> | .194 <sup>a</sup> .315 <sup>c</sup> |
| Multiple R from regression<br>analysis including 5<br>topical scales | .448 <sup>c</sup>                 | .452 <sup>c</sup> | .529 <sup>c</sup> | .647 <sup>c</sup> .501 <sup>c</sup> |

R Squared .201 .165 .280 .395 .251

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<sup>a</sup> = p<.05 <sup>b</sup> = p<.01 <sup>c</sup> = p<.001

### Acknowledgements

The authors would like to thank Jorge Mendoza, Ralph Alexander, H. John Bernardin, Greg Dobbins, Daniel Wren, Paul Nystrom, William Whitely, Mark Mone, and Vince Barker, for their valuable comments on, and assistance with, earlier editions of this paper.

# **ORGANIZATIONAL FINANCIAL PERFORMANCE: IDENTIFYING AND TESTING MULTIPLE DIMENSIONS**

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## **ABSTRACT**

In general, this research addresses the measurement of organizational financial performance to provide researchers and managers a better understanding of the implications of selecting variables for use in empirical studies and management practice where organizational financial performance is the criterion of interest. Since no prior research has empirically established the domain of organizational financial performance, this research is by necessity exploratory in nature. A two part approach is adopted to address this problem. First, a model of overall organizational performance is inferred from empirical data that includes the primary constructs of an organization's financial performance and empirical measures of these constructs. Next, the validity and reliability of the constructs and measures are tested.

This is the first study that has undertaken to empirically identify both distinct dimensions of organizational financial performance and the measures that represent those dimensions. The identification of different dimensions and measures of financial performance for annual and three-year timeframes are unique contributions of this research.

Another significant contribution of this research is the identification of financial variables that discriminate between high and low performing companies. These measures should receive the primary attention of researchers, management and users of financial statements. Those companies that attain and sustain competitive advantage in the market do not strive to be average. Therefore, the metrics they use to gauge performance should focus on outcomes that set them apart from the competition.

## INTRODUCTION

There is little dispute that one of the core purposes of both entrepreneurship and strategic management theory and research is the improvement of organizational performance (Eisenhardt & Zbaracki, 1992; Venkatraman & Ramanujam, 1986). However, there seems to be no consensus regarding the best, or even sufficient, measures of organizational performance. This is in no small part due to the many varied views on the most desirable outcomes of organizational effectiveness and because performance has often been characterized by the theory and purposes of the research being performed. Researchers further confound the problem by confusing determinants of performance with measures of performance (Cameron, 1986).

It has long been reported that different measures of organizational effectiveness and performance have been used in entrepreneurship and management studies with little or no thoughtful discussion of why the measures used in the studies were chosen. Little attention has been paid to the limitations that these measures may impose on the interpretation or generalizability of the results of the research, and most have concluded that organizational performance is multi-dimensional in character. The most frequently used measures of organizational performance are financial; however, no study has successfully proposed and empirically tested a generalizable multi-dimensional model of organizational financial performance. This is a particularly challenging issue since changing environmental conditions may dictate that different performance dimension priorities exist at different times. For instance, during economic recessions, liquidity may be more crucial than profitability, while during economic booms, profitability and growth may take precedence. This research examines the multi-dimensional structure of organizational financial performance and seeks to empirically identify distinct financial performance constructs and appropriate measures of those constructs.

The development of valid operationalizations of the key concepts and constructs used to form of both independent and dependent variables in the models used in entrepreneurship and strategic management research is fundamental to the description and corroboration of theoretical relationships being tested in research, and is the essence of the measurement stream of research. Put differently, the validity of research studies that use arbitrary dependent measures to represent overall organizational performance is highly questionable. Researchers need to know that the effects they are studying will reasonably be represented by the changes in the dependent variables. The use of different measures as proxies for “performance” makes extension from one study to the next dubious. Peter clearly summed up the importance of construct measurement as follows:

Valid measurement is the *sine qua non* of science. In a general sense, validity refers to the degree to which instruments truly measure the constructs which they are intended to measure. If the measures used in a discipline have not been demonstrated to have a high degree of validity, that discipline is not a science (1979:6).

Measurement is the “careful, deliberate, observations of the real world for the purpose of describing objects and events in terms of the attributes composing a variable” (Babbie, 1998:116). For a variable to be clearly and equally understood by many different individuals, it must be accurate, precise, quasi-invariant across observers, provide discrimination from other

variables, and be stable over time. As a result, it is problematic that overall organization performance has been “measured” in scores of research studies by dozens of variables that are generally not strongly correlated over time.

Part of this research involved an analysis of 1,045 articles published in the leading entrepreneurship and management journals between 1996 and 2001. Of these 1,045 articles, 138 purported to use overall organizational performance as the dependent variable. Over 70% of these 138 articles used a financial performance measure as the dependent variable. Further, 46% of these 138 articles used only a single measure, 25% used two measures, and 18% used three measures to represent organizational performance. Overall, a total of 88 different dependent measures were used to represent overall organizational performance in these 138 articles, generally without any support for the validity of the measures utilized. Consequently, it can be inferred from these statistics that there is no consensus in the entrepreneurship and strategic management research conducted over the 5 years with respect to valid measures of organizational performance.

The topic of this research is particularly important for several reasons. First, a multi-dimensional model of organizational performance has not been explicitly studied before. Murphy, Trailer and Hill (1996) examined the dependent measures used in entrepreneurship research and through exploratory factor analysis found nine distinct performance constructs among the more than 50 different dependent variables reported upon. Venkatraman and Ramanujam (1987) empirically demonstrated that growth and profitability were distinctly different measures of performance, but did not attempt to propose a specific model for financial performance measurement. Robinson (1998) empirically tested the relationship between four separate independent variables (stage of the life cycle, industry concentration, entry barriers, and product differentiation) with eight different measures of performance in new venture research and found significantly different results between each independent variable and the eight dependent variables. This further demonstrated the existence of multiple dimensions of performance.

Second, a generalizable and more powerful measurement model of organizational financial performance has significant implications for future research and for reexamining the findings of prior research where less powerful dependent variable measurement models were used. Such a model can help resolve multiple inconsistent theories where differing dependent variables were used.

Finally, a multi-dimensional model of organizational financial performance can significantly improve organizational stakeholders’ understanding of the effectiveness of management. It allows for the measurement of value creation and for reasonable comparison across companies that have chosen different routes to creating value.

Therefore, the objective of this research is to develop a model of organizational financial performance. The model demonstrates that organizational financial performance is a multi-dimensional construct. In addition, it shows that the simultaneous consideration of these multiple dimensions is more appropriate for drawing conclusions about the effectiveness of managerial actions than considering each performance dimension separately.

## SELECTED PRIOR STUDIES OF ORGANIZATIONAL PERFORMANCE

Despite the importance of accurately measuring organizational financial performance, there have been very few studies that have directly addressed the question of how organizational financial performance is or should be measured. Perhaps more importantly, none of these studies seem to have significantly influenced how organizational financial performance is actually measured in most of the empirical research that uses this construct as a dependent measure.

In 1985, Rawley & Lipson examined the relationships among several combinations of performance measures to demonstrate that different common measures of financial performance did not represent the same attributes. Of these comparisons, the only overall performance measures that they found to be related to each other at statistically significant levels were the Q ratio versus cash flow return on investment (“CFROI”) adjusted for the Capital Asset Pricing Model (“CAPM”) discount rate, and market-to-book value versus return on investment adjusted for inflation. The Q ratio was proposed by Callard & Kleinman (1985) as a substitute for Tobin’s Q, and is calculated as the ratio of the value of individual business units divided by the inflation adjusted purchase cost of assets. The other measures that they compared were clearly discriminant and do not measure the same construct. Table 1 summarizes their findings for the S&P 400 companies for the period 1982 through 1984.

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Table 1 about here

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Chakravarthy’s 1986 comparative study of seven “exemplar” firms with seven “maladapted” firms in the computer industry developed an eight variable discriminant function for the two groups. None of the individual profitability measures tested in this research was capable of discriminating between the two groups. The discriminant function developed included multiple dimensions of performance, once again indicating the importance of multivariate measures of organizational performance.

Using confirmatory factor analysis (“CFA”), Venkatraman and Ramanujam (1987) empirically examined the degree of convergence across methods of measuring organizational financial performance and in so doing, demonstrated that sales growth, profit growth, and profitability were discriminate measures of different dimensions of organizational financial performance. They selected these measures based upon a review of the different performance dimensions typically used by different disciplines done by Hofer (1983) and Woo and Willard’s (1983) findings of key dimensions of performance based upon an analysis of PIMS data. The implication of this finding is that in isolation, none of the three variables individually measure the organizational financial performance construct. Consequently, the findings from a study that uses sales growth to represent organizational financial performance should not be equated to findings from a study that uses either profit growth or profitability to represent business economic performance.

Brush and VanderWerf (1992) examined thirty-four different studies in the entrepreneurship literature that explicitly used firm performance as the dependent variable. They found that

thirty-five different measures of performance were used in those studies indicating that researchers perceived many different dimensions of performance, and that there was no agreement on what measures actually represent organizational performance. The most frequently used measures of performance were changes in sales, organizational survival, changes in number of employees, and profitability. Brush and VanderWerf state that they did not attempt to sort out the problem of which performance measures to use. However, they note that the fact that 35 different performance measures were used in just 34 studies indicates that more work needs to be done to identify measures that make sense for use across studies.

Robinson (1995) examined ten different new venture performance measures to determine which individual measure was the most effective in accurately assessing long-term economic value creation. The ten measures studied were change in sales, sales level, return on sales, return on invested capital, return on equity, return on assets, net profit, earnings before interest and taxes, earnings multiples, and shareholder value created. All ten performance measures were tested individually for their relationship with multiple independent variables that had been found in prior literature to have positive relationships to new venture performance. The shareholder value created measure (also commonly known as return to shareholders) was determined to be the most effective measure for effectively differentiating among new venture strategies, the second most effective measure for differentiating among the structure of the new venture's entered industry, and the most effective measure in differentiating among the interactions between new venture strategies and the structure of the industry the new venture entered. The fact that the different performance measures of overall new venture performance resulted in significantly different r-squares implies that the variables do not measure the same things.

Murphy, Trailer and Hill (1996) examined the variables used to measure organizational performance in entrepreneurship research in the years 1987 through 1993. They identified 51 articles published in the top entrepreneurship and strategic management journals that explicitly used firm performance as a dependent variable. They found, consistent with Brush & VanderWerf (1992) and Cooper (1993), that there was no consistency in the variables used to measure new venture performance. In total, they identified 71 different dependent variables used to measure performance in the 51 articles.

Murphy et al. then examined 19 financial variables from a sample of 995 public firms with 500 or fewer employees. They found that less than half of the intercorrelations between performance measures were significant, indicating that these variables measured different dimensions of performance. More than 25% of the significant correlations of performance measures were negative. Murphy, et al. concluded that the "...relationship between a given independent variable and performance is likely to depend upon the particular performance measure used." They further concluded "...research finding support for an effect on one performance variable cannot justify the assumption that the effect is similar across other measures of performance (1996: 21)." Their study also found that the performance measures tested failed to meet the requirements of convergent and discriminant validity necessary to validate a one-dimensional performance construct (Campbell & Fiske, 1959).

Next, Murphy et al. performed an exploratory factor analysis on the 19 variables, which yielded 9 factors that explained over 70% of the variance in the performance measures. In an attempt to more fully examine the results obtained by Murphy et al., we performed a confirmatory factor

analysis of the nine factors identified in their research, using LISREL 8.12 as suggested by Bollen (1989). The covariance data reported in the 1996 study was as the basis for the analysis.

The results of this CFA analysis indicated that the factors determined by Murphy et al. did not fit the data. The model yielded Chi-square = 1292 with 127 degrees of freedom ( $p < 0.0001$ ), Bentler and Bonnet normed fit index of .727 and a non-normed fit index of .657. This indicates that while the variables did load into factors, these factors may not be supported by the data. This is possible since exploratory factor analysis will force variables into the number of factors specified, even though the factors may not have the best possible fit for the data. Even if the data had fit the model, because the analysis was an exploratory factor analysis, there was no theoretical support for the identified constructs. Consequently, the variables within each factor, as determined by the exploratory factor analysis, fail the test for convergent validity using confirmatory factor analysis, and they also did not have any face validity.

It is clear from the prior empirical studies that there has been no consistency in the measures used to represent the construct of overall organizational performance in strategic management or entrepreneurship research. Further, prior empirical research has demonstrated that there are multiple dimensions to the performance construct. While Robinson (1995) found that return to shareholders was the most powerful individual performance with respect to new venture performance among companies that have undergone initial public offerings, these findings cannot be reasonably generalized to studies that use different samples. In short, there continues to be no conclusive research that has identified a “best” measure of overall organizational performance, nor has a measurement model that accurately represents the construct yet been developed.

## **METHODOLOGY FOR DEVELOPING & TESTING A MODEL OF ORGANIZATIONAL FINANCIAL PERFORMANCE**

Since no prior research empirically established the domain of organizational financial performance, this research was by necessity exploratory in nature. The process employed in this research for inferring a model of financial performance included four phases. First, a sample of public companies was segregated into high, medium, and low performers based upon both annual and three-year financial performance, as indicated by their return to shareholders over the specified period of time. Return to shareholders was previously found by Robinson (1995) to be the most powerful measure of organizational performance. Second, the high and low performing groups were compared using the financial measures most commonly used in past research and/or discussed in the entrepreneurship and strategic management literatures, for the purpose of identifying the specific measures that differentiated the two groups. Third, the variables identified that differentiated between high and low performing companies were grouped into constructs. Finally, the validity of these constructs was tested.

### **Developing a Sample**

The companies in the Standard and Poor's 1500 at December 31, 2002 (a combination of the Standard and Poor's 500, Standard and Poor's Mid Cap 400, and the Standard and Poor's Small Cap 600 indices) was the population of public companies used for this research. These companies include a wide cross-section of industries, organizational sizes, and organizational

ages. Four years of financial data was collected from the Standard and Poor's Compustat<sup>®</sup> database. One and three-year performance information was calculated from this data and any firm-year of data that was incomplete or contained significant outliers was eliminated from the final sample. The final sample included 2,894 individual firm-years of data and 925 three-year periods of data.

### **Developing a Sample of High and Low Financial Performing Companies**

The individual annual firm year and three-year periods in the sample were classified as high, medium, or low financial performance based upon return to shareholders. A firm was classified as high performing if its standardized value of return to shareholders was one or greater. A firm was classified as low performing if its standardized value of return to shareholders was negative one or greater. All other firms were classified as medium performing.

A total of 309 firm years were classified as "high", 321 firm years were classified as "low", and the remaining 2,264 firm years were classified as "medium". In the case of three-year period data, a total of 124 three-year periods were classified as "high", 143 three-year periods were classified as "low", and the remaining 658 three-year periods were classified as "medium".

### **Comparing the High and Low Financial Performing Companies**

The two samples of high and low performing companies were compared with respect to 20 of the financial measures most commonly used in past entrepreneurship and strategic management research and from the literatures of these fields. These measures were compared using *t* tests to determine if there was a statistically significant difference between the high and low performing companies with respect to each measure.

Those measures that indicated a statistically significant difference between the groups were retained for further evaluation in this research. Variables that did not discriminate between high and low financial performing companies were not utilized further. Each variable that was included in this research was evaluated both as a static value and for the change in the value over the period of interest to examine the relative information content of static vs. change scores.

### **Testing a Model of Overall Organizational Financial Performance**

Based upon the comparison of variables for their ability to discriminate between high, medium, and low performing companies, a set of variables was selected to measure each financial construct. The grouping of variables into financial constructs was based upon a review of accounting and finance literature (see Breley, Myers & Marcus, 2001; Copeland, Koller & Murrin, 2000; Penman, 2001). The combination of theoretical constructs and the variables used to represent the constructs became the model of organizational financial performance tested in the next stage of this research.

The validity of the constructs was tested using confirmatory factor analysis ("CFA") through the use of AMOS 5.0 structural equation modeling software (Bollen, 1989; Venkatraman & Ramanujam, 1987). The CFA framework uses a maximum likelihood approach to providing a statistical analysis of the entire validity of a construct and a decomposition of the measurement variance into its constituent components (Bagozzi, Yi, & Phillips, 1991). The proposed

constructs and their measures were tested for both discriminant and convergent validity. Those constructs or measures that were not found to be valid were eliminated from the model of organizational financial performance and a revised model was proposed.

## RESULTS

### Financial Measures That Discriminate Between High and Low Performing Companies

This research found that, for annual periods, thirty five of the forty financial performance measures tested discriminated between high and low performing companies at  $p < .10$ , using market adjusted return to shareholders as the basis for classification. For three-year periods, thirty two of the forty financial performance measures tested discriminated between high and low performing companies at  $p < .10$ . Table 2 summarizes the results of the  $t$  tests for the variables that did and did not discriminate between high and low performing companies for both annual and three-year periods.

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Table 2 about here

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One paradox of management research described by Cameron (1986) was that most empirical studies tend use measures and methods that explain average performance, while the primary focus should be on understanding what makes firms either very successful or very unsuccessful. It is, therefore, essential to select performance metrics that can discriminate sufficiently among companies that perform at different levels of performance. This study identified thirty two annual and twenty seven three-year financial performance measures that discriminated between high and low performing companies at  $p < .01$  with respect to market adjusted return to shareholders. Of these measures, those that provided the most information about the return to shareholders referent with respect to the sample of all companies, not just high and low performing companies, should provide the most statistical power for research where shareholder value creation is the phenomenon of interest.

### Tests of an Annual Model of Organizational Financial Performance

Figure 1 depicts the initial set of constructs that was tested for both convergent and discriminant validity for annual data. AMOS 5.0 software was used to test whether the annual data fit the proposed model. Constructs with only one observed measure were constrained to exactly equal the value of the measure, as suggested by Bollen (1989). The variance of each construct was constrained to unity so that the parameters for each observed variable could be freely estimated.

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Figure 1 about here

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The assumptions of structural equation modeling require that the estimated variance of each measure must be positive and the covariance matrices must be positive definite. Three fit indices, as recommended by Arbuckle and Wothke (1999), were chosen to determine if the data fit the model. The three indices included the comparative fit index (CFI; Bentler, 1990), the Tucker-Lewis coefficient (TLI; Bentler & Bonnet, 1980), which is also known as the Bentler and Bonnet non-normed fit index (NNFI), and the root mean square error of approximation (RMSEA; Browne & Cudeck, 1993). Arbuckle and Wothke (1999) suggest that a value of .90 or greater for both the CFI and the TLI indicates a reasonable fit of the data with a model and, an RMSEA value of about .08 or lower, but certainly no greater than .10 indicates an acceptable error rate for a model. Accordingly, a model that met all three criteria was considered to have an acceptable fit.

A random sample of 150 high performing firms and 150 low performing firms was used to test the model. This annual data did not fit the model as proposed in Figure 1, since the covariance matrix for the constructs that comprise the model was not positive definite. This indicates that there was a specification error in the model or that the sample size was too small (Jöreskog & Sörbom, 1996). As the sample in this case had 300 observations, it is reasonable to conclude that the model had a specification error.

An examination of the correlations between variables across constructs revealed that residual income return on investment (“RI ROI”) was more highly correlated with the profitability construct than with residual income (“RI”) in the economic value construct. The model specification error was eliminated by moving the RI ROI measure to the profitability construct. The revised model had  $\chi^2 = 2213.4$  with  $df = 334$  and  $n = 300$ . The CFI for the model was .83, the TLI was .78, and the RMSEA was .14. All three measures indicated that the data did not acceptably fit the model. Accordingly, the measures included in the model were reexamined to determine which should be kept and which should be excluded from a revised model.

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Figure 2 about here

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Figure 2 depicts the revised annual model of organizational financial performance that met the test for convergent validity of the measures with the separate constructs. As a result of these changes in the specification of the model, the data fit the revised ten-construct model. The model had  $\chi^2 = 405.4$  with  $df = 130$  and  $n = 300$ . The CFI for the revised model was .95, the TLI was .93, and the RMSEA was .08. All three measures indicate that the data fits the model. Accordingly, the model met the requirements of convergent validity (Arbuckle and Wothke, 1999; Bollen, 1989; Jöreskog & Sörbom 1996).

Using a confirmatory factor analysis framework, discriminant validity is achieved when the correlations between the separate constructs are statistically significantly lower than unity (1.0) (Bollen, 1989). Any correlations that appeared “high” were tested by setting the correlation between the two constructs equal to unity, and then testing the statistical significance of the change in  $\chi^2$  between the two models.

For the revised model, only two constructs, growth and growth change, were correlated in excess of 0.60. Accordingly, the correlation between the two constructs was constrained to unity and the model was retested. The result was  $\chi^2 = 414.0$  with  $df = 131$ . The change in  $\chi^2$  was 8.6 with  $df = 1$  and  $p < .01$ . Accordingly, for the revised model the constructs were found to be discriminant. All other combinations of constructs had correlations below 0.52, which indicates that all constructs met the requirements for discriminant validity.

In summary, ten of the original thirteen constructs and twenty of the original thirty measures were retained in the annual financial performance measurement model. It was also demonstrated that these constructs were discriminant and that the measures of the constructs met the test for convergent validity.

### **Tests of a Three-Year Model of Organizational Financial Performance**

Figure 3 presents a diagram of the initial set of financial performance constructs and their corresponding measures, for three-year data. The convergent validity of the measures for each construct was tested using confirmatory factor analysis, as was done with the annual data model.

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Figure 3 about here

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The three-year data did not fit the proposed model. The model had  $\chi^2 = 1013.2$  with  $df = 307$  and  $n = 120$ . The fit indices were  $CFI = .81$ ,  $TLI = .74$ , and  $RMSEA = .14$ . There were specification errors in the model, as indicated by estimated negative residuals for four measures including ROI, CROI, GR Sales, and COC. Consequently, adjustments to the base model were necessary, as was the case with the annual data model. Accordingly, the measures included in the three-year model were reexamined in order to determine which should be retained in a revised model.

As a result of the changes in the model specification, the data fit the revised, ten-construct model depicted in Figure 4. The model had  $\chi^2 = 212.1$  with  $df = 137$  and  $n = 120$ . The fit indices were  $CFI = .93$ ,  $TLI = .91$ , and  $RMSEA = .07$ . All three measures indicate that the data fits the model. Further, modification indices do not indicate any significant improvement in fit would be achieved by including a measure with an additional construct. Accordingly, the measures meet the requirements for convergent validity (Arbuckle and Wothke, 1999; Bollen, 1989; Jöreskog & Sörbom, 1996).

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Figure 4 about here

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As with the testing of the measurement model for annual data, any correlations between constructs that appeared “high” were tested by setting the correlation between the two constructs equal to unity, and then testing the statistical significance of the change in  $\chi^2$  between the two models. Two pairs of constructs appeared to possibly be “highly” correlated. They were the (1) change in profitability and the change in survival and (2) the cost of equity capital and the change in survival.

First, the correlation between the change in profitability and the change in survival was constrained to unity, and the model was retested. The result was  $\chi^2 = 251.1$  with  $df = 138$ . The change in  $\chi^2$  was 39 with  $df = 1$  and  $p < .001$ . Accordingly, the constructs were deemed to be discriminant. Next, the correlation between the cost of equity capital and the change in survival was constrained to unity and the model was retested. The result was  $\chi^2 = 230.0$  with  $df = 138$ . The change in  $\chi^2$  was 17.9 with  $df = 1$  and  $p < .001$ . Accordingly, for the revised model, the constructs were deemed to be discriminant.

In summary, ten of the original thirteen constructs and twenty of the original twenty nine measures were retained in the measurement model. It was demonstrated that these ten constructs were discriminant and that the revised set of measures of the constructs met the test for convergent validity.

### **Limitations of this Research**

Overall organizational performance is a multi-dimensional construct. This research only focused on one of the primary dimensions, namely financial performance. Operational and stakeholder dimensions were not examined. As a consequence, the relative importance of financial performance to the two other performance dimensions was not examined. A model of overall organizational performance that includes all major performance dimensions might require a different set of financial dimensions or different measures of the identified dimensions due to overlapping information across the higher order constructs.

An additional limitation of the research design was the selection of only two timeframes, one and three years. While these two timeframes are those most frequently used in entrepreneurship and strategic management research, 21% of the empirical studies summarized in this research used other timeframes, most notably single point in time measures and five-year measures. Also, the annual and three-year models of financial performance developed in this research were not the same, implying that different dimensions of financial performance are more or less important at different times. Accordingly, the generalization of the results of this research to other timeframes requires additional testing.

A final limitation of the research design of the study was the omission of risk from consideration in financial performance model. While financial risk is indirectly included through the calculation of the cost of equity capital, strategic risk was not calculated. Bromiley (1990) suggested that risk should be a component of the analysis of organizational performance. However, it should be up to the discretion of the researcher whether it is appropriate to capture the effects of risk as an independent measure or as a component of the dependent measure.

The sample utilized in this study limits the generalization of the findings in several ways. These limitations include: (a) only U.S. companies were included in the sample; (b) only publicly traded companies were included; (c) financial services firms such as banks and insurance companies were disproportionately eliminated from the sample because they did not report sufficient information to calculate the measures tested in this research; (d) only one three-year period was used to develop and test the three-year financial performance model; (e) the annual data was from the same timeframe as the three-year data; (f) one primary source was used to gather most of the financial data; and (g) the three-year sample did not include any companies that went out of business during the three-year period.

## **SUMMARY AND CONCLUSIONS**

For over fifty years, management scholars have suggested that organizational performance is a multi-dimensional construct. However, this is the first study that has undertaken to empirically identify both distinct dimensions of organizational financial performance and the measures that represent those dimensions. The identification of different dimensions and measures of financial performance for annual and three-year timeframes is also a unique contribution of this research.

### **Implications for Future Research**

This research empirically demonstrated that organizational financial performance is a multi-dimensional construct. Consequently, if the unit of analysis for a study is the entire organization, and if the phenomenon of interest is organizational financial performance, it is incumbent upon the researcher to consider the effects of the independent variable on multiple performance dimensions simultaneously.

However, if only one dimension of organizational performance is examined in a study, then it is inappropriate to claim to be studying the effects of the independent variables on “overall organizational performance”. In such situations, it would be more appropriate to specify the specific dimensions of organizational performance being studied, which would provide better context and understanding to readers of the research.

This research identified ten separate performance dimensions for both annual and three-year timeframes as well as multiple measures of these constructs. The theory being tested should help guide the researcher in selecting the dimensions of organizational performance to examine. Specifically, those dimensions of organizational performance that are hypothesized to create value for the constituents of interest should be used as the dependent variables. In general, dependent measures representing the phenomenon of interest should be selected with great care and a full explanation for the selection criteria should be provided for users of the research.

### **Implications for Management Practice**

Potentially the most important finding for practitioners is the fact that the changes in performance metrics are separate constructs from the static measures. Top management already places some emphasis on changes in performance metrics as demonstrated by the content of management discussion and analysis (MD&A) sections in annual reports and SEC filings. Typically, the change in performance period-over-period is the focus of MD&A. However, while changes may

be explained post hoc, management planning should focus on actions that accomplish organizational change.

Those performance metrics that have been shown in this research to discriminate between high and low performing companies should receive the primary attention of management and users of financial statements. Those companies that attain and sustain competitive advantage in the market do not strive to be average. Therefore, the metrics they use to gauge performance should focus on outcomes that set them apart from the competition.

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**Table 1** Summary of Relationships Among Selected Performance Measures from Rawley and Lipson (1985)

| Variables Compared  | R <sup>2</sup> |
|---|----------------|
| Price-to-earnings ratio vs. EPS growth                                    | .12            |
| Price-to-book ratio vs. ROE less CAPM cost of equity                      | .19            |
| Price-to-book ratio vs. Return on capital employed – CAPM cost of capital | .34            |
| Q ratio vs. CFROI less discount rate                                      | .65            |
| Market-to-book ratio vs. ROI less inflation                               | .71            |

**Table2** Measures That Discriminate Between High and Low Performing Companies by Construct

| Variable                             | Static Measures |            | Change Scores |            |
|--------------------------------------|-----------------|------------|---------------|------------|
|                                      | Annual          | Three-Year | Annual        | Three-Year |
| <b><u>Profitability</u></b>          |                 |            |               |            |
| Return on Assets                     | **              | **         | **            | **         |
| Return on Equity                     | **              | **         | **            | **         |
| Return on Sales                      | **              | **         | **            | **         |
| Return on Investment                 | **              | **         | **            | **         |
| EBITDA Return on Investment          | **              | **         | **            | **         |
| Operating Margin                     | **              | **         | **            | **         |
| <b><u>Growth</u></b>                 |                 |            |               |            |
| Growth Rate of Sales                 | **              | **         | **            | *          |
| Growth Rate of Operating Expenses    | **              | *          | **            | **         |
| Growth Rate of Total Assets          | **              | **         | **            | **         |
| Growth Rate of Employees             | **              | *          | **            | NS         |
| <b><u>Cash Flow</u></b>              |                 |            |               |            |
| Growth Rate of Operating Cash Flow   | *               | *          | *             | NS         |
| Operating Cash Flow to Equity        | **              | **         | NS            | **         |
| Free Cash Flow to Equity             | NS              | NS         | NS            | NS         |
| <b><u>Liquidity</u></b>              |                 |            |               |            |
| Liabilities to Total Assets          | NS              | NS         | NS            | **         |
| <b><u>Survival</u></b>               |                 |            |               |            |
| Altman's Z Score                     | **              | NS         | **            | **         |
| <b><u>Efficiency</u></b>             |                 |            |               |            |
| Asset Turnover                       | +               | NS         | **            | **         |
| <b><u>Economic Value</u></b>         |                 |            |               |            |
| Residual Income                      | **              | +          | **            | **         |
| Residual Income Return on Investment | **              | **         | **            | **         |
| <b><u>Cost of Equity Capital</u></b> |                 |            |               |            |
| Cost of Equity Capital               | **              | **         | **            | **         |
| <b><u>Market</u></b>                 |                 |            |               |            |
| Price to Book Ratio                  | **              | NS         | **            | **         |

\*\*  $p < .01$  \*  $p < .05$  +  $p < .10$  NS  $p > .10$

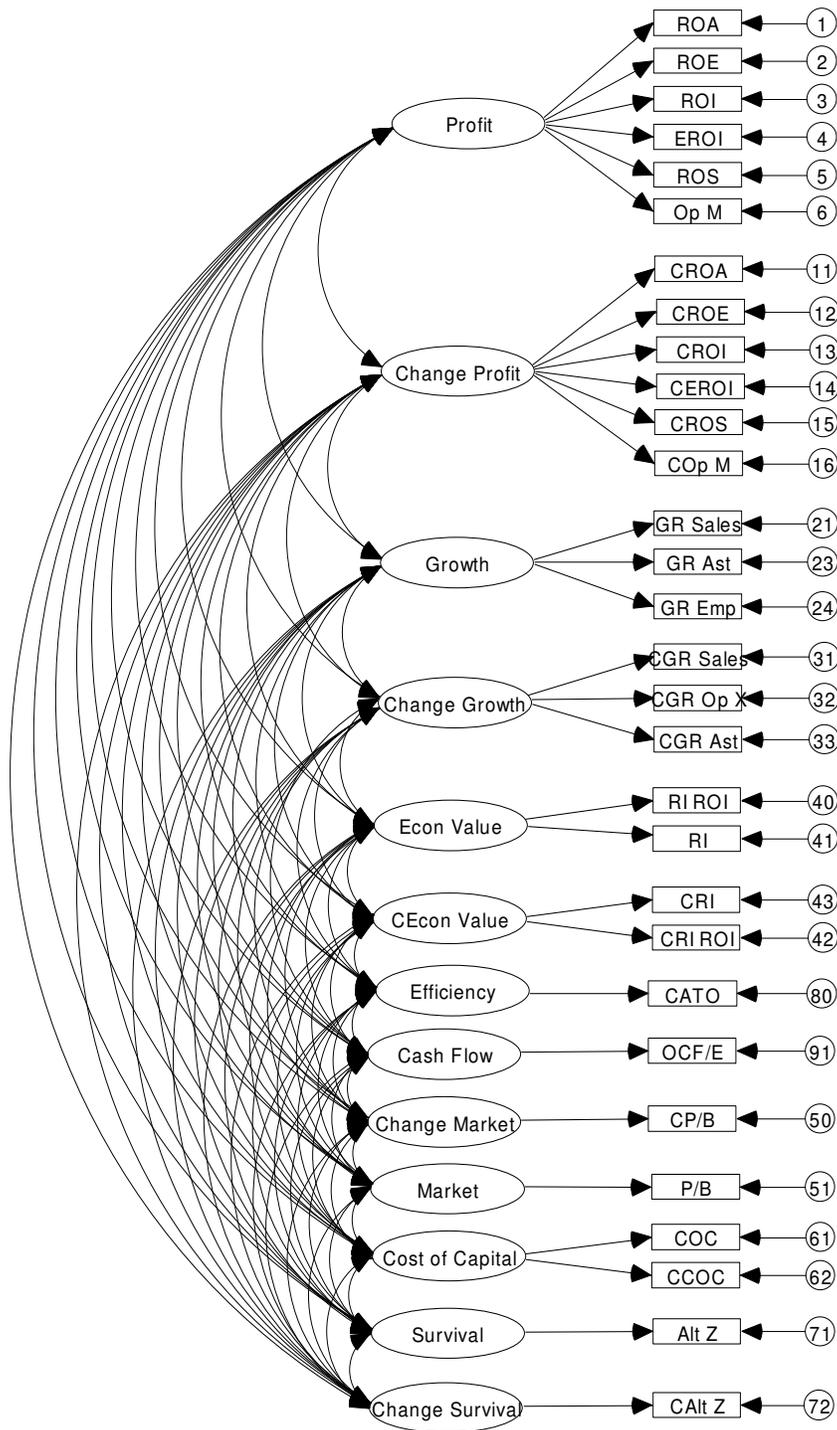


Figure 1 Proposed Constructs and Measures for a Model of Financial Performance for Annual Data

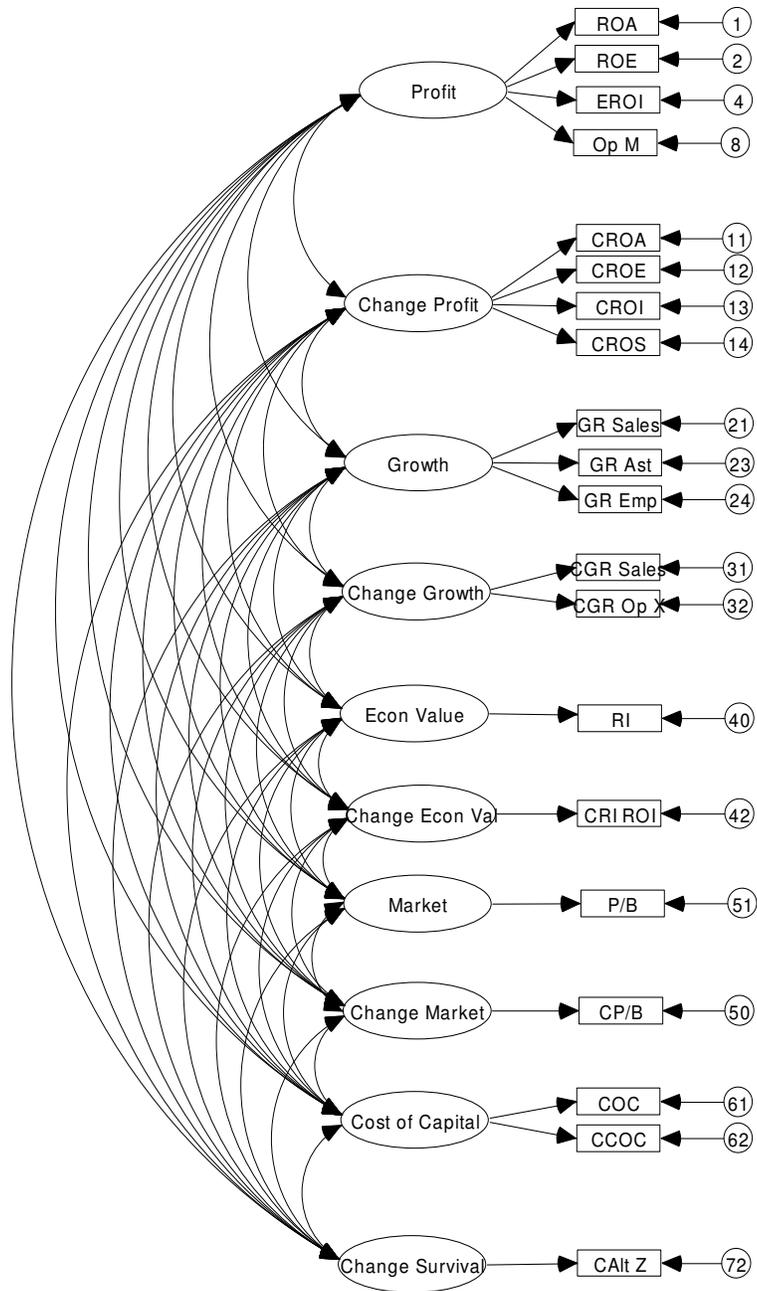


Figure 2 Revised Constructs and Measures for a Model of Financial Performance for Annual Data

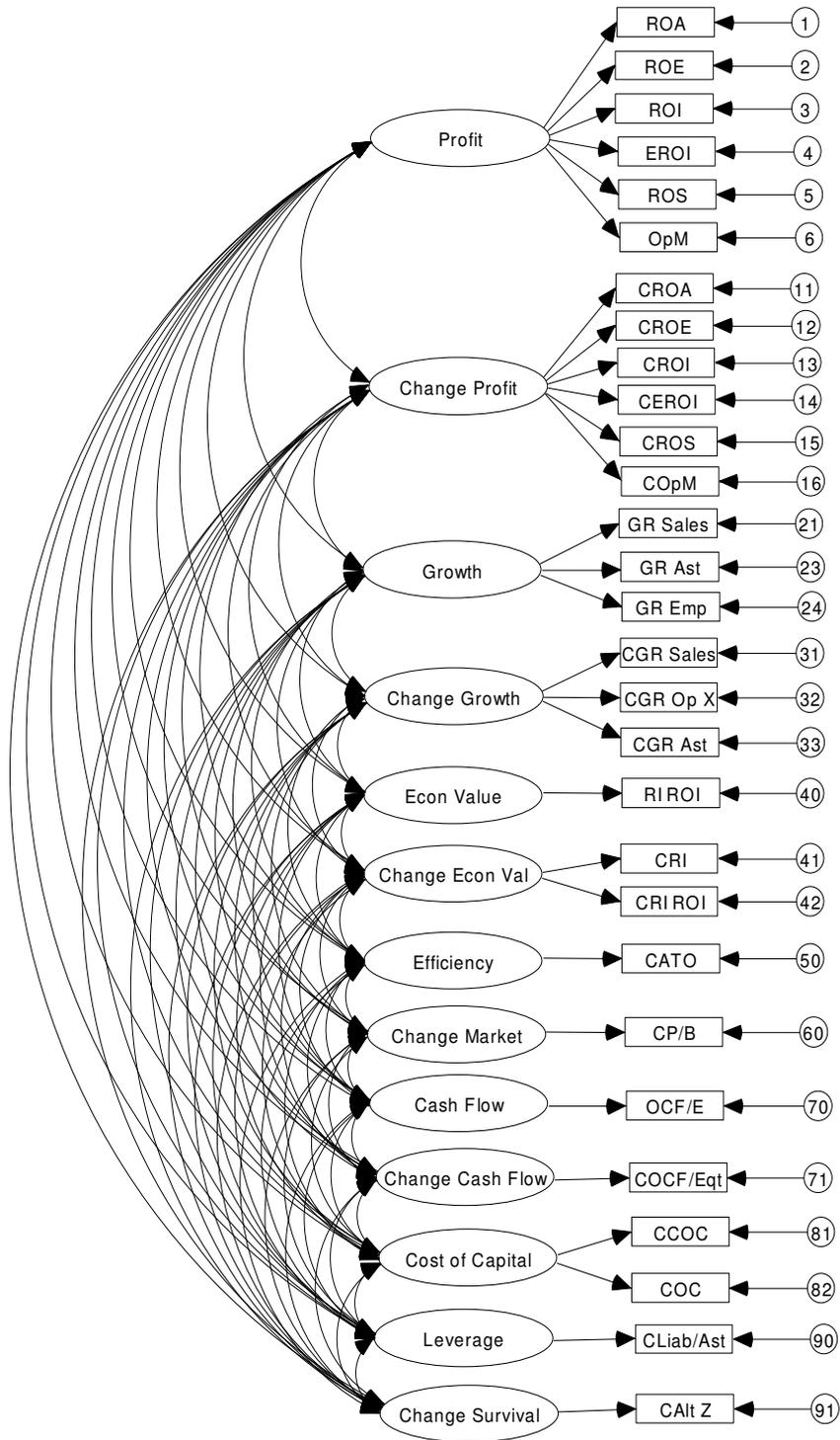


Figure 3 Proposed Constructs and Measures for a Model of Financial Performance for Three-Year Data

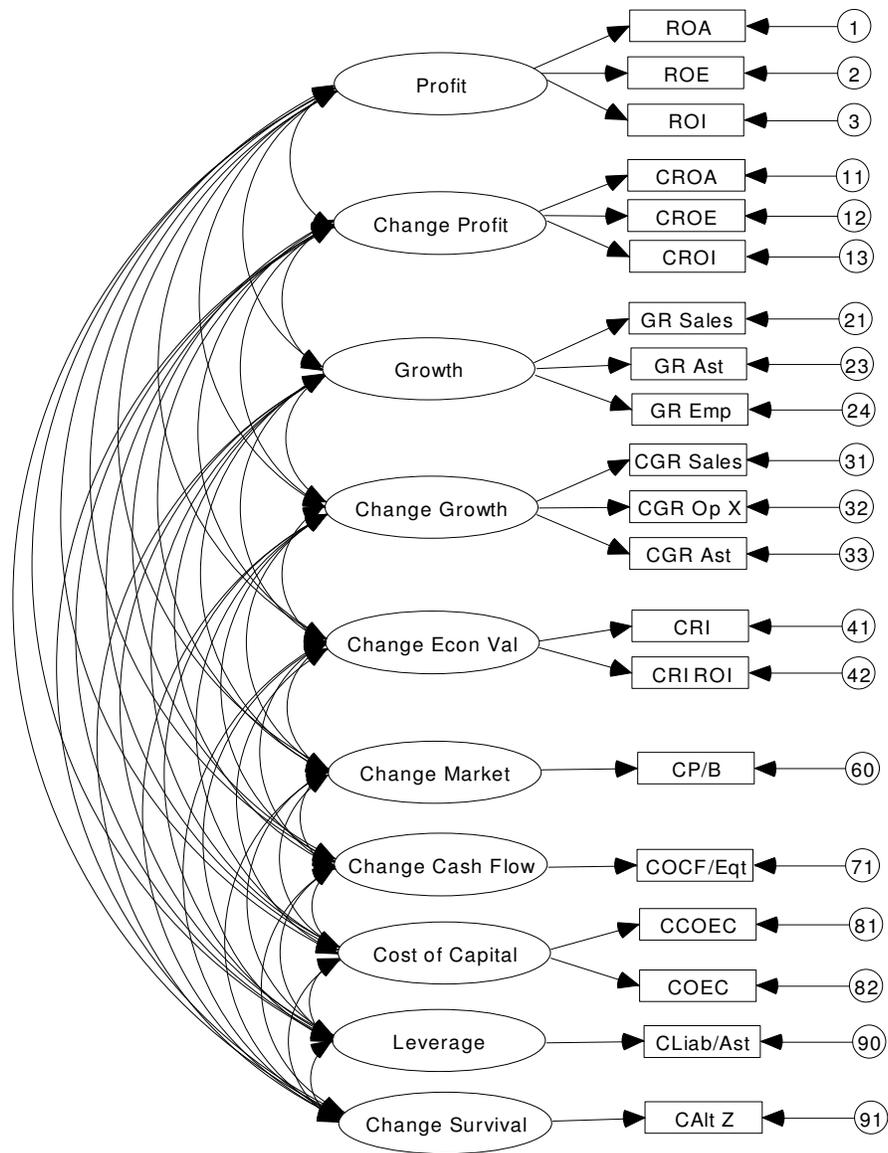


Figure 4 Revised Constructs and Measures for a Model of Financial Performance for Three-Year Data

**DEMYSTIFYING THE WOMEN ENTREPRENEURS IN SYDNEY, AUSTRALIA  
A BEST PRACTISE MODEL**

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**Abstract**

The aim of this research was to explore and identify the underlying dynamics of the women in business in the Sydney region. With the main focus on challenges and barriers, women in business face, in general and specifically with obtaining resources in the form of funding and support services as entrepreneurs.

This research spoke to 150 women entrepreneurs in the Sydney metropolitan area from August 2004 to November 2004 with the assistance of Australian Business Women's network.

The findings stated that the main challenge women entrepreneurs in Sydney faced were getting funding to start or grow their business. Access to capital was a serious issue for them and they have a hard time getting credit.

Another challenge was the conflict between work and family and they found it extremely difficult to obtain a balance and the commitment was huge. Managing business growth successfully, obtaining training and developing skills, finding and keeping qualified employees and keeping up with technology and other marketplace changes were the other challenges.

This unique paper presents the profiles of three women entrepreneurship in practice from amongst the 150 respondents. Based on the analysis and findings of this survey this paper puts forward "A Best Practice Business Support Model" for women entrepreneurs to launch and grow their own small business. This paper also recommends a public policy for its adaptation through local councils.

# **DEMYSTIFYING THE WOMEN ENTREPRENEURS IN SYDNEY, AUSTRALIA A BEST PRACTISE MODEL**

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## **Background**

Since its election to office in March 1996 the Howard government has suggested that policies designed to promote growth in the small business sector provide women with particular benefits and opportunities.

In March 1997 the Prime Minister stated that small business is the engine room of the Australian economy and a source of economic opportunity for women business. (Timms & Still, 1997)

Since then there has been a change in the women small business scene, as today Australian women constitute almost a third of people working in their business and have also outnumbered their male counterparts. (ABS, 2002)

Female participation in entrepreneurial activity rose sharply from 5.6 per cent to 9.6 per cent, not far below the 2001 level of 10.6 per cent. The proportion of female entrepreneurs to male entrepreneurs rose from 48 per cent to 71 per cent - the highest proportion in four year's of participation in GEM. (GEM, 2003).

More than 250,000 women are now running their business from home, an increase of more than 20% in the past five years according to Federal Government figures

Their contribution to the economy is estimated to be worth tens of billions of dollar. (Markson, 2004).

There can be little doubt that the women business community in Australia is making and will continue to make, unique and vital contributions to the nation's economic and social welfare. They are making a significant contribution to our national and local economy. Women in the Sydney region in Australia are a growing sector of the population, increasingly well educated and entrepreneurial against market norms, with a growing share of overall small business stock.

## **Introduction**

Throughout the world, women make a significant contribution to the entrepreneurial advantage of nations and women-owned businesses are critical to economic prosperity. A higher level of participation by women in the economic arena is associated with higher standards of living (Reynolds, Bygrave & Autio, 2004). Women in the USA are starting businesses at twice the rate of men (Delaney, 2003; Coleman, 2002). From 1987-1999 the number of women-owned businesses in the United States increased by 103 percent nationwide (Gundry et al, 2002). "Women's entrepreneurship is growing in OECD Member countries and around the world, with start-up rates outpacing the national average in several OECD member and non-member countries" (Koreen, 2000,). In Brazil, Ireland and Spain women are beginning new businesses at a faster rate than men, and are also expanding their share of business ownership. The OECD recognised the value to national economic growth of growing the female entrepreneurial sector, very often by identifying and removing barriers (Koreen, 2000).

New Zealand and Australian data are consistent with the growth of women's entrepreneurship. In New Zealand the number of female employers and self-employed has doubled over the last 30 years (Ministry for Economic Development, 2004). In Australia,

the participation rates for men have declined, while the rates for women have been on the increase. In 1971, 89% of mature age men (aged 45-64 years) were participating in the labour force, i.e. were either employed or unemployed, decreasing to 77% in 2001. At the same time, the rate for mature age women increased from 32% to 58%. This increase for women reflects changes in society and the economy such as a general acceptance of women in the work force, and an increase in the availability of flexible and part-time work, influenced by the growth of service industries such as finance and tourism, allowing women to participate in paid work while raising children. (Bureau of Statistics, 2003)<sup>1</sup>

Women entrepreneurs are under-researched in the entrepreneurship literature, in general. A 1982 to 1995 review found only .007% of articles (22 out of 3206) focused on women entrepreneurs (Baker et al., 1997). A second 1995 to 1997/98 review found .06% of articles (28 out of 435), across 6 journals and one proceeding, focused to some extent on women entrepreneurs (Brush & Edelman, 2000).

Notwithstanding the limited number of research studies on women entrepreneurs, there are many “myths” relating to women entrepreneurs. The US Diana project (Brush, Carter, Gatewood, Green, Hart, 2001) examined 8 myths relating to women entrepreneurs. These myths are being explored all around the world. Recently a similar study was undertaken in Canada (Menezies, Brenner & Jacques, 2003) the same study was also undertaken in Belgium. (Cornet & Constantinidis, 2003). This research was part of a wider research project on women's entrepreneurship in Belgium. This project, called “The Diane Project”, took place within the framework of an equal opportunity action and aims to enquire whether there are any specificities in female entrepreneurship and if necessary to point them out.

To enhance the growth of entrepreneurship we need to improve knowledge about women entrepreneurship, by gathering and analysing a range of statistical information across a range of sectors. (OECD, 2000)

Besides acquiring data and statistical information it is crucial to understand these women in business through qualitative researches as each individual case tells her own story and gives researches an insight into the unique situation and problems faced by the women in business.

## **Research methodology**

Research methodology included two parts. First, a qualitative research concerning the targeted public- women entrepreneurs operating in the Sydney region has been conducted. In this phase 40 individual semi structured face-to-face interviews were conducted with existing businesses, operating in areas such as Liverpool, Bankstown, Parramatta, Hills and other business districts in Sydney. Telephone interviews were conducted with bank managers and support agency staff where applicable to get information on the differences if any in the number of loans granted to male entrepreneurs and female entrepreneurs and also

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provision of service to male and female businesses. In the second phase a detailed questionnaire was sent to a diversified sample of 150 women entrepreneurs in Western Sydney.

In the last phase, again focus group discussions were conducted to ascertain that findings are not generalized. Assistance was provided by the “Australian Business women’s network” <http://www.abn.org.au/default2.htm> and the Chambers of Commerce for obtaining respondents data.

Research papers on women entrepreneurs at conferences present data analysis without giving a real picture of the real women in real businesses. This qualitative paper aims to put forth the case studies of these real women in real business in their own words to understand the real problems and presents some real solutions, which can be implemented by policies through the local councils.

## **CASE STUDY**

The existence of women entrepreneurs or even women in the workplace is an idea that once was not common. Many women including at least one of the women which we interviewed faced much resistance and the often heard of glass ceiling while trying to further their career. As times changed, the idea of women entrepreneurs became more recognized and accepted, although it is still a problem within some countries. Fortunately, we live in a society now that promotes women having a career, and in some cases such as those discussed within this report, very successful businesses of their own.

Businesses within multiple industries were contacted for this survey ranging from smaller retail outlets, to restaurants, mechanics shops and even privately owned hostels. It was at this point contact was made with three women entrepreneurs, June Hibbard, a real estate agent who now owns and operates her own agency, Karen Makin, an optometrist who after years of working as a fill in doctor for many organizations purchased her own practice, and Marina O’Neill, a creative woman with a storied background who stumbled across an entrepreneurial opportunity by accident while renovating her own kitchen and has turned this into a growing successful business. These women provided great insights into some of the trials and tribulations of starting and operating their own business.

### **CASE 1: KAREN MAKIN**

Karen has a rather interesting story to tell about how she came to choose the career path she did. As a high school student Karen didn’t really have any idea in relation to where she wanted to go after she graduated high school. Having done exceptionally well in all of her classes it left a lot of doors open for her in regards to universities. When it was time for Karen to choose what sort of course she wanted to take her exact words were: “I just sort of fell into optometry”. She didn’t really have much more of an explanation than that other than it was something that she thought she might enjoy it.

After graduating from university Karen went to work at a couple of different jobs locally before packing up and heading off to England and worked in the optometry area there for a

couple of years. When she finally returned home she had no plan and no idea of what to do. So she went back to work just doing some small jobs locally again. Things started to come together for her when after she started working at OPSM. She was working part time there but she was putting her education to use, by doing eye tests and things like that. She's wasn't sure whether or not it has changed since she worked at the OPSM, but when she was working optometrists weren't hired, they were licensed. She didn't like it there very much because she wasn't involved enough in the entire business.

### **Makin - Optometry**

So when she heard about an optometrists business coming up for sale from a friend of hers in the industry she went and checked it out. This was an already fairly well established business that the current owner was just getting out of. It took some financial support from her parents but she bought the business in early June of 2001. After she purchased the business she moved it to a better location and changed the name. She didn't move it very far because it was already close to the area where she lives and that was one of the main reasons she bought it in the first place. She changed the store when she moved and made it look more appealing and tried to get the business more widely known to get more people through the door. Karen's sister is also in the business with her putting the glasses together and dealing with the accountants. Karen is the sole optometrist in her business, which makes her presence at the store crucial. She bought another store close by after her first one was established. She made it very clear that she was not buying any more as she had a great difficulty obtaining finances for buying the second one as the bank kept asking her to add her husband as a partner in the business to obtain more funds.

Karen is also a single mother and it's made it difficult for her to divide up her time between her kids and her business. Having a family that she was the sole provider for made it even more crucial for her new business to be successful. Being a single mother Karen said does take up a lot of her time so she doesn't have time for herself. Karen told us that it took roughly two and a half years before her business started to pay off financially but now it's hard for her to take time off. When she's sick or goes on vacation she needs to find a replacement optometrist and according to her that's not an easy task. She does really enjoy owning her own business though, she mentioned how she enjoys the flexibility of being her own boss and the control over where you want your business to go, and there's a much greater sense of achievement at the end of the day as well. Karen also likes the fact that she's making money for herself and not making money for someone else. She also added that one should have their head checked before entering into a business like hers where you end up doing a lot more work for not that much extra money. The parts of her business she doesn't overly enjoy are the 46 to 48 hours a week she puts in, the extra responsibilities, not to mention all the paper work and book keeping she needs to do. There's also the dealing of staffing issues, and as mentioned before the fact that she's the only optometrist and has to find a replacement when ever she can't be there. Karen also went into a bad-staffing issue she had not that long ago. It was a young woman she had hired to work the front counter and it was just by chance Karen discovered how this young woman was acting when none of the other employees were around.

Karen said that when she first opened the business she had no strategies for evaluating their success and that was one big failing they now see. She told us that they had a business plan but didn't follow it, they sort of set up some basic practice management, and with the

computer system they have now they can track their sales and things like that, but they really had no direction and no idea as to where they needed to be.

Then last December her company joined a student business program of some sort that involved five other optometry practices. These optometry practices get together once in a month to discuss problems and ideas. Karen says it's really got them back on track, they're tracking things, and they know where they're going. She also told us they now have budgets and goals and can compare themselves with other businesses.

Karen also gave us a bit of insight to what she thought she could have improved upon in running her business. She first talked about how she would have liked to learn more about business. Karen feels very strongly that there should be somewhat of a business course offered along with the optometry course. She says since there are so many optometrists that go into business for themselves' it would be a good idea, or at least those who plan to go into business for themselves should take a business course first. In regards to running her business she mentioned, if she could do it over again she would go back and make sure to have a good business plan and stick to it. She said she would also pay better attention to budget, and would learn more about employing and keeping staff.

Karen feels comfortable now with how her business is being run, and she happy with the staff that help her run it. Expanding the business is something she implied but isn't putting too much thought into, because of the difficulty of obtaining funds and she enjoys being a smaller business. It allows her to be better oriented towards the people in her community, family and friends and that's the way she wants to keep it.

## **CASE 2: MARINAL O'NEILL**

Marina Isles - Unique Architectural Hardware is a small, family operated business located in the industrial district of Castle Hill. Originally founded in 1993, it remains a small establishment, however substantially larger than its humble beginnings being operated from the home of Marina O'Neill. The story of the business and how it has developed is an interesting one, although an equally intriguing story is how Marina O'Neill herself came to be a small business entrepreneur.

### **Background**

Marina comes from a strong Italian up bringing; from this she gained a set of values and views all to her own, and her strong interest in horticultural activities became more evident. But she describes her life as being pre-determined by her parents, father in particular. Belonging to the very traditional Italian background, it was believed that women did not need education, nor to work, however she began to work in the banking business, the industry in which her father worked. She slowly began to climb the corporate ladder, picking up education and valuable training along the way, proving she was a capable person in this industry. She says that as bad as it sounds, there was a glass ceiling, a level within a company that women could reach and go no further. She finally was fed up with the politics and realized she did not enjoy where her career was taking her, so simply left. At this point her life took a sharp turn, she began pursuing an acting career, which she describes as being very difficult in Australia, so when her husband was transferred to New York, she and her children moved as well, this gave Marina the opportunity to expand her acting credentials to levels difficult to reach in Australia. It was at this point that acting began to take more and

more of her time, which meant her children were suffering the most, being left with caregivers for much of the day while she and her husband worked... She chose her children and says she has no regrets whatsoever regarding this. Following this she returned to Australia with her family and briefly contemplated the idea of opening a restaurant, realizing this would quickly be a seven day a week job, she realized again where her true interest laid, horticulture. Wondering why she never thought of working in this industry before, she quickly began earning her way with this business, while still having the time to spend with her children during their important years.

From this point she continued the horticultural business to some success, but inspiration comes from all around, and it was a home renovation project rebuilding their kitchen that gave her the inspiration to open the business she runs to this day. When building her cabinets the sometimes arduous task of choosing those small details, the handles and door-knobs. Wanting to have something unique to herself and not a mass produced product found in most stores, she proceeded to design her own and search for someone to produce it. From this point came the realization that if she wanted something unique and new, she was most likely not the only one. From this point door-to-door visits began to find people who were willing to either purchase, or display one of the products they designed and produced. Once she realized that there would be a demand for her handles she decided to put into motion the beginnings of what is now known as Marina Isles – Unique Architectural Hardware.

### **Marina Isles – Unique Architectural Hardware**

When the first order arrived to her local home she and her husband were ecstatic; they were excited that their business venture might be a success. They received two orders their first month of being open it was barely enough to pay for the expenses yet Marina and her husband found strength and the motivation to carry on. She has shown a great deal of resiliency in the past she did not feel it was going to be any different when she started this venture.

As business grew Marina, came across many obstacles; an initial problem was finding suppliers who would be willing to produce small batches. Many suppliers would only manufacture a minimum of 10,000 units; this was an unacceptable number for such a small family based company.

Another issue she faced when Marina started to produce more products and become more popular was with suppliers once again. She found it hard at first to identify the truthful and straightforward suppliers from the untrustworthy and misleading suppliers. The problem she was having was manufacturers were giving her lead times that were not consistent. This reflected poorly on her company and its reputation. With Marina Isles – Unique Architectural Hardware growths being slow yet steady they were able to iron out the supplier issue before it became an extreme problem. They were able to keep the suppliers that were accurate with their time frames and discard the suppliers who were unable to deliver the goods in a timely manner.

### **Goals and Objectives**

When Marina, started this company she really had no goals in mind. She did however, have hope, and she hoped people would like her product. This hope has fueled both her and her husband to go to great lengths to see the success of this company. They had an objective

when they started to not have a debt that was not manageable. They did not want any banks telling them what they had to do and they did not want to be forced to have any worries about paying their debtors. Their decision to sell their home to purchase their building in which the company operates shows a great deal of dedication to the company. Not many people would be willing to part with something as large as a house to see a vision to fruition. Marina and her husband both have the hearts of true entrepreneurs.

As the company has grown Marina, has reevaluated her company and has decided that she does want to become an international company, they have built a web site in which products can be ordered and shipped around the world. Marina would like to see some small operations start in North America along with Europe. The key with this would be to stick with the core philosophies of being a small company that deals with small quantities of products with little to no mass production and a product that is unique and specific for its design. She would like to expand, but only if she would be able retain the control she has now. A fear of having people tell her how to run her business is a fear she has always dealt with. People lose sight of their goals and values in the light of expansion and growth, which is why she has grown slowly since the birth of her business. However, realizing that growth is a by-product of a well-run company, she also is happy to grow slowly.

### **CASE 3: JUNE HIBBARD**

Baulkham Hills Real Estate is located on Seven Hills Road in Baulkham Hills, New South Wales. When the business first opened in 1998, Principal and Licensee June Hibbard wanted “to create a culture within the organization of trust and commitment” (Baulkham Hills PRD, 2004). It is a franchise of PRD nationwide, and is owned by June Hibbard in a partnership with her sister. While June is involved in the daily operation of the business, her sister has a weekly job elsewhere. Her involvement in the business is limited to helping out with open houses on the weekends and the business’ accounting. The rest is up to June and her staff.

#### **Background**

June Hibbard’s original plans for life after high school were to become a secretary. She also wanted to have a family, which may have originally influenced her career plans. Upon completion of high school, June enrolled in a TAFE secretarial course and began work for the PRD nationwide franchise in West Pennant Hills as their secretary. While June was happy working as a receptionist and secretary, she began to realize that as a secretary her income was going to always be limited. There was an urge to expand her skills and moneymaking ability and when the opportunity for going into sales came up, she jumped at the opportunity. After completing a real estate licensing course, she began selling real estate for the West Pennant Hills office. Due to her strong sales skills, developed from a previous job selling office supplies, she quickly excelled at real estate sales. After about ten years of experience in the real estate industry with West Pennant Hills PRD, she reached a point where she had become bored with what she was doing. Looking for a new challenge, June began to conjure up ideas of going into business for herself. After making the decision to go into business, June began researching where she would like the

business to be located. Baulkham Hills was the obvious choice as there was no PRD nationwide franchise currently there and she wanted to continue with the same franchise she had worked with in the past.

When the time came to open the business, she tried getting finances from banks but to had to face a lot of bureaucracy, so June and her sister provided all of the initial capital from their savings and from their paid mortgage for the startup. June had a chance to sit down with her previous boss and plan out the kind of budgets that were needed on a monthly basis. They also determined the goals the business needed to reach each month in order to keep the business going. June admitted that she did not do much planning for the business beyond the budget making.

When the business started out, June was working 12 to 14 hours a day and usually six or seven days a week. She quickly realized she was not going to have as much free time as she had thought. More recently, June works about 50 hours a week, and has more time to attend dancing and kickboxing classes in her spare time. After the business was on its feet, it took about six months to make a profit. The reality of the real estate business is that you may not make a sale for quite some time after the business has opened, possibly six weeks. Even after the first sale has been made, the sale still has to settle, so it could take three or four months before the business receives any money from the sale.

June found that being a new business owner was tougher than she imagined. She found it to be a struggle learning how to run the business on a day-to-day basis, including learning about taxes, payroll, and trust accounting. Trust accounting is the holding of other people's money when the business takes a deposit on a property. It requires the money to be deposited into a special account and there is a lot of software to go along with it that needs to be learned. Although June's sister looked after the accounting for the business, they also had an accountant that they called in to check the books when needed. June's franchise is involved in a group with other franchise owners who get together once a month to discuss things in the industry and talk about common problems everyone is facing. The group then discusses how they can overcome those problems. The franchise owners also give each other advice and explanations on how to run the business based on what they've done. Some of these meetings also include training sessions where franchise owners can learn how to do property auctions or property management for rental properties.

June believes that location is one of the business' strong points, as it is located at a very busy intersection in Baulkham Hills where plenty of people can browse her rental listings and see her signage. She meets and networks with the other bcal PRD franchises each Tuesday night to look at each other's properties that they have for sale that might fit one of her clients. Her business is a very small franchise, but the size of the business has not stopped June from achieving success in the real estate market. Among her notable achievements is an industry gold award, which recognizes a high level of sales for her office, and award she considers to be the reward for everyone's hard work.

### **June Hibbard's Management Ideals**

June was able to learn a lot of management ideas from one of her previous employers. The man she worked for was very tough in how he ran his business and June felt it was a good experience to learn both what to do and what not to do in situations. While she didn't agree with some of his ways, he was one of her stepping-stones to her becoming an entrepreneur. One of June's favorite parts about the real estate business is that she can put some of her

own ideas into practice and run the business the way she wants to run it. With her sister being more of a silent partner, it allows June to have the freedom to develop her own philosophies.

One of June's major on-going goals with the business is to be able to get the staffing to a level where she does not have to be at the office every day. She is currently still trying to find two or three people who she can feel comfortable with leaving at the business that she knows will be doing what they are supposed to be doing without her needing to check on them to see what's happening.

June believes that selling real estate is harder than other sales industries. Another problem with real estate sales is a lack of motivation. Many salespeople don't want to do prospecting, which consists of knocking on doors or making phone calls to try and find people who want to buy or sell a house.

June believes that attitude is the most important trait that an entrepreneur must have when starting a business. This statement also goes for her employees. If they have a poor attitude, they are hard to train because they think they know everything. It may also result in the employee being rude to the customers, which is not good for business in a sales environment. Beyond the few courses that must be completed before getting into real estate, June believes the knowledge and the experience will come with practice, and that attitude is still the most important. Her advice to aspiring entrepreneurs is that you need to work in and obtain experience in the industry that you are starting a business in. She has found that a lot of people, who have never worked in the industry that they are trying to start a business in, are normally the ones who go broke first. Those people don't know how to deal with the problems they encounter because they have never experienced them before.

The biggest reward for June has been the fact that she has owned and run her business successfully since its inception because she knows that most people don't make it that long in business. The profits over that time have also been very rewarding, as any entrepreneur would agree.

June has thoroughly enjoyed her experience as an entrepreneur and is very glad she went through with it. Over her time as an entrepreneur, she has learned a few lessons. Her greatest lesson has been how to communicate with other people. There have been times where she has blamed staff for a failure, but maybe she had played a more major part in the failure because she did not communicate to them what she wanted correctly.

### **Recommendations**

Some recommendations that we would have made to these entrepreneurs when they started their companies was to have apparent goals that were set within the birth of each organization and that they had better planned, for the beginning of their company.

Another recommendation would be to have a contingency plan in place when starting their business so that they would be more flexible. Through all three interviews, there was evidence of a lack of a structured business plan and contingency plans. We feel that those plans are integral parts of a successful business and should be the focus of an aspiring entrepreneur.

It is also advisable to get into a business at as early an age as possible. This allows time to learn and work toward success when you have fewer attachments and people dependant on you in your life, such as a spouse and children.

A critical factor that must be carefully considered before opening the business is capital. An entrepreneur must ensure that they have enough back-up cash to get them through the first year. Many businesses do not prepare for the lack of cash flow in the first few months and run out of money before the business gets off the ground. It was also noted by some of the entrepreneurs we interviewed that you must remain focused and smart with your money.

Businesses always go up and down, and it can be very easy during one of the 'up' phases to get caught up in it and start spending money, then the 'down' period will arrive and you will not have to capital to sustain yourself.

An issue raised by some of the entrepreneurs was staffing, this seemed to a universal problem for the business that had hired people outside their family. The ultimate goal is to hire good people, so one must evaluate the criteria in which they hire a person. It is one thing to be a good judge of character, but it is another to be able to pick a person on their skills and abilities.

These women have all done a very excellent job with their businesses thus far, and all have excellent outlooks on the way things are progressing. The keys points to a successful business are attitude and knowledge, be smart with decisions and you can be successful, just as these three women have proven. Obstacles will come along that need to be overcome; there will be the periods where you question whether it is all worth it. But the gratification, the freedom and the feeling of accomplishment when your business succeeds will make it all seem worthwhile.

During the survey, the respondents that would assist women to unlock their potential as entrepreneurs made many additional points. Recommendations include: (a) The establishment of support agencies and advisers; (b) the provision of accessible childcare facilities, (c) the removal of the discrimination against women in the Australian finance sector; (d) providing access to training specific to women and their needs, on-the-job training, the changing of community attitudes which work against women in business; (e) attempts to improve business networks small businesswomen and (f) conducting more research into women in small business (including immigrant small business women).

This paper found that difficulties facing the potential and the current small businesswomen can be divided into two areas: (a) barriers affecting women considering or planning a career in small business and (b) problems experienced by women managing their own business. We are now familiar with these problems, issues and challenges faced by the women in business... The question therefore is how we can overcome the issues highlighted above.

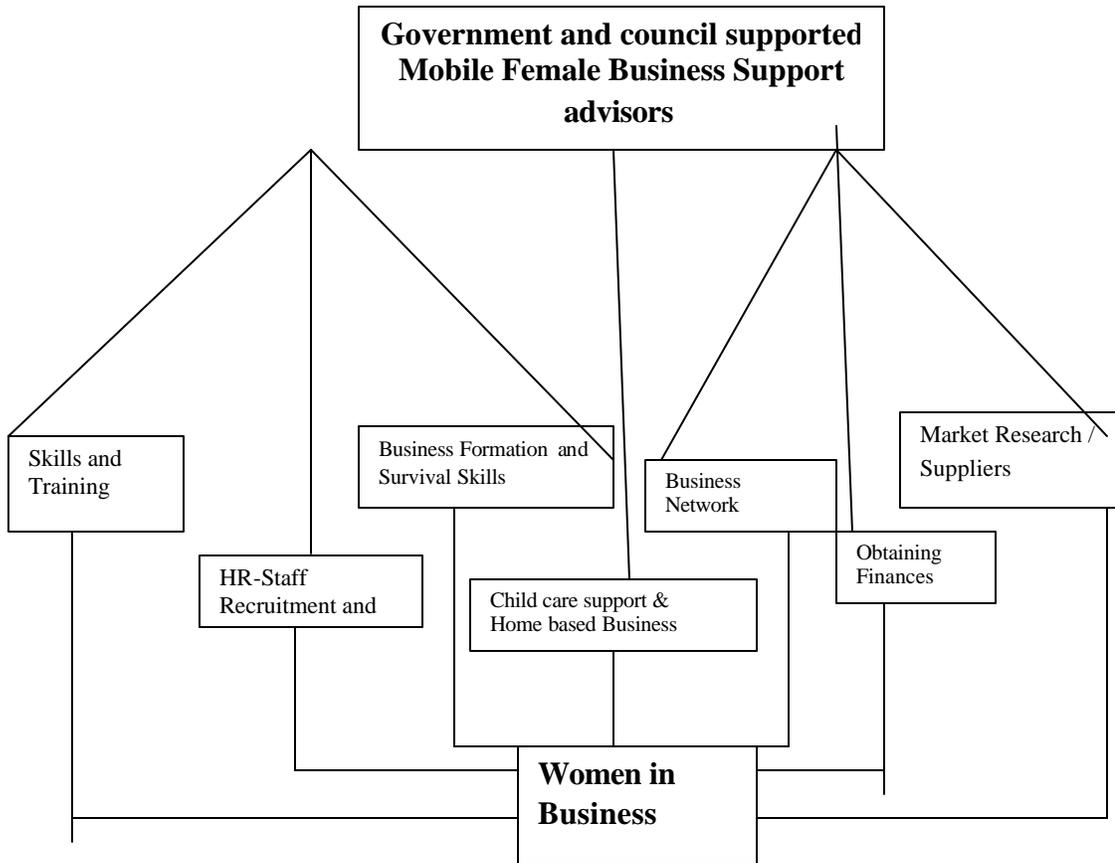
This paper recommends a unique best practice model through the appointment of "Mobile Female Business Support Angels" who will provide customized support to women in business and is also a partner in the mainstream support structure, thereby helping to inform policy and develop appropriate strategy enabling the development of this sector of businesses. These Angels will also play an important part in government policies by coming up with policy implications for the development of women in business.

Mobile, female, dedicated support business advisors who are sensitive, multiskilled business advisors with mainstream networks in place. These advisors will represent these women to banks for loans and assist with other support services.

These mobile female business support officers would provide support in the areas of obtaining skills and training, child care responsibilities, obtaining finances, business

formation and survival, business networks and mentoring and to home based business women.

### BEST PRACTISE MODEL - WOMEN IN BUSINESS



**PUBLIC POLICY FOR ADAPTATION BY THE LOCAL COUNCILS:**

## **Skills and Training Needs**

One of the major concerns raised by women in small business is the lack of appropriate and suitable training. One of the most common causes of business failure has been identified as poor business planning, lack of business plans or under-developed business plans and unclear goals. National and state industry training plans and Australian National Training Authority by Industry Training Advisory Bodies and State Governments should address the training needs of women employed in small business;

Providers of training should be encouraged to specifically design their training offerings in ways that will enable women to participate; Training designed for employees in small business be flexibly delivered to enable participation by all workers, including women with family responsibilities; and Programs should be marketed to women. Local councils should sponsor such training programs and provide them at subsidized rates.

## **Carer Responsibilities**

One of the concerns in both establishing and operating a small business, and as an employee in small business, is childcare and other carer responsibilities. The issue of available adequate and affordable childcare is, for many women, one of the reasons for setting up in business at home. Many industries are now setting up child minding facilities in the workplace and are adopting a more flexible approach to working hours. Investment in childcare is regarded as a benefit and not a cost and government through councils should provide adequate support services to women in business and also cash rebates to them.

## **Obtaining Finance**

Historically, women's access to finance has been an area of concern and is generally perceived to be one of the main barriers to be overcome by women in establishing and operating a small business. Recommendations are: Financial support for small business to obtain advice on financing options; and Improved availability of finance to women small business through council networks with banks for assistance to women in business.

As part of the White Paper initiatives, the Government in Australia also did expand the number of places in the New Enterprise Incentive Scheme (NEIS) available to unemployed women wanting to establish businesses. Participants selected for the scheme receive training and support to establish their businesses, policies likewise should be implemented by each individual council to improve the rate of women in business.

## **Business Formation and Survival**

Women are often not seen as 'real' business operators. Women generally tend to establish or operate small businesses in areas where they have worked and gained expertise as employees.

To assist women to make informed choices about small business ownership and to increase women's awareness of the financial and business services and support available to small business, the councils should undertake a public information campaign. The campaign should be specifically aimed at:

- a) Potential female small business owner/managers;
- b) Girls in schools, to assist them with career choices, including in nontraditional areas such as manufacturing; and
- c) Suppliers of financial and business services to small business to raise awareness of women's success in small business.

The campaign should utilise media which have a large following amongst the target audience.

### **Business Networks and Mentoring**

It has been observed from the 3 cases as well as from our survey that business networks and mentoring arrangements are widely regarded as effective, valuable sources of business advice and training and an important means by which business activities and practices are improved and developed leading to improved competitiveness and growth. Anecdotal evidence suggests that women are more prepared than men to take advice and learn from others, and in many cases actively seek such advice. However, it can be difficult to identify reliable channels and sources of advice. A major constraint to women's involvement in more formal networks is time.

Recommendations were that small business owner/managers work very long hours and are not able to access formal networks unless meetings, etc. are held at a suitable time, in an informal setting and possibly with childcare provided within their local councils at no cost. These factors need to be taken into consideration to encourage women to access networks and mentoring arrangements. There is a need to ensure that there are sufficient women involved in the operation and delivery aspect of these schemes so that other women are encouraged to participate in them, regional networks; common interest support networks (such as networks for rural women); support mechanisms for women making the transition from being employees to managing their own businesses; and related mentoring mechanisms. Appropriate other technologies should also be investigated to electronically link networks.

### **Home-Based Employment**

The reasons for women turning to home-based employment are similar to those reasons for entering small business generally. However, some specific reasons for women seeking home-based employment are: Ability to combine work and family care responsibilities; desire for flexibility; and desire to run business and avoid overheads involved in leasing premises; there is a need to promote the establishment and access of supportive networks, such as through existing women's associations, particularly for self-employed women operating home-based enterprises.

Some other recommendations for these women are an open learning program. This program should particularly assist the large numbers of women working from home.

A network should be formed specifically for these women as they have no chance of interacting with similar such women in business. A website can be dedicated to accessing support services for women working from home which would have its link on the local council's website.

### **Conclusions:**

This paper has focused on real women and real businesses and focused on real problems and tried to put forth real solutions to them via the analysis of the three case studies.

There still remains a great deal of confusion and contradiction about the factors that contributes to women's success in small business. Further research and study into the role of women, as employers and employees in small business and the documentation of effective models need to be conducted to understand that story.

In addressing the important issue of women and small business this paper hopes that it will encourage the pursuit in greater depth of the issues that have emerged as priorities. It is also hoped that it will act as a catalyst for the suppliers of financial and other business services to improve their marketing and targeting of programs.

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**FACTORS OF E-COMMERCE ADOPTION IN MINORITY-OWNED  
VERY SMALL BUSINESSES**

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Washington, D.C.

## INTRODUCTION

The small business community has a significant impact on the American economy. According to the SBA (2002), small businesses represent 99.7 percent of all employer firms in the United States, employ half of private sector employees, generate 60 to 80 percent of new net jobs and are employers of 39 percent of high tech workers. Small businesses are the principle source of new jobs in this country, and they generate more than 50 percent of the private sector gross domestic product.

As we study the continued influence of small businesses, it is critical that we evaluate the impact of the technological revolution on these important enterprises. The Internet has changed the way we do business. Now, the small business owner can make the “playing field” more level through the use of e-commerce. But, how has the decision to adopt e-commerce been incorporated by the minority business community?

A recent search of the Infotrac Business Index ASAP, covering the last 20 years, identified 547 refereed journal articles on “electronic commerce and business,” six refereed journal articles on “electronic commerce and small business,” and no refereed journal articles on “electronic commerce and minority business.”

The Hudson Institute’s *Workforce 2000* (1987) study indicated that beginning in the year 2000, minorities would represent the largest group of new entrants into the workforce. Further, the growth of minority entrepreneurship has grown significantly over the last 20 years; minority share of U.S. businesses has increased to 15.8 percent from 14.6 percent just between 1997 and 2003 (Hisrich, 2004). Given the increase and expected continued increase of the minority population in the United States, according to the 1999 Global Entrepreneurship Monitor, (GEM,

1999) based at the Babson College, the development of minority-owned business is critical to the stability and growth of our economy.

Based on these crucial concerns about minority business development, its role in the minority communities, and its impact on the American economy, this study seeks to identify the factors that significantly influence the adoption of e-commerce in minority-owned small businesses (MOSB).

## **LITERATURE REVIEW**

Clearly e-commerce has changed the way commerce is conducted all over the world. Prior research has identified a number of factors affecting the adoption or growth of information technology (IT) in small businesses. Baker (1987) analyzed the factors that seemed to influence the implementation of IT in small businesses. His analysis indicated that lack of knowledge of new technology significantly hindered the adoption of information technology in both the manufacturing and professional service firms. Lees (1987) studied the development of information systems (IS) in small businesses. He found that availability of in-house IT expertise, good vendor support, and larger firm size are positively correlated with successful development of IS. His research is supported by the finding that company size and understanding of the potential of e-commerce are positively correlated with the adoption of e-commerce as a business strategy (Radovissky and Hedge, 2004).

Delone (1988) investigated the factors that affect the successful use of IS by small businesses. His principle findings showed that chief executive knowledge of computers and involvement in computerization leads to more successful computer use in small manufacturing firms. Montazemi (1988) surveyed the factors affecting IS satisfaction in the context of small

business environment and concluded that intensity of computer literacy, presence of a systems analyst, and end user involvement are related to IS success.

Palvia and Jackson (1990) examined the adoption and use of IS in very small businesses. Their findings showed that the most important factors related to IS in very small businesses include: size of the business, age of the business, general education of the owner/manager, and the computer knowledge of the owner/manager. Yap et al. (1992) conducted an empirical study of key factors associated with IS success in small businesses. They reported that IS success is positively associated with consultant effectiveness, level of vendor support, sufficiency of financial resources, level of CEO support, and level of user participation.

Cragg and King (1993) inspected IT growth in small firms and found that owner enthusiasm toward technology, relative advantage (savings in time and efforts, and economic benefits, etc.), consultant support, and competitive pressure motivate growth. Inadequate resources, particularly in the form of finance and managerial time, and limited internal expertise discourage growth. Lacovou et al. (1995) examined major factors that influence the adoption of electronic data interchange (EDI) in the small business context. The level of financial and technological resources of the firm, competitive pressure, imposition by trading partners and perceived benefits were identified as the major factors that influence small firms in adopting EDI. Igarria et al. (1997) analyzed the factors affecting the acceptance of personal computing in small firms. They found that perceived usefulness has a significant influence on system usage, while internal support and internal training do not. Prekumar and Roberts (1999) researched into the state of use of various communications technologies and the factors that influence the adoption of these technologies in small businesses located in rural communities. The results indicated that relative advantage, top management support, organizational size, external pressure

and competitive pressure are important determinants of adoption. Lee and Runge (2001) examined the drivers of IT adoption for small retailers and reported that the degree of Internet adoption was strongly related to the owner's perception of the relative advantages of using IT.

Based on the studies cited above, it was concluded that the factors that may affect the adoption of IT in a small business include (1) imposition by trading partners, (2) age of the business, (3) firm size, (4) general education of the CEO, (5) CEO's knowledge of IT, (6) CEO enthusiasm toward technology, (7) in-house IT expertise, (8) financial resources, (9) competitive pressure, (10) relative advantage, (11) vendor support, and (12) consultant effectiveness. But how do minority businesses respond to these factors? These twelve factors are examined for e-commerce adoption by MOSB firms in Northern Virginia .

## **METHODOLOGY AND FINDINGS**

### **Data**

In March 2004, four-hundred questionnaires were mailed to MOSB firms located in the Northern Virginia metropolitan area. The names and addresses of the firms were extracted from the Minority Vendor List maintained by the Department of Minority Business Enterprise, Commonwealth of Virginia.

The questionnaire asked the firms to answer questions on imposition by trading partners, the age of company, number of employees, and the CEO's Educational level. The firms were also requested to evaluate factors 5 through 12 using a seven point Likert-type scale ranging from very low (weakly, negatively) to very high (strongly, positively). A total of 68 questionnaires were answered and returned by the respondents. This is equivalent to a response rate of 17 percent. Five of the 68 questionnaires were incomplete. After discarding such

questionnaires, we had 63 usable questionnaires. Thirty nine (62 %) of these 63 companies had adopted e-commerce whereas 24 (38 %) had not.

### **Profile of Businesses**

The respondents to our survey are very small. The number of employees ranges from zero to forty and the median is six. They have been in business from two to thirty years and the median number of years in business is eight. In terms of type of business, professional services are the main business activity of 81% of the firms responding; followed by other services (16%), and trade (3%).

### **Findings**

The data concerning the trading-partner imposition and e-commerce adoption for each of the 63 respondents are given in Table 1. Since the measures are both dichotomous and since two cells have an expected frequency of less than five, the Fisher's exact probability test was employed to test the null hypothesis that the adoption of e-commerce is independent of the imposition by trading partners. Table 1 reveals that only six (9.5%) firms were pressured by their trading partners to adopt e-commerce, all of them, however, embraced e-commerce. The finding indicates that though imposition by trading partner is not a common phenomenon, it is a determinant of e-commerce adoption when it occurs. The Fisher's  $p$  of 0.048 confirms the validity of the inference.

The finding also reveals that despite the efforts of the federal government to reach out to small businesses, the small minority business community has not successfully taken advantage of business opportunities offered through government contracting. SOMB firms could be more successful were they to exploit government contract opportunities.

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**Table 1 about here**

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To begin the investigation of the influences of the other eleven factors on the adoption of e-commerce, univariate independent sample t-tests were conducted to determine if the means of the 11 other factors were significantly different between the adopters and non-adopters of e-commerce,. The results are shown in Table 2.

Table 2 shows that the mean age difference between adopters and non-adopters is minimal, indicating number of years in business is not related to the use of e-commerce. Financial resources were also found not to be significantly different between the two groups implying they are no longer an inhibitor for MOSB firms to adopt e-commerce. The possible causes include the availability of powerful computer hardware, the user friendliness of ready-to-use software, and the declining prices of both hardware and software (Palvia & Jackson, 1990). Vendor support and consultant effectiveness did not differ significantly either. While the findings concerning external support are contradictory to some studies (Lees, 1987; Yap et al, 1992), they are consistent with others (Delone, 1988; Raymond, 1985).

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**Table 2 about here**

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Seven factors were found to be significantly different between the two groups and are displayed in bold font. The seven factors are size of company, the CEO's educational level, the CEO's knowledge of IT, the CEO's enthusiasm, in-house IT expertise, competitive pressure, and relative advantage.

A shortcoming of the univariate t test (and other univariate approaches) is that it ignores the correlations among the variables. The multivariate approach takes correlation into account by incorporating the covariance matrix into the test statistic. The correlation matrix of the seven factors that may affect the adoption of e-commerce are shown in Table 3. Many of the correlation coefficients are significant at either 5% or 1% level of significance, indicating a multivariate approach should be employed to investigate the seven factors further.

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**Table 3 about here**  
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Because Multivariate discriminant analysis is the appropriate statistical technique for testing the hypothesis that the group means of a set of independent variables for two (or more) groups are equal (Hair et al, 1998), it was selected to further analyze the seven factors. Discriminant analysis involves deriving a variate, the linear combination of multiple independent variables, that will maximize the separation between the group means relative to the within-group variation.

The suggested minimum ratio of observations to independent variables, and the minimum number of observations per group for discriminant analysis are 5 to 1 and 20, respectively (Hair et al, 1998). Our sample of 63 observations for 7 independent variables meets the suggested minimum ratio by providing a 9-to-1 ratio. Both groups also exceed the minimum size of 20 observations per group. A step-wise procedure, with the selection rule of maximizing the Mahalanobis  $D^2$  between groups and a maximum significance value of 0.05 to enter, was used to derive the discriminant function. Table 4 provides the overall stepwise discriminant analysis

results after all the significant variables have been included in the estimation of the discriminant function.

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**Table 4 about here**

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To assess the predictive accuracy of our discriminant function, the classification accuracy of our model was compared with two chance models: the proportional chance model and the maximum chance model. The formula for the proportional chance model is

$$C_{\text{pro}} = p^2 + (1 - p)^2$$

where

$$p = \text{proportions of firms in group 1}$$

The calculated proportional chance value is 0.528 ( $0.619^2 + 0.381^2 = 0.528$ ).

The maximum chance measure is simply the percentage correctly classified when all firms are placed in the larger group. Because 61.9 percent of the firms are adopters, the maximum chance value is 0.619. Because the maximum chance value is greater than the proportional chance value, our model should correctly classify substantially more than 61.9 percent of the cases.

Table 5 lists the cross-validated classification result of our model. In cross validation, each case is classified by the functions derived from all cases other than that case. The correct classification rate provided by the resubstitution method is not reported here because it has an upward bias. A *t* test ( $t = 2.599$ ,  $df = 62$ ,  $p < 0.01$ ) shows that the classification accuracy of 77.8 percent of the discriminant model was significantly higher than the maximum chance criterion of 61.9 percent and confirms the validity of our discriminant model.

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**Table 5 about here**

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The Wilks'  $\lambda$  shown in Table 4 was highly significant (0.000) indicating that the vectors of means of the three variables – relative advantage, in-house IT expertise, and CEO's educational level – differ significantly between the adopters and non-adopters. Multicollinearity precludes the other four variables from entering the model, but that does not necessarily mean that they do not have significant effects. This can be determined by evaluating their corresponding discriminant loadings. Discriminant loadings (also referred as structure correlations) are the simple correlations between the discriminant function and each of the independent variables. Loadings are considered relatively more valid than weights as a means of interpreting the discriminating power of independent variables, and any variables exhibiting a loading of  $\pm 0.30$  or higher are considered substantive (Hair et al., 1998). Table 4 shows that relative advantage is the most significant factor in determining the adoption of e-commerce.

A rational adoption decision would involve the evaluation of the relative advantage. The highly significant positive correlation between CEO's enthusiasm and relative advantage (see Table 3), and their substantive loadings confirming that the higher the relative advantage of e-commerce is perceived, the more enthusiastic the CEO is, and the more likely e-commerce will be adopted. The extremely high correlation (0.925) between competitive pressure and relative advantage indicating that the higher the relative advantage is, the higher the competitive pressure is, because relative advantage also applies to competitors.

It may become a strategic necessity to adopt e-commerce to compete in the market place. The CEO's knowledge in general and in IT is also found to be positively associated with the

adoption of e-commerce. The CEO is the key to perceive the relative advantage. External IT expertise is no substitute for the CEO's knowledge because the CEO is the person who understands the factors which are critical to the business' success and the areas where the IT will have the best payoff (DeLone, 1988). Moreover, The CEO's low level of knowledge may discourage others from exploring possibilities (Cragg & King, 1993). Our data also suggests internal IT expertise is an important factor in the adoption of e-commerce and is positively related to the CEO's IT knowledge, the CEO's enthusiasm, relative advantage, and competitive pressure. Internal IT expertise helps the CEO to perceive and realize the relative advantage as well as minimize the risk of adopting e-commerce. Firms that do not have the IT expertise may be unaware of new technologies or may not want to risk the adoption of new technologies (Premkumar & Roberts, 1999).

## **IMPLICATIONS**

The results of this study have important implications. The respondents to our survey are located in the Northern Virginia area which has been infused with high-technology firms over the last 20 years. They are the minority businesses that are more likely to adopt e-commerce and pursue government contracts than the other minority businesses. This study found that 62 percent of them use e-commerce which is only four percent higher than the SBA's finding that 58 percent of small businesses used e-commerce in 2002 (SBA, 2002). It is safe to conclude that the other minority businesses are possibly way behind. Moreover, the fact that only six out of 63 firms were pressured by their trading partners to adopt e-commerce indicates minority businesses have not successfully accessed government contract opportunities. A study developed by Innovation & Information Consultants, Inc. (2004), contracted by the SBA Office of Advocacy, concluded that policies should be developed to ease the interface process between small

businesses, and particularly small minority businesses, and government contracting. The government needs to reach out to the minority business community. Government employees could provide very specific training for small minority owned business and help them to understand the process and how to use it. Our findings support the conclusions of Innovation & Information Consultants.

The situation is not one-sided, however; we encourage small minority businesses to research *and persistently pursue* business opportunities with the government and other businesses. Student internships and coops can be a very strong source of identifying such opportunities. Through their entrepreneurship centers and small business development centers, local universities and colleges can provide a wealth of resources to small minority businesses. Small minority business owners need to be encouraged to join *and utilize* local and national organizations that provide access to business opportunities, e.g., the Minority Supplier Development Council.

Our data also suggest that CEO's knowledge in general and in IT, as well as internal IT expertise help the CEO to perceive the relative advantage, and the higher the relative advantage of e-commerce is perceived, the more enthusiastic the CEO is, and the more likely e-commerce will be adopted. Clearly education underlies the adoption of e-commerce. Chen et al. (2002) have suggested that to meet the computer training needs of minority businesses and the others, universities and colleges should offer courses in a short, intensive format with a duration of just one or two days, in addition to the evening-and-weekend format. In terms of meeting the needs of the small business firms for consulting, colleges should encourage the faculty to lend their expertise on a pro bono basis. As an incentive, colleges may recognize the consulting efforts of the faculty as a service to the community, by giving them credit at the time of annual

evaluations. Of course, if the colleges decide to charge the companies for their services, the rates must be affordable.

## **CONCLUSION**

This study has investigated the effects of twelve factors on the adoption of e-commerce by MOSB firms and has found significant results for seven of the twelve factors: imposition by trading partners, general education of the CEO, CEO's knowledge of IT, CEO enthusiasm toward technology, in-house IT expertise, competitive pressure, and relative advantage. The results suggest that MOSB firms have not successfully taken advantage of government contract opportunities and that education underlies the adoption of e-commerce. Policies need to be in place to ease the interface process between small businesses, and particularly small minority businesses, and government contracting. To meet the education and consulting needs of small businesses, universities and colleges should offer courses in a short, intensive format with a duration of just one or two days, in addition to the evening-and-weekend format, and offer professional services through their entrepreneurship centers and small business development centers.

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**Table 1****Trading-Partner Imposition and E-Commerce Adoption**

| E-Commerce Adoption                            | Imposition by Trading Partner |                | Total |
|--|-------------------------------|----------------|-------|
|  | Yes                           | No             |       |
| Yes  | 6<br>(3.714)                  | 33<br>(35.286) | 39    |
| No   | 0<br>(2.286)                  | 24<br>(21.714) | 24    |
| Total  | 6                             | 57             | 63    |
| ( ) Expected Frequency<br>Fisher's $p = 0.048$ |                               |                |       |

**Table 2****Tests of Equality of Group Means between Adopters and Non-Adopters of E-Commerce**

| Factor                                  | t            | df        | Sig.<br>(2-tailed) | Mean<br>Difference | Standard<br>Error |
|---|--------------|-----------|--------------------|--------------------|-------------------|
| Age of Company                          | -.129        | 61        | 0.898              | -0.218             | 1.687             |
| <b>Size of Company (# of Employees)</b> | <b>2.281</b> | <b>61</b> | <b>0.026</b>       | <b>1.128</b>       | <b>0.495</b>      |
| <b>CEO's Educational Level</b>          | <b>3.429</b> | <b>61</b> | <b>0.001</b>       | <b>1.013</b>       | <b>0.295</b>      |
| <b>CEO's Knowledge of IT</b>            | <b>4.503</b> | <b>61</b> | <b>0.000</b>       | <b>1.510</b>       | <b>0.335</b>      |
| <b>CEO's Enthusiasm</b>                 | <b>4.948</b> | <b>61</b> | <b>0.000</b>       | <b>1.346</b>       | <b>0.272</b>      |
| <b>In-House IT Expertise</b>            | <b>4.201</b> | <b>61</b> | <b>0.000</b>       | <b>1.378</b>       | <b>0.328</b>      |
| Financial Resources                     | 1.318        | 61        | 0.192              | 0.516              | 0.392             |
| <b>Competitive Pressure</b>             | <b>4.992</b> | <b>61</b> | <b>0.000</b>       | <b>1.420</b>       | <b>0.284</b>      |
| <b>Relative Advantage</b>               | <b>5.264</b> | <b>61</b> | <b>0.000</b>       | <b>1.548</b>       | <b>0.294</b>      |
| Vendor Support                          | 1.657        | 61        | 0.103              | 0.474              | 0.286             |
| Consultant Effectiveness                | 1.654        | 61        | 0.103              | 0.442              | 0.267             |

**Table 3****Correlation Matrix**

|   | Number of Employees | Education of CEO | CEO's IT Knowledge | CEO's Enthusiasm | In-House Expertise | Competitive Pressure | Relative Advantage |
|---|---------------------|------------------|--------------------|------------------|--------------------|----------------------|--------------------|
| Number of Employees                                       | 1                   | .197             | .330**             | .086             | .365**             | .155                 | .203               |
| Education of CEO  |                     | 1                | .432**             | .361**           | .139               | .260*                | .305*              |
| CEO's IT Knowledge  |                     |                  | 1                  | .629**           | .823**             | .361**               | .354**             |
| CEO's Enthusiasm  |                     |                  |                    | 1                | .460**             | .680**               | .647**             |
| In-House Expertise  |                     |                  |                    |                  | 1                  | .319**               | .290*              |
| Competitive Pressure                                      |                     |                  |                    |                  |                    | 1                    | .925**             |
| Relative Advantage  |                     |                  |                    |                  |                    |                      | 1                  |
| * Significant at 5% level.<br>** Significant at 1% level. |                     |                  |                    |                  |                    |                      |                    |

**Table 4****Discriminant Function Statistics**

| <b>Variables</b>   | <b>Standardized Coefficients (Weights)</b> | <b>Discriminant Loading</b> |
|--|--|-----------------------------|
| Relative Advantage   | 0.651                                      | 0.717                       |
| In-House IT Expertise  | 0.578                                      | 0.572                       |
| CEO's Educational Level  | 0.434                                      | 0.467                       |
| Competitive Pressure   | NI   | 0.655                       |
| CEO's IT Knowledge   | NI   | 0.638                       |
| CEO's Enthusiasm   | NI   | 0.566                       |
| Number of Employees  | NI   | 0.239                       |
| Wilks' $\lambda = 0.531$ , $\chi^2 = 37.683$ , Sig. = 0.000<br>NI: Not included in the step wise solution. |  |                             |

**Table 5**

**Cross-Validated Classification Result**

|   | <b>Predicted Group Membership</b> |             | <b>Total</b> |
|---|-----------------------------------|-------------|--------------|
|   | Adopter                           | Non-adopter |              |
| Adopter                                   | 29 (74.4%)                        | 10 (25.6%)  | 39           |
| Nonadopter                                | 4 (16.7%)                         | 20 (83.3%)  | 24           |
| 77.8% of cases were correctly classified. |                                   |             |              |

# **Growth Patterns and Performances of Asian American-Founded Ventures in Silicon Valley**

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## **ABSTRACT**

This paper examines the development patterns and performances of companies founded by Asian American entrepreneurs in Silicon Valley and compares them with those of companies founded by non-Asian Americans. We find that companies founded by Asian Americans tended to have more Asian Americans in the executive team than those founded by their counterparts. Asian American ventures were more likely to secure venture capital and strategic investments from Asia-based companies and less likely to obtain strategic investment from US-based corporations. In spite of the differences in management composition and financing patterns, the two groups show no systemic difference in founder equity share or company valuation at IPO. We also find little statistical difference in the time to IPO (time from company founding until reaching IPO) or post-IPO performances between the two groups.

Keywords: Asian American Entrepreneurs, Silicon Valley, Social Capital Theory

# **DEVELOPMENT PATTERNS AND PERFORMANCES OF ASIAN AMERICAN-FOUNDED VENTURES IN SILICON VALLEY**

## **INTRODUCTION**

Asian American entrepreneurs, particularly those in high technology, have made a significant contribution to the Silicon Valley economy over the last three decades. By the late 1990s, Chinese American and Indian American entrepreneurs were running 29% of technology firms in Silicon Valley, accounting for more than \$19.5 billion in sales and 72,839 jobs (Saxenian, 2002a). Furthermore, Asian-American entrepreneurs have been critical in building a bridge between the US and Asian economies, successfully managing otherwise culturally and linguistically complex business relationships (Saxenian, 2002b).

Nevertheless, extremely little research exists in management literature on the experiences of Asian American entrepreneurs or the performances of their companies. We know very little about their experiences on such key issues as access to venture funding, ability to recruit, and effectiveness in raising capital in the public market. We have virtually no information about their companies' growth patterns or performances. A better understanding of their experiences and strategies could provide useful insights for other minority entrepreneur groups and perhaps all entrepreneurs.

This paper examines the experiences and performances of Asian American-founded ventures by addressing the following questions:

- Do Asian American entrepreneurs exhibit significant differences in hiring patterns that may (or may not) impact company performance? For example, do they hire more Asian Americans than non-Asian American founders do?
- Do ventures founded by Asian Americans have access to the same level of venture capital and strategic investments as those founded by other entrepreneurs in Silicon Valley? If not, where and how do they obtain the needed venture financing?
- Do Asian American entrepreneurs maintain the same level of (equity) ownership as their counterparts at the time of their IPOs? Are there differences in ownership due to their inability to raise capital or any other challenges they face?
- Do Asian Americans take about the same amount of time to grow their companies (e.g., as measured by time to reach an IPO) or are their performances vastly different? At the time of IPO, are Asian American ventures as valuable as other companies?
- Do companies founded by Asian Americans exhibit the same level of short term or long term performance as those founded by non-Asian Americans?

## **LITERATURE REVIEW**

Extremely little research exists in management literature on the experiences of Asian American entrepreneurs or performances of their companies. In fact, Cheng and Thatchenkery (1997) note that "Asian Americans have hardly been studied by organizational science scholars." Most of the traditional work on Asian American entrepreneurs have been sociological or historical in nature and have explored such issues as exploitation or the impact of immigrant entrepreneurship on the broader society. (Portes & Bach, 1985; Light & Bhachu, 1993). Even the more recent entrepreneurship literature on Asian Americans mostly examines small businesses in low-skilled professions (Bates, 1999; Park, 2001).

A few researchers have compared entrepreneurial activities of different racial or ethnic groups from sociological and public policy perspectives. Bates (2000) conducts statistical analysis to compare and contrast the self-employment experiences of Asian immigrants to US-born African Americans. Fernandez and Kim (1998) analyze inter-group differences in self-employment rates and business activities of four different groups of Asian immigrants. While these publications present examples of successful inter-group comparisons, they measure and compare sociological variables.

Some regional studies have examined certain ethnic groups' entrepreneurial activities in a particular city or region. Halter (1995) presents a collection of essays on ethnic entrepreneurs in the Boston area, and Park (1996) and Saxenian (2002) study skilled Asian immigrant entrepreneurship in Silicon Valley. While both Park (1996) and Saxenian (2002) provide valuable demographic information and sociological insight, they do not examine the issues from a management viewpoint.

An area of research highly relevant to our paper, which has gained significant attention in management literature in recent years, is the social capital theory (Nahapiet and Ghoshal, 1998; Florin et al. 2003; Bosma et al. 2004). Social capital theory is founded on the premise that a network provides value to its members by allowing them access to the social resources that are embedded within the network (Bourdieu, 1985; Seibert, Kramer, & Linden, 2001). In the context of entrepreneurship, social capital is believed to be useful in the same way that financial capital is for initiating, creating and building a business (Lin, 1999). Indeed, there is growing evidence that social capital has a significant impact on the performances of entrepreneurial companies. It has been shown to play an important role in the survival of small businesses (Granovetter, 1984), growth of firms (Ostgaard & Birley, 1994), companies' ability to accumulate financial capital during its growth stages (Florin, 2003) and organizations' competitive advantage (Nahapiet and Ghoshal, 1998).

## **SOCIAL CAPITAL THEORY AND HYPOTHESES DEVELOPMENT**

Our core thesis is that Asian American entrepreneurs, many of whom are first or second generation immigrants, may not have access to the same level of social capital as non-Asian American or "mainstream" entrepreneurs in Silicon Valley.<sup>1</sup> Thus, although we are examining only those ventures that were entrepreneurially successful (as measured by reaching an IPO), we suspect that we may still observe notable differences in their development patterns and performances. We formalize our thesis in the next 6 sets of hypotheses.

First, Asian American entrepreneurs may differ from others in whom they found their companies with or whom they hire as executives. Granovetter (1973) and Seibert et al. (2001) find that people tend to hire others from their social and business networks. We posit that Asian American entrepreneurs have more other Asian Americans in their social network than non-Asian Americans, and vice versa. Thus, our first hypothesis:

H1: Companies founded by Asian American entrepreneurs have more Asian Americans on the executive team than do companies founded by non-Asian Americans.

Ventures accumulate financial capital during their pre-IPO growth stages to survive and fund development (Dean & Giglierano, 1990; Starr & MacMillan, 1990). Florin et al. (2003) show that social capital can affect a venture's ability to accumulate financial capital during its growth stages. Given their limited connection with the mainstream business community, Asian American entrepreneurs are likely to face greater difficulty in raising capital. As a result, Asian American entrepreneurs might be forced to surrender more of the equity stakes of their companies.

H2a: Asian American founders will have lower equity ownership at the time of IPO than their counterparts (non-Asian American founders).

H2b: Venture capital companies will have a larger share of the equity in companies founded by Asian Americans than in companies founded by their counterparts.

We conjecture that some of the Asian American entrepreneurs will be able to leverage their social capital to obtain financing from Asia-based venture capital firms or large corporations, which non-Asian entrepreneurs might not have access to. On the other hand, Asian American entrepreneurs may face more difficulty in raising venture capital and strategic investments from US-based firms:

H3a: Companies founded by Asian American entrepreneurs more commonly obtain venture capital/strategic investment from Asia-based firms/corporations than do companies founded by their counterparts (non-Asian American founders).

H3b: Companies founded by Asian American entrepreneurs less commonly obtain venture capital/strategic investment from US-based venture capital firms/corporations than do companies founded by their counterparts.

Zhao and Aram (1995) argue that businesses with less diverse networks may grow more slowly. Florin et al. (2003) in a study of 275 ventures that went public shows that social capital leverages the productivity of a venture's resource base and provides the venture with a durable source of competitive advantage. Based on such findings, we conjecture that companies with stronger social capital will grow more quickly and experience a shorter "time to IPO" – the time between the date of company founding and the date of its IPO.

H4. The time to IPO is longer for companies founded by Asian Americans than those founded by their counterparts (non-Asian Americans).

Companies with more social capital, and thus those with a stronger organizational competitive advantage and other aforementioned benefits, will likely be more valuable. Indeed, Florin et al. (2003) have shown that social capital can affect a venture's ability to accumulate financial capital in an IPO. Thus, our hypothesis:

H5. Company valuation at IPO is lower for companies founded by Asian Americans than those founded their counterparts (non-Asian Americans).

We hypothesize that companies with greater social capital will perform better even after the IPO. Companies with larger IPOs would leverage their expanded financial base to

fuel continued growth. In addition, Florin et al. (2003) show that social capital can affect a venture's performance two years after its IPO. Thus, our final hypothesis:  
H6. Post-IPO performances of companies founded by Asian American entrepreneurs are inferior to those of companies founded by their counterparts.

## RESEARCH METHOD

We obtained data from the Securities Data Corporation (SDC) database a list of 6,201 companies in the US that went public in the 10-year period from January 1, 1992 to December 31, 2001. We narrowed down the list of our sample using the criteria that the companies

- Were located inside the traditional definition of “Silicon Valley”(displayed in Table 1).
- Were in specific high tech areas, i.e., semiconductor, software, and computer components whose SIC codes are listed in Table 2.
- Had complete SEC S-1 filing documents available.<sup>2</sup>

Our final sample is composed of 214 Silicon Valley companies – 75 Asian American-founded and 139 comparable non-Asian American-founded ventures that fit the above mentioned criteria. We defined a company to be “Asian American” when one or more of their founders were Asian American. We defined companies as “non-Asian American” when none of the founding members were Asian American. In reality, very few companies had multi-ethnic founding teams consisting of both Asian Americans and non-Asian Americans.

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Insert Table 1 here

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Insert Table 2 here

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## RESULTS

Table 3 organizes our sample into two groups, Asian American (AA) and non-Asian American (Non-AA), by the year of their IPOs. The share of Asian American IPOs appears to be on an upward trend from 20% in 1992 to more than 40% in 2001.

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Insert Table 3 here

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To test for hypothesis 1, we examine the composition of Asian Americans listed as executives in the S-1 filings. Table 4 shows that the percentage of Asian Americans in executive management was dramatically higher among Asian American-founded companies (34.48%) than in non-Asian American-founded companies (2.35%). Even excluding the founders, the composition of Asian Americans in management team was significantly higher for Asian American founded ventures (16.09 vs. 2.35%). Hypothesis 1 is supported.

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Insert Table 4 here

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Next, we examine the founders' ownership level of the company at the time of IPO. Our analysis suggests that the differences between the two groups are not significant, as shown in Table 5. We also measure the venture capitalists' share of the companies'

equity at IPO, also displayed in Table 5. Again, we find that the differences between the two groups are not statistically significant. Neither Hypothesis 2a nor 2b are supported.

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Insert Table 5 here

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Table 6 divides the major sources of funding into four categories, US strategic investors, Asian strategic investors, US venture capitalists and Asian venture capitalists. Interestingly, 30% of Asian American ventures received financing from Asian venture capital groups, while none (0%) of the non-Asian American ventures did. Some of the Asian American ventures obtained strategic investments from Asian corporations (12%), when very few non-Asian American companies did (1%). A slightly lower percentage of Asian American-founded companies obtained US venture capital (84% vs. 96%), although the difference was not statistically significant. On the other hand, Asian American founded companies were much less successful in receiving strategic investments from US corporations (26.0 % vs. 44.9%). Thus, Hypothesis 3a is supported and Hypothesis 3b is partially supported.

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Insert Table 6 here

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Our results in Table 7 show that the aggregate average time to IPO of 5.6 years for Asian American companies is lower, not larger, than that of the non-Asian founded companies of 6.2 years. The difference is not statistically significant. Hypothesis 5 is not supported.

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Insert Table 7 here

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Table 8 compares the valuations of companies at IPO for the two groups. While the t-tests do not produce any statistical differences, the Wilcoxon signed rank test identifies systematic differences in two of the ten years: In 1999, the non-Asian American firms had a higher valuation while in 2000 Asian American firms had a higher valuation. In total, it was the Asian American-founded ventures that had a higher valuation at IPO – mostly due to year 2001. Thus, our results do not support Hypothesis 6.

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Insert Table 8 here

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Table 9 examines the post-IPO performances of the 2 groups. Table 9 displays the short term (12-month) share price performances of the companies after going public. Data for the stock prices are obtained from a database provided by Center for Research on Stock Price (CRSP) of the University of Chicago. As reported in Tables 9, neither the t-test nor the Wilcoxon signed rank tests find any significant differences in short term share price performance. Overall, hypothesis 6 is not supported.

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Insert Table 9 here

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## **DISCUSSION AND CONCLUSION**

Our results show that there are distinct differences in terms of how companies founded by Asian American entrepreneurs in Silicon Valley develop in comparison to those founded

by non-Asian American entrepreneurs. We learn that Asian American founders were more likely to hire other Asian Americans as executives while it was almost impossible for Asian Americans to be recruited by companies not founded by Asian American entrepreneurs.

While the two groups exhibit notable differences in the acquisition patterns of human and financial resources, we find little systematic difference in the performance of the companies in terms of time to IPO, valuation at IPO or post-IPO performance. Our results indicate that social capital may indeed play an important role in recruiting and receiving financing - activities at the earlier stage of a company's development. However, social capital appears to have less impact on company performance as the company develops and grows. Among the ventures that are successful enough to go public, founders' ethnicities seem to make little difference.

Our findings raise additional interesting research questions with respect to the acquisition of human and financial resources. For example, it would be interesting to learn why and how our Asian American entrepreneurs received financing from Asia-based companies. We are not sure if Asian corporations provided better terms or whether they were the only source of investment for our Asian American entrepreneurs.

It should also be noted that we examined only a small subset of the Asian American companies in Silicon Valley – the ones that have successfully gone public. For example, we do not know for certain whether the financing patterns or relative performances would be similar among companies that were not able to reach IPO. Future research should include these firms as well as conduct a longitudinal study of ventures to understand the decision processes and growth patterns of Asian American entrepreneurs more closely.

## **ENDNOTES**

1. According to Statistics: Joint Venture's 2004 Index of Silicon Valley, the largest population in Silicon Valley is White, non-Hispanic with 44% followed by Asian Americans who are 26% of the population. We assume that most of the non-Asian American entrepreneurs are mostly “mainstream” in terms of ethnicity. We later question this assumption.
2. S-1 is a document filed with the Security Exchange Commission (SEC) in preparation for an IPO which reveals information about a private company. S-1 filings provided our research with important information, including who the founders were.

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Table 1: Definition of Silicon Valley (obtained from (Saxenian 2002a))

| <b>Santa Clara County</b>   | <b>San Mateo County</b>  | <b>Alameda County</b>                                       | <b>Santa Cruz County</b> |
|---|--|---|--------------------------|
| Campbell, Cupertino<br>Gilroy, Los Altos, Los Altos Hills, Los Gatos, Milpitas, Monte Sereno, Morgan Hill, Mountain View, Palo Alto, San Jose<br>Santa Clara, Saratoga<br>Sunnyvale | Atherton 94027<br>Belmont 94002<br>East Palo Alto 94303<br>Foster City 94404<br>Menlo Park 94025<br>Redwood City 94070<br>San Carlos 94070<br>San Mateo 94400-03<br>Woodside | Fremont 94536-39, 94555<br>Union City 94587<br>Newark 94560 | Scotts Valley 95066-67   |

Table 2: SIC Codes of Companies in the Analysis

| <b>Industry Group</b>                             | <b>Sub-groups</b>                              |
|---|--|
| 357: Computer And Office Equipment                | 3571, 3572, 3575, 3577                         |
| 367: Electronic Components And Accessories        | 3671, 3672, 3674, 3675, 3677, 3679             |
| 355: Special Industry Machinery                   | 3599   |
| 366: Communications Equipment                     | 3661, 3663, 3669                               |
| 372: Aircraft And Parts                           | 3721, 3724, 3728                               |
| 381: Search, Detection, Navigation, Guidance      | 3812   |
| 382: Laboratory Apparatus And Analytical, Optical | 3821, 3822, 3823, 3824, 3825, 3826             |
| 504: Professional And Commercial Equipment        | 5045, 5047, 5048, 5049                         |
| 506: Electrical Goods                             | 5063, 5064, 5065                               |
| 737: Computer Programming, Data Processing        | 7371, 7372, 7373, 7374, 7375, 7376, 7378, 7379 |
| 871: Engineering, Architectural, And Surveying    | 8711   |
| 873: Research, Development, And Testing Services  | 8731, 8732, 8734                               |

Table 3: Number and share of IPOs by year

|        | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | Total |
|--------|------|------|------|------|------|------|------|------|------|------|-------|
| AA     | 1    | 4    | 4    | 8    | 9    | 3    | 4    | 19   | 19   | 4    | 75    |
| Non-AA | 4    | 14   | 6    | 7    | 14   | 11   | 11   | 30   | 37   | 5    | 139   |
| % AA   | 20.0 | 22.2 | 40.0 | 53.3 | 39.1 | 21.4 | 26.7 | 38.8 | 33.9 | 44.4 | 35.0  |

Table 4: Percentage of Asian Americans in Executive Management (\*P<0.05, \*\*P<0.01)

|        | Total including Founder(s) | Total excluding Founder(s) |
|--------|----------------------------|----------------------------|
| AA     | 34.48 %                    | 16.09 %                    |
| Non-AA | 2.35 %                     | 2.35 %                     |
| T-Stat | 11.06**                    | 5.71**                     |

Table 5: Share of equity at IPO by year (\*P<0.05, \*\*P<0.01)

|        | Founder Equity Share (%) | Venture Capitalist Equity Share (%) |
|--------|--------------------------|-------------------------------------|
| AA     | 19.54 %                  | 34.79 %                             |
| Non-AA | 19.70 %                  | 40.70 %                             |
| T Stat | -0.054                   | -1.87                               |

Table 6: Sources of Funding (\*P<0.05, \*\*P<0.01)

|        | Venture Capital |              | Strategic Investment |              |
|--------|-----------------|--------------|----------------------|--------------|
|        | Asian           | US           | Asian                | US           |
| AA     | 30.0%(15/50)    | 84.0%(42/50) | 12.0%(6/50)          | 26.0%(13/50) |
| Non-AA | 0%(0/98)        | 95.2%(94/98) | 1.0%(1/98)           | 44.9%(44/98) |
| T Stat | 4.58**          | -2.12        | 2.31*                | -2.35*       |

Table 7: Average Number of Years to IPO (by year of IPO issued) (\*P<0.05, \*\*P<0.01)

|        | 1992 | 1993  | 1994  | 1995 | 1996 | 1997 | 1998 | 1999  | 2000  | 2001  | Total |
|--------|------|-------|-------|------|------|------|------|-------|-------|-------|-------|
| AA     | 5.0  | 6.5   | 7.0   | 7.8  | 5.8  | 4.2  | 8.0  | 5.0   | 4.8   | 5.0   | 5.6   |
| Non-AA | 4.5  | 9.5   | 11.2  | 5.4  | 5.2  | 4.3  | 7.6  | 5.5   | 5.8   | 6.6   | 6.2   |
| T-Stat | N/A  | -1.22 | -1.13 | 1.68 | 0.29 | 0.06 | 0.10 | -0.44 | -1.07 | -0.61 | -1.18 |

Table 8: Company valuation at IPO (\$1,000)

| Year        | 1992    | 1993    | 1994    | 1995    | 1996    | 1997    | 1998    | 1999      | 2000      | 2001      | Total     |
|-------------|---------|---------|---------|---------|---------|---------|---------|-----------|-----------|-----------|-----------|
| AA          | 101,232 | 68,807  | 99,750  | 276,494 | 267,313 | 241,391 | 241,416 | 1,109,272 | 2,301,574 | 1,364,146 | 1,014,865 |
| Non-AA      | 159,119 | 187,152 | 241,467 | 445,421 | 298,877 | 456,954 | 345,484 | 1,631,531 | 1,058,991 | 336,852   | 819,719   |
| T-Stat      | N/A     | -2.79*  | -1.33   | -0.61   | -0.26   | -0.99   | -0.77   | -1.10     | 1.81      | 1.25      | 0.84      |
| Signed Rank | 1.0000  | 0.1296  | 0.1779  | 0.4433  | 0.7894  | 0.7998  | 0.7237  | 0.0452*   | 0.0006*   | 0.2410    | 0.0430    |

\*P<0.05, \*\*P<0.01

Table 9: 12-Month Post-IPO Performance (% in share price)

|             | 1992   | 1993   | 1994   | 1995   | 1996  | 1997   | 1998   | 1999   | 2000   | 2001   | Total  |
|-------------|--------|--------|--------|--------|-------|--------|--------|--------|--------|--------|--------|
| AA          | 51.3   | -10.7  | 34.6   | 33.5   | -8.90 | 92.6   | 258.9  | 109.3  | -80.4  | -50.5  | 28.7%  |
| Non-AA      | -9.7   | 9.3    | 40.3   | 34.4   | 0.32  | 13.1   | 128.3  | 45.8   | -68.1  | -65.1  | 4.8%   |
| T-Stat      | N/A    | 0.03   | -0.09  | -0.02  | -0.39 | 0.82   | 1.39   | 0.90   | -1.72  | 0.98   | 1.05   |
| Signed Rank | 0.4370 | 0.8948 | 0.4939 | 0.9003 | 1.000 | 0.2935 | 0.1684 | 0.8480 | 0.3532 | 0.4162 | 0.8853 |

\*P<0.05, \*\*P<0.01

**Korea's Regional Industrial Promotion Projects(RIPPs)  
and Regional Innovation Agency(RIA)**

Choi, Yong-Ho and Hwang, Woo-Ik

**(Abstract)**

Korea has gone ahead with various regional industrial promotion policies for the nation's balanced development and strengthening national competitiveness through the development of regional industry. In Korea's regional economy, small & medium size enterprises (SMEs) are very important. Therefore one of the major regional industrial promotion policies in Korea to build up a foundation for SMEs-focused technological innovation is the regional industrial promotion project (RIPP) as an example. This project promotes the development of regional SMEs-focused industry by selecting a strategic industry which has great potential for growth in each region and then helping it form an industrial cluster. This study suggests the functions and roles of the Regional Innovation Agency (RIA) as an organization to promote the success of RIPPs in Korea. Korea's RIPPs, in the first stage, supported textile, shoes, optical, mechatronics industries in four provinces for five years from 1999 to 2003 with the funds of 1,897 billions won (US \$1,897 millions). In the second stage, they have carried out new projects in nine provinces from 2002, and further some follow-up projects in four provinces from 2004. This study suggests that the RIA should strengthen its role through overall management of RIPPs. In addition, the necessity of expanding it into the planning and adjusting organization of regional industrial policy is raised. For the RIA to accomplish this, the systematic accomplishment of several functions such as planning & adjusting, evaluating & managing, networking, and clustering is required.

## **I. Introduction**

Since the 1990's, Korea has pursued a knowledge-based economy on the basis of the foundation of globalization, localization, and information-ization. The government has set the goal of becoming one of four largest economic countries in the world by 2010, and for that, has set the goal of realizing annual 6% growth of GDP and GNI of 30,000 dollars. Korea's economy has secured its status as the 11th biggest power by the GDP standard in 2003 with a rapid development through compressed growth for the past 40 years. As an industrial development strategy to realize these visions, the government has converted its industrial vision from a factor-driven stage into an innovation-driven one.

One of the major problems in the Korean economy is the population concentration in the metropolitan area centering around Seoul. Inactivity of local economy in the industrial section has contributed to population concentration in the Seoul metropolitan area, and has become a primary factor detrimental to the heightening of national competitiveness. To solve these problems, the Korean government has enacted various policies for local industrial development; location support like developing industrial complex, financial support, technology-innovation support, human resources development support, and marketing support program for local small & medium size enterprises (SMEs) by central & local governments. One of the major regional industrial upbringing policies is the regional industrial promotion projects(RIPPs). The greatest problem in Korea's regional industrial policy may be the shortage of a planning project of local government itself due to the high weight of central government-leading projects. The second problem is that the system to adjust and evaluate various support policies for local enterprises by central government, which have been enforced in the various regions, is insufficient.

This study considers the performing situation and the problems of the RIPPs, one of major policies for promotion of local SMEs, and proposes a direction for the function expansion of the Regional Innovation Agency(RIA), a planning, adjusting, evaluating, and managing organization to guide these projects.

The purpose of Korea's RIPPs is to promote the growth of local SMEs-centered industry by choosing a strategic industry having high possibility of growth by each region and then providing a support to the formation of an industrial cluster by central government. This project has been carried out in 13 provinces, except for the capital area, among 16 metropolitan cities and provinces throughout the country. In 4 of the 13 provinces the project has entered its second stage; in the other 9 provinces the first stage project is still in progress.

RIPPs have not been rated very high in terms of their performance even though they have been carried out with the intention to provide support for an epoch-making growth of regional strategic industries by providing technology innovation and administrative support to regional enterprises. This critical evaluation is mainly based on the poor linkage system of the planning function and evaluation management in carrying out the project.

To solve this problem and to perform the function of planning & evaluating management of RIPPs in 9 regions which were initiated in 2002, RIA was established in each metropolitan city and province and is currently ongoing. However, there is still much criticism concerning the project performing system and the roles of the Agency, and a specific performance has not come out because its experience of operation is not long. The current study suggests a desirable operational system and the role of the Agency through literature and case study about clustering theory and a regional industrial adjusting organization. Especially, it would like to search for a scheme for strengthening the roles of the Agencies not only as simply a planning and managing organization of RIPPs but also as a synthetic planning and evaluating organization of regional

industrial innovation and technological innovation policies in preparation for decentralization in the long run.

## **II. A Theoretical Background of Regional Industrial Promotion and Case Study**

### **1. A Theoretical Background of Regional Industrial Promotion**

Korea's RIPPs initiated in 1999 are based on clustering-based, innovation-driven type, and industrial development strategy, which is focused on concentrating all-out efforts of the region for high-tech, high value added, high productivity. And Korea's RIPPs stresses a close partnership between enterprises and government, and the construction of a knowledge network in the Industry-University-Research Institute (KIET, 2003).

Clustering theory, as suggested by M. Porter and M. Enright et al., asserts that clustering has a significant influence on innovation-performing ability of enterprises. A regional industrial policy employing clustering approach concentrates specific value chain production bodies within the region and then constructs an industrial environment in which they can speed up innovation through learning by interaction, while correcting market and system failure.

For earlier studies concerning clustering strategy, see the theoretical discussion based on a flexible production method (Hwang, Woo-Ik, 2003). Theories about the clustering and enterprise environment for industrial growth after Fordism, include new industrial space theory, district theory, milieu innovator theory, clustering theory, regional innovation system theory, and learning region theory. These above theories have stressed these characteristics: against the concepts of traditional industrial complex, the clustering of a specialized industrial field, professional SMEs, a developed network among enterprises, and the mixture with various city

industrial activities. These flexible production system theories start from Marshall's industrial district theory.

Industrial district (or new industrial district, industrial clustering) refers to a close network constructed between the enterprises of a special industrial field and their related activities. This network involves not only professional enterprises but also the related universities, research institutes, producers' services, city infrastructures, etc. That is various related activities within a specific district provide support to multi-kind, small-amount production system through interaction and then create a clustering economy(Kwon, O-Hyuk, 2003).

Therefore, for the cultivation of SMEs and then, through it, for the development of local industry, new industrial districts or cluster construction is needed. The clustering is induced by markets; here the role of government is to promote this cluster-formation process through indirect support, not direct intervention: concretely, to help develop a self-regulating control structure and inducing system to reform the market & system failure detrimental to the formation of cluster(KDI, 2001). For the innovation of cluster and the revitalization of a network, an organization to conduct the planning and adjusting work of regional innovation in direct or to execute it as an agent should be established.

In a successful clustering, the roles of the major constituent members is clearly divided into a vision provider; a system organizer, and a specialized supplier (Bok, Deuk-Kyu et al. 2003). Here, a member in charge of the role of vision provider shows a difference according to the type of cluster; sometimes a university and research institute may take charge of the role or a large size enterprise or local government may do it. This study examines the role of the regional development agency (RDA), as a vision provider or a planning organization for clustering.

## **2. Regional Industrial Promotion and the Operational Cases of RDA**

For the formation and revitalization of an industrial cluster, the role of government and public organization as a facilitator for the formation of a cluster and network is needed. Because competition among districts has intensified and a rapid conversion into knowledge-based society occurred, the roles of a intermediating organization to plan, devise, carry out a policy have come to the fore as an important task. This intermediating organ is commonly called as a Regional Development Agency; RDA. Because its role in the construction and improvement of regional innovation system (RIS) has been stressed, it has received a great deal of attention recently from scholars and policy decision-makers. RDA can be defined as a intermediating organization that deal with the tasks concerning a specific industrial field or regional development (EURADA, 1999), and even though the purposes of its establishment show little difference according to political, social, and economic conditions by nation or region, it is generally the same on that point of raising intrinsic development ability of the region, and the agency has been mainly operated by local government. RDAs have become pivotal intermediating bodies for regional innovation structure in several nations in Europe including Italy, Austria, and Germany where decentralization of power have been successfully made (Lee, Chul-Woo et al. 2003).

Let us examine the operational cases of RDAs in England and of Emilia Romagna RDA in Italy to obtain some points of suggestion about the performing system and the roles for the cluster planning organization in Korea's RIPPs.

### **1) England's RDA**

England's RDAs were established in 8 provinces throughout the country in April 1999, and further in London in July 2000 (Webb & Collis, 2000). These bodies are not called RDAs

however, they can be called regional RDAs for convenience. The object of RDA is to facilitate regional development by conducting a mediating role so that the existing projects in local, central government level can be carried out consistently; that is, its purpose is to play the roles of the central body in devising, adjusting, and carrying out of a strategy and plan from the regional-level, overall viewpoint (Min, Kyung-Hwui, 2001).

The all-inclusive supervision agency for RDA is Department of the Environment, Transport and the Regions(see <Figure 1>). The Minister of Department of the Environment, Transport and the Regions(DETR) can give instructions and guide concerning the performance of the functions of RDA, which has a close connection with each local government. However, it is not placed under local government control. The GO (Government Office for the Regions) gives guidance and adjusts the activities of RDA to keep them in step with the central government's policies. GO corresponds to 'the regional window' of central government which performs the functions of effectively enforcing the central government's policy and the measures in the region. The highest legislative organ of RDA is the board of directors, whose daily work is in charge of the board of operation in which the highest responsible person is the chief executive.

The functions given to England's RDA are the activities directly related to industrial promotion and raising competitiveness of the region concerned, and cover a wide range including physical re-development of a vulnerable area within the region, providing business support service, and manpower education activities. RDA formulates regional innovation strategies as a part of regional development strategy, and plays many leading roles, for example, formulating support measures for facilitating the inducement of investment into the region.

## **2) Italy's RDA in Emilia Romagna (EARVET System)**

In 1972, Italy's local governments including Emilia Romagna received the authorities about regional industrial policies from central government. Soon after, in 1974 Emilia Romagna local government established ERVET SpA (Ente Regionale per la Valorizzazione Economica del Territorio) as a regional development agency to facilitate the industrial development of the region. ERVET SpA, founded by a joint investment of local government and private economic firms, is an organization which carries out a unified character project of raising the competitiveness of regional economy and of providing a support for it.

The operation system of this organization is closely connected with the Emilia Romagna government. That is, the local government performs a role as a planner of projects related with regional development and innovation in broad prospective, and ERVET SpA provides the information needed. By doing so, ERVET SpA fulfills a role not only as the main assistant for regional industrial policy-making of Emilia Romagna, but also as an executor which puts it into practice directly (Bellini & Pasquini, 1998). However, it seems that the relationship between the both is reciprocal in that they have a work performing procedure through feedback, rather than vertical.

ERVET SpA is in charge of comprehensive planning & executing works throughout the whole fields related to regional development in lieu of local government. After ERVET SpA was established the establishment of real service centers by industry began to follow. Centers such as Centro Ceramico, CITER, CESMA, and CERCAL were founded in the regions concerned (see <Figure 2>)

. From the middle 1980's, service centers to provide a support to all the enterprises in the Emilia Romagna region beyond a specialized industry were established. The ASTER (Technology Transfer Center) and CERMET (Quality Research and Qualificatory Center) were established as pan-industrial service centers to raise the technological innovative ability of

regional enterprises by facilitating the transfer of technology (Cooke & Morgan, 1998; DelNet & ASTER, 2002).

ERVET SpA in EARVET system, though fulfilling a role as an organization, keeps a horizontal relation structure with individual service centers which provide specialized service support to a specific field.

### **3) Suggestions from Oversea RDAs**

To promote regional industry effectively, various policies of the central government are needed that can be adjusted and that have a connection with each other at the regional level. In addition, for RIPPs to formulate an inter-business cluster and to construct regional innovation system, a revitalizing network and a vision provider are needed. In this respect, England's RDA is the one in which the central government's projects can be planned and adjusted at the regional level. The EARVET system, the RDA of the Emilia Romagna region in Italy, has contributed to the development of regional specialized industry by adjusting the operation of the pan-industrial service centers and the service centers by industry and connecting them with each other.

When considering the fact that the planning, adjusting, evaluating, and connecting functions among various policies of central and local government for regional industrial development and enterprise support are very vulnerable, Korea also, like England's RDA or Italy's EARVET system, feels keenly the necessity of operating an industrial policy planning organization at the regional level.

### **III. The Present State of RIPPs in Korea**

#### **1. RIPPs in 4 Districts**

Base direction of government support for Korea's RIPPs is focused on each project raising its innovation ability. Government's investment give priority to creating a foundation and indirect environment in which enterprises can raise their competitiveness, growing out of the former way of providing direct support to individual enterprises.

Korea's RIPPs began in 1999, as the first stage, in 4 districts including Daegu, Busan, Gyeongnam, and Gwangju provinces(see <Table 1> and <Figure 3>). The structural reform of the textile industry in Daegu and of the footwear industry in Busan, the high added value-ization of the machine industry in Gyeongnam, and the optical industry in Gwangju are included. Here, a total 1,897 billion won were invested for construction of public infrastructure, support for technology development, manpower education & training, and marketing support.

The evaluation results of the first stage projects carried out from 1999 to 2003 show that they have contributed to raising the competitiveness of regional industry and revitalizing the regional economy in terms of the following:

First, a foundation for a structural reform of regional industry focused on trial production facilities and research development equipments was constructed. Second, owing to the fruits of technology development, a sales increase is occurring.

Third, with the construction of a foundation and system for manpower cultivation which corresponds to the characteristics of regional industry, various needs of enterprises for manpower have been met.

In these 4 districts, the second stage projects have been carried out from the year 2004. In the second stage, an additional strategic industry by region is chosen which will then be promoted

by actively utilizing an innovative infrastructure constructed in the first stage. The performing direction of the second stage project, like that of the first stage, is focused on formulating and revitalizing an industrial cluster through the strengthening of the clustering and networking among the innovation subjects, giving priority to the regional strategic industry (MOCIE, 2004). For that, a total 2,266.9 billion won will be invested from 2004 to 2008.

## **2. RIPPs in 9 Districts**

In 2000 when the first-stage projects in 4 provinces had been carried out, the necessity of the carrying-out of RIPPs throughout the country in addition to the 4 provinces was raised. Therefore, after a feasibility study the projects were expanded into the 9 provinces of the non-capital area. The process period of the project in 9 districts is five years from 2002 to 2006, and with 9 provinces being divided into 3 circles, the development of a new specialized industry suitable to the characteristics of each district has been made. For these projects in 9 provinces, a total 1,547 billion won, including national, local expenditure, and private funds, will be invested(see <Table 2>).

Concerning the performance of RIPPs, in-depth analysis of the first-stage projects in 4 provinces was made. However, a concrete analysis of the second projects in 4 provinces and RIPPs in 9 provinces has not been made yet, because these projects are still in progress. Some problems pointed out in the first stage project in 4 provinces are as follows (KDI & KIET, 2003):

First, on the whole, mid-and long-term vision and strategies by regional strategic industry leave something to be desired.

Second, the outcomes in the unit program were not quite satisfactory due to not devising a systemic plan.

Third, in case of enterprise support service work including overseas marketing and the information-ization project, the general effect was limited due to poor investigation of the needs of enterprises within the region.

Fourth, an Industry-University-Research Institute (I-U-R) network construction and its practical cooperation leaves something to be desired. To solve these problems, RIAs have been founded from the year 2002.

### **3. The Operational Present State of RIA**

RIA, with the foundation object of managing the outcomes of RIPPs, have been established and operated in 13 provinces where the projects have been carried out. The major tasks of this organization are to conduct the planning and evaluating management function for the successful performance. Financial resources for the operation of this organization are provided by the government, so this organization is of a public character. Currently the number of professional research workers of each agency is about 10, and the operational budget amounts to about 6~8 billion won(US \$6~8million) for 5 years.

The major roles of RIA are planning and evaluating management for RIPPs including the following:

First, providing technology support, manpower training, devising a plan for management support and its adjusting are involved.

Second, the Agency proposes a direction of technological innovation through the drawing of regional technology road map (RTRM), and performs the roles of supplying and managing R&D funds.

Third, to raise the ability of regional innovation subjects (firms), it operates a council.

Fourth, it constructs an industrial information data base. In addition, it carries out a project to raise the planning and evaluation ability of the local government in devising mid- and long-term development strategies for the region.

However, because it has only been a short time since the RIA was founded and it does not have enough practical, institutional authority, it has not fulfilled the function of adjusting the projects adequately. In addition, by not securing an adjusting and evaluating authority based on institution for central and local government projects, it has experienced difficulty in growing into a regional development organization.

On the basis of a discussion of new industrial district theory, the cases of overseas regional development organization and the present status of RIPPs, the researchers would like to suggest a direction for RIA's development in section IV. Especially, in terms of the construction of strategic industry-focused industrial cluster and RIS, the operating system and right-functioning direction for RIA will be proposed.

#### **IV. The Operating System and Right-functioning Direction of RIA**

##### **1. The Direction for constructing a performing system.**

Korea's RIA was founded to perform the function of planning and evaluating management for increasing the performance of RIPPs, but it needs to strengthen its institutional function since it has been restricted in its function. Currently, the organization of RIA is under the supervision of the Ministry of Commerce, Industry, and Energy(MOCIE), and in addition to it, under the direction and support from local government. In addition RIA has carried out an evaluating management work jointly with ITEP, an organization of evaluation management under the influences of central government. It has not secured an independent legal authority in the

operation of the organization in each province, and currently assumes the form of the affiliated organization of an existing one such as Technopark.

For RIA to strengthen the right of self-regulation and independence as a planning and evaluating organization, it is necessary to convert it to an independent organ. Additionally it can actively conduct the outcome managing work by strengthening its mediating authority for the specialized center by industry, an executive organ for RIPPs.

As localization increases and a flexible production system of knowledge-based economy is strengthened, the security of planning and linkage policies and mediating function has become important. In this point of view, the researchers think that an institutional organizational system, by which RIA can conduct a planning and evaluating management work for central and local government's projects besides RIPPs, should be constructed.

When looking at some support programs for SMEs in Korea, they can be classified into 7 types: finances, technology, start-up, marketing, business administration, manpower, and location support. These programs have been executed in three forms by the central government or jointly by local government, or jointly by central and local government. However, most of the support programs for regional enterprises have been implemented in a central government-leading and local government-subsidiary form. The major central government-leading programs include Technopark(TP) construction project by the Ministry of Commerce, Industry and Energy; the software support center project by the Ministry of Information and Communication; the RRC project by the Ministry of Science and Technology; the New Business Center's operational program by the Small and Medium Business Administration; and diverse programs by the Small Business Corporation. There are very few support programs for regional enterprises developed by local government.

Even though there is synergistic effect when these programs are carried out collectively in the region and are closely connected, they have been executed individually, and no linkage has been made. Therefore, various regional support programs for regional SMEs are needed to be planned and adjusted synthetically of the regional level. Currently the most suitable organization for performing the function of planning and evaluating regional industrial policies is RIA, and it is expected that in the future this organization will be expanded into one which operates throughout the regional industry.

For the Korean RIA to make own way in this direction, it would be good to refer to England's RDA model and EARVET system, and the regional development organization of Emilia Romagna region in Italy. England's RDA has conducted the functions of collectively planning and adjusting the various policies for regional industrial development from several departments of the central government. We can also learn from the fact that the EARVET system has contributed to the development of a specialized industry at the district level by adjusting the operation of pan-industrial service centers and the centers by industry and then linking them.

For Korea's RIA to secure a status as a planning and adjusting organization, a vision and will for local government to promote it into a central organ for the planning and evaluation of regional industrial development are needed. Central government also would have to provide institutional supports while being fully aware of RIA as a window to link and adjust local and central industrial policies.

<Figure 4> shows a desirable structural system for Korea's RIA. When prior planning and adjusting various policies of central government being enforced in the region, supervision, and support are needed from both the central and local government, and on the basis of it, RIA should conduct the linkage function between them. In addition, it is necessary to secure the authority to link and adjust between the pan-industrial service centers and the regional service

centers by industry with the backup of an institutional framework. That is, the organization expansion of RIA should be made with the security of financial resources so that it can play a role in planning and evaluating organization not only for RIPPs but also for regional industry. And it would be good that under close cooperation relation with regional innovation council, a legislative organ for regional innovative projects of each district, RIA conducts a preliminary evaluation function for the matters for decision of regional innovation council according to the characteristics of the projects.

## **2. The Right-functioning Direction of RIA**

The MOCIE has proposed some points for reform in the future through the experience and evaluation of the first stage RIPPs in 4 provinces as follows(2004):

First, it is necessary to formulate a vision and strategy of mid- and long-term development by industry for the formation of industrial cluster.

Second, it is needed to construct an evaluation system for inducing the effective performance of the projects. That is, one should induce an effective attainment of the strategic industrial development vision by constructing a synthetic evaluation system.

Third, the systematic construction and effective carrying out of unit projects for substantial enterprise support and for strengthening I-U-R networking is needed; that is, it is necessary to develop various support programs for enterprises to encourage them to visualize their outcomes with the construction of infrastructure in which the propriety of scale and the industrial character are considered.

As noted in Chapter II and III, Korea's RIA should be able to perform a central role of planning and evaluating regional industrial policies. For that, it would have to faithfully conduct the functions of a planning and adjusting, evaluating and managing, linkage and cluster

formation. Given the short history of Korea's RIA these functions should be classified into short-term tasks and mid-term ones (5 years).

In terms of its short-term role, RIA should place its focus on providing a support for the successful performance of RIPPs. The planning and adjusting function is to design and adjust the specific programs for raising the performance of the projects(see <Table 3>). The evaluating and managing function is for raising the efficiency through the evaluation and management of the projects. It is necessary of maximize the fruits of the strategic industrial promotion projects through evaluating and managing programs which have been carried out in the center by industry of RIPPs. The linkage construction function is to plan a linkage scheme and carry out it between industrial innovation subjects and innovative projects. The cluster formation function helps create an environment for product market creation, raw material market expansion, strengthening enterprise strategies and competition circumstances, and support industry promotion.

Next, in terms of mid-term roles, the RIA must choose its approach method of expanding the planning and managing function into the whole of regional industry on the basis of a regional innovation ability accumulated so far. They can be summarized as follows:

First, the planning and adjusting function, the creation of a vision for regional industrial development should be made through the planning of industrial policies on the basis of analyzing a given circumstance for regional industry and a developmental environment at home and abroad in the future. It is important for the RIA to help conduct these tasks. The planning and evaluation of regional strategic industry, establishing mid- and long-term development strategies, and establishing a regional industrial promotion plan by local government.

Second, the RIA should conduct the function of evaluating and managing various programs for the support of regional industry. Through the evaluation of the selecting and performing

process of various industrial innovation projects of government including regional industrial promotion project and industrial technology foundation construction programs, the necessity of improving the conformity with regional industrial policies and securing the linking property among the projects is raised.

Third, the linkage construction function provides support to the revitalization of linkage among enterprises, main subjects of strategic industry promotion, and university and research organizations concerned. It is also important to raise the efficiency of policies' performance by various industrial promotion policies of central government so that they can faster regional industrial development.

Fourth, it is the function of encouraging an industrial clustering. RIA should play to propose a re-development scheme for deteriorated industrial complex to strengthen the strategic industry's clustering and of invite domestic and oversea promising enterprises in the strategic industrial field.

## **V. Conclusion**

Industrial policies in the knowledge-based economy of the 21C stress flexible production system and innovative environment. Especially, a clustering theory expects the elevation of the fruits of enterprises through the minimization of the costs and the revitalization of collective learning by clustering I-U-R resources. The Korean government has carried out various policies for providing support to enterprises for the development of regional economy since the 1960's. However, while the weight of regional industry having been shrunk in the high speed growth process of the Korean economy, national balanced development has come to the fore as a major task of national administration. The Korean government has carried out RIPPs based on a

cluster as one of major policies for the development of regional industry, and has operated RIA as a managing organization of these projects.

These projects are regional economic development policies focused on specialized industries having competitiveness in the region. The first stage projects began in 4 provinces in 1999. On the one hand, the first stage projects produced the effect of supporting technological innovation and manpower cultivation for enterprises in the region where the industrial foundation is fragile. Practically, they did not meet the needs of enterprises and produced problems of not satisfying them.

To make up for the problems in the performing process of the first stage projects in 4 provinces, the government established RIA in the performing process of the projects in 9 districts and of the second stage projects in 4 districts to make the tasks of planning, adjusting, evaluating, and linking performance. However, the institutional backup for the performance of the functions and roles of RIA has not been satisfactory, and the direction for its functions is not clear.

The current study suggested a performing system, function, and role of RIA to raise the performance of RIPPs. As a performing system of RIA, it is desirable that it be operated as a public corporation in which central and local government provide financial support when considering the publicity of the project operational objects. In addition, the necessity of establishing a long-term support system and institutionalizing it is raised so that it can perform the role of RIA. Concerning this matter, England's RDA model and Italy's EARVET system have given many points of suggestion. In the long run, it is necessary that RIA to grow into a regional development organization, beyond the evaluating and managing role of the projects, which adjusts and evaluates various policies of central and local government to be carried out in the region. Especially, an institutional foundation should be constructed to synthetically

adjust and link the support centers by industry and the pan-industrial support centers in each district. When this foundation is prepared, regional planning and evaluating capability in the future will be strengthened and an industrial development appropriate to the actual circumstances of the region will be fostered.

The 4 functions of RIA to raise the performance of RIPPs, are planning and adjusting, evaluation and management, linkage system construction, and cluster formation. These functions are classified into the short-term ones and the mid-term ones (after 5 years) when considering RIA's short history. The short-term functions are the roles as a planning and evaluating organization to raise the performance of RIPPs. In the long run, RIA should conduct the functions as a planning and adjusting organization for an industrial technology innovation and for providing support to enterprises throughout the district beyond the RIPPs.

As Korea's industrial development has been changed from the factor-driven development strategy into the innovation-driven one, the formation of industrial clusters and innovative systems has become very important. In this respect, it is expected that RIA's securing its status as a planning and adjusting organization for regional strategic industrial clustering and industrial innovative system will contribute to the localization of the Korean economy, because industrial policies of the central government will encourage the development of regional industry by being formulated through the performing of comprehensive planning & evaluating functions for regional industry by RIA.

The current study analyzed the performing system and roles of RIA as a planning and adjusting organization for the development of regional industry in terms of theories and the present situations. Future studies will examine the specific roles of RIA by analyzing the interrelation between a statistical performance of RIPPs and the functions of RIA.

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<Table 1> Regional Industrial Promotion Projects of 4 districts in Korea

(Unit: billion Won)

| Stage                     | District  | Total Amount Invested | Projects  |
|---------------------------|-----------|-----------------------|---|
| First<br>(1999~<br>2003)  | Busan     | 386.6                 | Footwear  |
|                           | Daegu     | 680.0                 | Textile   |
|                           | Gwangju   | 402.0                 | Optical   |
|                           | Gyeongnam | 428.4                 | Machinery   |
|                           | Subtotal  | 1,897.0               |   |
| Second<br>(2004~<br>2008) | Busan     | 690.9                 | Footwear, Machine parts materials,<br>Marine life resources |
|                           | Daegu     | 420.3                 | Textile, New tech industry, Mechatronics                    |
|                           | Gwangju   | 491.8                 | Optical, Electronic parts                                   |
|                           | Gyeongnam | 663.9                 | Machinery , Intelligent home network,<br>Biochemical        |
|                           | Subtotal  | 2,266.9               |   |
| Total                     |           | 4,163.9               |   |

Note: 1 dollar is 1,000won

Source: MOCIE(2004)

<Table 2> The Present Status of RIPPs in 9 Provinces

(Unit : Billion Won)

| District  | Total Amount Invested | Support Fields                          |
|---|-----------------------|---|
| Daejeon •Chungchung                               | 470.5                 | Electronics, Biological                 |
| Cheonlla •Cheju                                   | 406.3                 | Automobile parts, Machinery, Biological |
| Ulsan•Gyeongbuk•Gangwon                           | 520.9                 | Automobile, Electronics, Biological     |
| Joint R&D   | 74.4                  | Providing support to joint R&D          |
| R&D planning & Innovative foundation construction | 75.0                  | Operation of RIA                        |
| Total   | 1,547.1               |   |

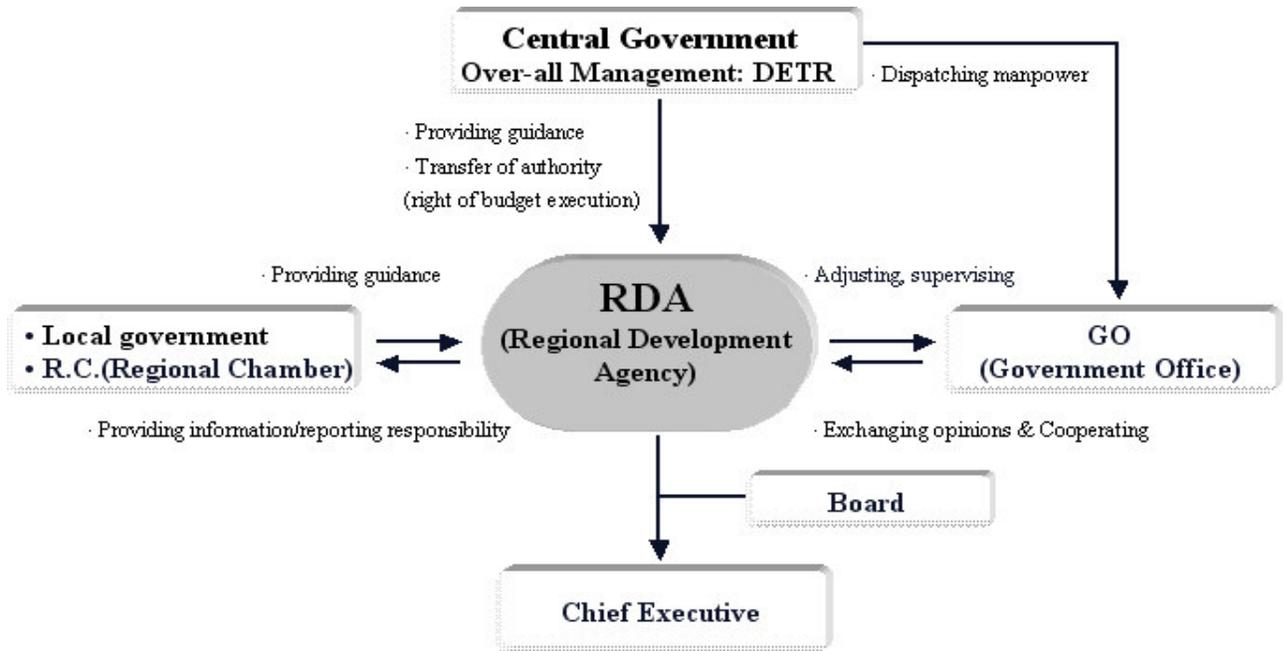
Note: 1 dollar is 1,000won

Source: MOCIE(2002)

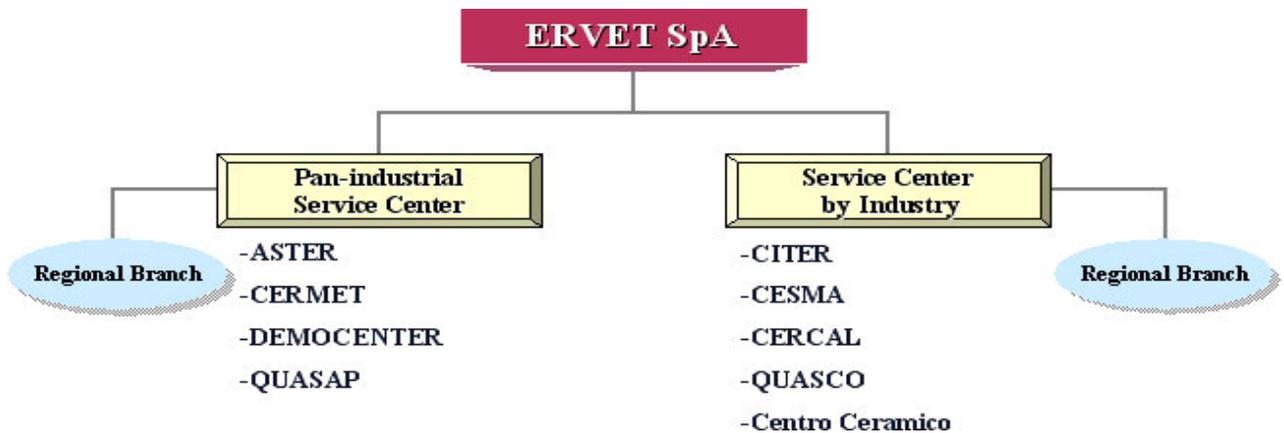
<Table 3> The Right-functioning Direction of Korea' RIA

| Function                | Short-term role<br>(Managing the outcomes of RIPPs)                                   | Mid-term role<br>(Construction of innovative system for regional development)                      |
|-------------------------|---|--|
| Planning and adjusting  | Specific project planning & adjusting of the second stage RIPPs                       | Planning & adjusting the industrial technological innovative policies                              |
| Evaluating and managing | Planning & research management of regional industrial technology development projects | Evaluating & managing of regional industrial technology, and scientific technology policies        |
| Linkage construction    | Construction of mutual cooperative system among the centers                           | Regional firms support, and cooperation support among industrial technology research organizations |
| Clustering              | Inducement of strategic industrial firms and construction of clustering environment   | Inducement of high-tech firms and construction of firms clustering environment                     |

<Figure 1> England's RDA System



<Figure 2> Emilia Romagna Regional ERVET System in Italy

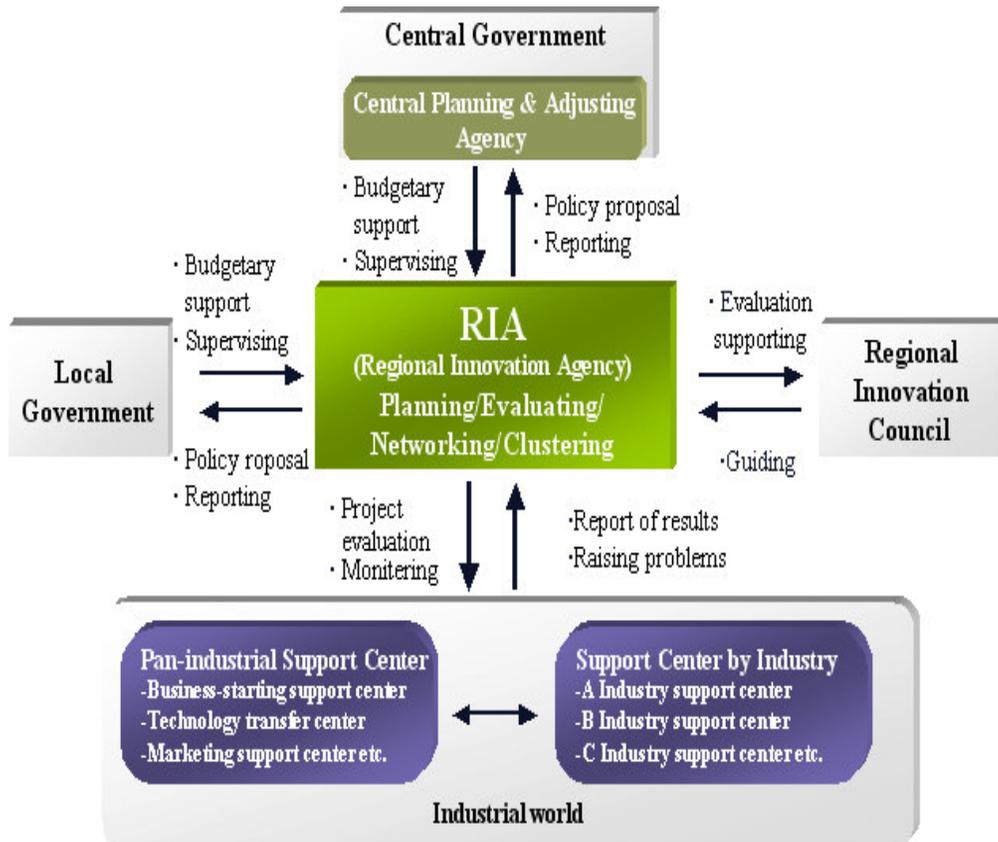


Sources: Lee, Chul-Woo et al.(2003)

<Figure 3> RIA's location in Korea



<Figure 4> Direction of Structural System for Korea's RIA



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**SHARING THE VISION:  
ALIGNING MICRO-FINANCE AGENCIES WITH NEW TECHNOLOGY BASED SMES**

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**Abstract**

The relationship between lender and borrower can be contentious. The entrepreneurship literature contains countless anecdotes regarding mistrust and conflicting objectives between these stakeholders. Simultaneously, there is inescapable interdependence between these stakeholders. Capital is the lifeblood of the growing venture. No financing entity will survive without making loans.

In this paper, we examine the relationships between lenders, specifically micro-finance agencies, and borrowers, in this case new technology-based enterprises. The purpose of the paper is to develop a model to explain the exchange of tacit knowledge from one party to the other. The knowledge exchange is a precursor of cognitive trust, ultimately leading to a shared strategic vision. The result is better investment decisions by both the agencies and the enterprises.

Investigating the respective roles of the micro-lender and the technology-based entrepreneur, we develop a set of propositions regarding causal relationships among variables leading to a shared vision for the SME. Our model contends the following:

- There are identifiable factors contributing to interdependence of lending officers and high-tech entrepreneurs.
- There are identifiable processes for vision sharing between the lenders and the entrepreneurs.
- Interdependence impacts mutual risk assessment.
- Vision sharing processes impact risk assessment.

We examine the practices of micro-finance agencies in Australia and the United States to ascertain how shared vision develops and the decisions and results that follow. The study concludes with a typology of the management processes of micro-finance agencies based on interdependence and shared vision.

**Key words:** Micro-finance, knowledge management, technology-based SME, interdependence, sharing strategic vision

## INTRODUCTION

This paper contributes to a new area of research, namely: institutional preparedness of economic development agencies for developing technology-based small and medium-sized enterprises' (SMEs). It explores the institutional preparedness of micro-finance agencies (Woolcock 1999). Micro-finance is often associated with lending to the poor with transactions that are based on a group of borrowers, such as rotating loans (Auwal 1996). Existing literature focuses on debates about financial management credit analysis (for example Howorth 2001; Hutchinson & Ray 1985; Holmes, Dunstan & Dwyer 1994; McMahon, 2001 and 2003; Ray & Hutchison 1985), finance gaps (for example, Hamilton & Fox 1998; McMahon 2003) and demand and supply of micro-credit (for example, Deakins & Hussain 1994; Gibbs 2000; Kotey 1999).

This paper examines the role of the micro-finance agency that lends to high-technology based SMEs operating under complex conditions (Hamilton & Fox 1998). Complexity is the number of elements in an organization's environment (Dess & Beard 1984). To meet the challenge of developing new industries that operate under complex conditions, governments are increasing their efforts to provide assistance to new and emerging technology-based SMEs (Hall 2003), particularly those in bio-technology and information technology (Sprigings 2002). This complexity makes it important to better understand how the nature of the lender/ borrower relationship allows for better investment decisions.

Though access to micro-finance is important for all SMEs, it has become highly critical for technology-based firms when initial sales are being carried out and equity investments have been maximized. Despite the fact that equity investments are available in the pre- and sales stages of technology-based SMEs, little is known of the processes involved with micro-debt finance for these firms. Unlike the different types of equity finance in the forms of sweat equity, owner, partner, silent, angel and venture capital, the nature of the repayments structure of micro-debt finance requires that the high technology firm is carrying out sales. This means that the micro-loan is best utilized when initial sales are being made in the start-up phase (Roberts 1991) where equity finance may not be appropriate and micro-funds are required to develop the business further.

If technology-based firms are characterized by longer lead times to initial sales, the typical cash flow problems experienced by SMEs will be compounded for these firms. The primary cause of cash flow problems reported by firms in the United States is collecting money due to them (Dennis 2001). Thus, SMEs that are cash starved at the start of sales are likely to become even more desperate when customers delay payments. According to the National Federation of Independent Business, firms experiencing these problems are more likely to draw from personal resources than to borrow from a lending institution.

Mechanisms like micro-finance are required to assist high technology-based SMEs to reach their markets for two reasons. First, they have limited resources and secondly, new and emerging SMEs play a critical role of developing new industries for small national economies like Australia through to the international economy. The size of micro-finance loans varies in the SME literature. In Hong Kong micro-loans are made available up to US\$128,000 (Cattani 2002)

while those in the United States of America vary from US\$5,000-US\$25,000 (Bhatt & Tang 2001). Access to micro-finance is particularly important as it allows high technology-based SMEs to make sales for rapid growth and to reach into new markets (Bank of England Quarterly Bulletin 1999).

The focus on research of micro-finance is often on financial management and credit analysis. In addition, research is emerging on the interdependence of aspirations between micro-finance agencies and technology-based SMEs (Lapie 2001). Understanding the interaction in the nature of the relationship between demand (technology-based SMEs) and supply side (micro-finance agencies) of micro-credit (Deakins & Hussain 1994; Gibb 2000) provides insight in how micro-finance can be more effectively managed. In this paper, management of investment risk by the lender and ROI for the successful growing technology-based SMEs (Westhall, Ramsden & Foley 2000) is explored through the interdependence and shared vision of these stakeholders. The nature of micro-finance as an interdependent system and how to operate effectively within it is not well understood. The question is not whether stakeholders can cooperate. The question is "How well can they cooperate?" The focus of this paper is to explain how, when the relationship between lenders and borrowers is close, useful tacit knowledge about investment is exchanged and can result in better investment decisions.

This study conceptualises a theoretical model that clarifies the variations in processes for sharing vision (Leonard & Sensiper 1998), cognitive trust (Sako 1998) and variations in interdependence (Pfeffer & Salancik 1978), that are predictors of the effective tacit and explicit knowledge of a micro-finance agency lending officer and the SME owner or his/ her agent (for example the finance director) (Nonaka & Takeuchi 1995). Being able to assess the type of business relationship (MacMillan, Money & Downing 2000) will assist both the micro-finance lender and the technology-based SME owner to develop and grow these two sectors. Knowledge can be both "explicit" and "tacit". Explicit knowledge is formal and systematic. It is objective and rational. It can take the form of financial data, contracts, business plans and ratio analysis. That is, it is expressed in words and numbers. On the other hand, tacit knowledge is something not easily visible and expressible. It is subjective and intuitive. Examples of tacit knowledge include insights, intuitions and hunches. Tacit knowledge is deeply rooted in an individual's actions and experience as well as in the ideals, values or emotions he or she embraces (Nonaka & Takeuchi 1995). However, there is an inextricable link between the two.

## **THE GENERAL FINANCE GAP FOR SMES**

Micro-finance involves lending small amounts of funds for very specific initiatives. It is distinct from angel investors and venture capital. New technology-based SMEs can experience difficulties in gaining access to traditional sources of finance. Thus in the early growth cycle on technology-based SMEs in Australia there exists a gap in easily accessible funds. For instance an historical source of micro-finance for SMEs that is no longer available due to changes in the banking regulation was solicitors' funds that were offered at competitive interest rates. Most banks in Australia now direct SMEs towards credit cards as their solution to micro-finance for SMEs. In this way banks have no or little working knowledge of the SME in its early stages of development. In the United States, banks remain the primary source of external financing for working capital and capital expenditures, but are declining in relative importance to credit cards and trade credit (Scott, Dunkelberg & Dennis 2003).

Thus there is a call for improving the supply side of this sector. An exploration of cognitive trust, interdependence and buy-in to shared vision of the micro-finance lender and the SME owner (or delegate) can provide a possible explanation of how explicit and tacit knowledge is developed for assessing the SME's level of risk. For instance, the relationship with the traditional bank branch assumed established relationships between the bank branch manager and the SME owner (or delegate). This traditional relationship was based on trust and the paper-based transaction. A good number of banks have now moved away from the traditional model of bank branch manager to a regional structure at the same time the relationship of the bank manager has come under scrutiny as being limited (Gibb 2000; Mole 2002). Thus the banking sector seems to have moved away from developing and maintaining relationships with SME owners in Australia and other countries. In the United States, the federal government's efforts to overcome such behavior by banks has occurred primarily through incentives and encouragement from the Small Business Administration (SBA), such as guaranteed loan programs.

Another controversy is whether the bank manager is meant to provide industry specific business advice along with assessing SMEs risk (Gibb 2000). To address industry specific issues banks are increasingly assuming those SME owners (or their delegates) will partner with their accountants during the loan application process. This has been a means that has allowed banks to overcome the limitations of paper-based transactions and assuming the accountant will provide the necessary advice and base their reputation on the credit worthiness of the loan applicant. It has meant an increased burden for accountants for which micro-loans may not justify the transaction. This banking strategy also assumes all SMEs have an accountant who in turn has a relationship with a bank.

### **ROLE OF THE MICRO-FINANCE AGENCY**

A call for more research on the role of the micro-finance agency has been made for investigating greater efficiencies in the delivery of loans between the micro-finance agency and the client (Bhatt & Tang 2001; Gibb 2000). A number of studies have been carried out that examine agencies that are active in providing risk finance for new and emerging technology-based SMEs (Harris & Bovaird 1996; Westhall, Ramsden & Foley 2000). Why some agencies are successful and others are not is a matter of providing research on the interdependence of relationships that are based on individual stakeholder interests being mutually beneficial (Woolcock 1999).

There are a multitude of micro-finance agencies in the United States. Some are government-sponsored and may be based at any of the three levels of government in the American system: federal, state or local. One example is the SBA Micro Loan Program. Through this program, the SBA provides very small loans to start-up, newly established, or growing small business concerns. The SBA makes funds available to non-profit community based lenders (intermediaries) which, in turn, make loans to eligible borrowers in amounts up to a maximum of \$US35,000. The average loan size is about \$US10,500. A non-governmental agency example is the U.S.-affiliate of ACCIÓN International. The mission of this organization "is to make access to credit a permanent resource to low- and moderate-income small businesses owners in the United States. By providing small or "micro" loans to men and women who have been shut out of the traditional banking sector, ACCION helps build their businesses and increase their incomes" (ACCION USA, 2003).

It is difficult to separate the formal risk assessment from the nature of the relationship of the micro-finance agency and the technology-based SME (Deakins & Hussain 1994). Relying only on ratio analysis in risk assessment does not take account of the broader information sources concerning technology-based SMEs. These broader information sources are often based on interpersonal relationships that provide tacit knowledge of a technology-based SME's operations and the firm's potential. Explaining relationships in the financial transaction of micro-finance (Gibb 2000) is the focus of this paper. Understanding the management preferences, beliefs and expectations of the micro-finance agencies and technology-based SMEs (Hamilton & Fox 1998) will assist in understanding interdependence and shared vision of these stakeholders in the lending transaction.

Micro-finance has traditionally been perceived as in the domain of reducing poverty and unemployment and has been for firms that are marginal rather than those that are high growth or have high growth potential (Devereux & Fische 1993). Micro-finance agencies operate through community banks that include the Bendigo Bank or the South Side Bank of Chicago, along with credit unions in developed and developing countries and as agencies specifically for micro-finance such as the E.C.L.F. micro-finance agency of South Africa. Other examples are found in New Zealand—the Prometheus Foundation and the Prometheus Credit Union; in Canada—Assiniboine Credit Union, Credit Union Central of Ontario, Metro Credit Union and the VanCity Savings Credit Union; and in the United States of America—the Capital District Community Loan Fund.

Micro-finance agencies are closer to SME owners and provide more flexible services and loans than trans-national banks. Micro-finance agencies are usually incorporated independently of any government initiative, though they may receive government sponsorship in the funding of micro-loans (Westhall, Ramsden, & Foley 2000). How they manage assistance to finance SMEs is not well understood. There is little research about the micro-finance agency's internal operations of managing tacit knowledge in their assistance to new and emerging entrepreneurial SMEs.

### **INTERDEPENDENCE**

The overall interdependence between the lender and the technology-based SME owner is fundamentally underpinned by a power imbalance skewed towards the micro-financer. The reason for this is the coercive power of the lender to disapprove or call in loans (Mole 2002). However, it is in the best commercial interests of both the lender and the technology-based SME owner to develop a partnership in analyzing and interpreting risk from the internal and external environment of the technology-based SME.

Resource-dependence explores the exercise of power-dependence (interdependence) of individual organizations in an environment (Pfeffer & Salancik 1978; Pfeffer 1981; Thompson 1967). Resource-dependence for entrepreneurial development programs explores the degree of power-dependence (interdependence) micro-finance agencies can experience. It also infers a range of strategic initiatives that micro-finance agencies can implement to affect their degree of independence. Not much is known about why micro-finance agencies, with low power-dependence (interdependence) and with high cooperation, enable faster speed to market, sophisticated business practices and ROI/profit for their clients. What is known is that both social environment and organizational context have an impact on the frequency of learning (Amabile, Conti, Coon, Lazenby & Herron 1996; Martin, Rowe, & Christie 2001; Moorman & Miner 1998).

Power-dependence encompasses the power in the relationship(s) between the micro-finance agency and the SME client. The focus is on the power-dependence (interdependence) that these relationships create within the delivery of an entrepreneurial development program. For instance, a micro-finance agency that is highly centrally planned and controlled would have a high level of power-dependence with technology-based SMEs compared to an organization with a greater emphasis on partnership. Under conditions of partnership, power-dependence is far more dispersed. This view is consistent with the innovation literature. In one study, managerial influence on variations in ideas creation is characterized by the level of power in operational decisions and activities (McGrath 2001). Under conditions of dispersed dependence, micro-finance agencies seek resources through a number of differing institutions rather than a single sponsor.

Drawing on the resource-dependence literature provides an explanation of the influence that interdependence has on a micro-finance - micro-firm relationship. Interdependence characterizes the relationship between the agents creating an outcome, not the outcome itself (Pfeffer & Salancik 1978: 40). Within this resource dependence perspective, in the micro-finance relationship, interdependence exists whenever one actor does not entirely control all of the conditions necessary for the achievement of an action or for obtaining the outcome desired from the action. The theory offers a definition of interdependence that, like Axelrod (1984), identifies the notion of shadow of the future when it refers to the structure of resource dependence relations shadowing how micro-finance partners conform to each other's demands or how they extract profits from one another (Salancik, Krackhardt, Andrews & Tolbert 1995: 343).

Interdependence characterized by cooperation establishes a high-trust environment in which a micro-finance agency can undertake episodic interactions with a technology-based SME to build a shared understanding and mutually agreed upon decisions. The emergence of inter-organizational trust in the micro-finance relationship can reduce transaction costs (Sako 1998). Building trust in the micro-finance relationship is also an investment to increase future returns and a relation-specific skill (Asanuma 1989). Further, it gives rise not only to lower transaction costs or to higher net benefits from investment, but also to more rapid innovation and learning (Sabel 1994). In these situations, governance by trust can evolve as an informal control mechanism that enhances the effectiveness of transactions (Sako 1998; Smitka 1992). The higher the level of mutual trust, the better the micro-finance relationship innovation and learning performance is likely to be (Sako 1998). Strong trust emerges in response to a set of internalized norms and principles that guide the behavior of exchange partners and is independent of whether or not specific formal governance mechanisms exist (Barney & Hansen 1994).

### **PROCESSES FOR SHARING VISION**

It is important to recognize that processes for sharing vision between the micro-finance agency representative and the technology-based SME owner (or delegate) are a means for directing the talents and energies of each stakeholder towards valued ROI goals. Though ROI is not the only goal of SME owners, it is a means to measure the owners' success and a means to measure the return on the effort to grow the business. The "process" perspective explored in this paper is unlike the "content" perspective that focuses on strategic objectives such as the sharing of vision about the mission of a business. Processes for sharing vision occur at the operational level between a micro-finance agency representative and a technology-based SME owner (or delegate). The paradox is that a knowledge utilization capability is more likely when simultaneously, both openness in a transaction but also closure are managed well to converge on specific solutions

(McGrath 2001). Processes for sharing vision are dual mechanisms that enable this duality to operate in a relationship. This duality relates to divergence and convergence of thinking around a common aim (Leonard & Sensiper 1998). That is, the processes for sharing vision provide mechanisms to shift from generating maximum variation in ideas creation (McGrath 2001) and maximum contradiction in viewpoints to decisively limiting micro-finance outcomes to a minimum number of courses of action (Lazega 2000; McGrath 2001).

The buy-in to strategic vision by lender and borrower is characterized by a duality in its processes. First, differing viewpoints about risk emerge during discussions that occur in the micro-finance relationship as a result of non-routine activity (Fiol & Lyles 1985; Marks, Mathieu & Zaccaro 2001). Individuals' explicit statements or suggestions carry with them the weight of unspoken knowledge. That is, mental models, life examples, perhaps physical skills, even unrecognized patterns of experience which people draw upon to increase the wealth of possible solutions to the risk problem. This experience, stored as tacit knowledge, often reaches consciousness and made explicit in the form of insights, intuitions, and flashes of inspiration (Leonard & Sensiper 1998). When micro-financing addresses an unexpected, non-routine challenge, each skilled participant frames both the problem and its solution by applying mental schemata and patterns he or she understands best. The result can be a cacophony of perspectives. In a well-managed process in the micro-finance partnership, these varying perspectives can foster creative abrasion, intellectual conflict between diverse viewpoints producing energy that is then channeled into new ideas and products (Leonard-Barton 1995: 63).

On the other hand, knowledge utilization requires convergence upon acceptable action to clarify the way forward. Both tacit and explicit knowledge play an important role. Confining the discussion here to managing the tacit dimensions of knowledge, we suggest that three different types of tacit knowledge need to be managed in the micro-finance partnership. That is, tacit knowledge consists of the overlapping dimensions namely: specific, collective, and guiding. These three types of tacit knowledge combine to form a rough hierarchy from low to high tacit knowledge in terms of abstraction. A micro-finance partnership can have processes for sharing vision that consensus involves acknowledgement and acceptance that it is time to end the voicing of differing viewpoints for the purpose of decisively getting on with the task (McGrath 2001). This systemic view reflects the assumption that processes for sharing vision in the micro-finance partnership provide mechanisms to shift from generating maximum variation in ideas to limiting a partnership to a particular course of action.

Processes for sharing vision are an important antecedent to knowledge generation/ utilization because their absence undermines key partners' ability to develop a focused response to SME challenges and opportunities (Dougherty 1989). To date, however, they have not been the focal point of empirical studies. Thus, this study is an early contribution to our conceptualization of processes for sharing vision.

Based on this review, we find a gap in the literature pertaining to the relationship between interdependence, processes for sharing vision and knowledge generation/ utilization. A proposed relationship between types of micro-finance agency processes of sharing vision and interdependence is summarized in figure 1.

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**Figure 1 about here**

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## **DISCUSSION**

The theoretical proposition of this paper is: the greater the degree of both micro-finance agency/ technology-based SME owner interdependence and the development of processes for sharing vision, the more likely effective knowledge generation/ utilization can occur.

Cell 1 relates to two factors of interdependence and processes for sharing vision that correspond to a situation that is characterized by “knowledge utilization capability” because of effective buy-in to strategic vision and high cooperation that is observable through well conceived assessment of the business plan/ concept. First, it relates to interdependence and processes for sharing vision that facilitate knowledge generation/ utilization practices for firms and micro-finance agencies to interpret and evaluate the risk of investment from both the internal and external environment to get products and services to market (faster speed to market). Better interpretation and evaluation of risk allows for issues and problems to be identified early and for appropriate action to be taken. Secondly, it relates to interdependence and processes for sharing vision that proactively encourage cognitive trust.

Cell 2 relates to two factors of interdependence and processes for sharing vision that correspond to a situation that is characterized by “knowledge utilization ad hoc” because of ineffective buy-in to strategic vision and poor cooperation that is observable through individually conceived assessment of the business plan/ concept. First, it relates to interdependence and processes for sharing vision that only sometimes facilitates knowledge generation/ utilization practices for firms and micro-finance agencies to interpret and evaluate the risk of investment from both the internal and external environment to get products and services to market (faster speed to market). Secondly, it relates to interdependence and processes for sharing vision that proactively discourages cognitive trust. For instance a lender may promote risk-averse advice that will protect the bank’s exposure and be only concerned with financial and collateral details (Gibb 2000; Mole 2002).

Cell 3 relates to two factors of interdependence and processes for sharing vision that correspond to a situation that is characterized by “knowledge utilization frustration” because of poor cooperation that is observable through poorly conceived assessment of the business plan/ concept. First, it relates to interdependence and buy-in to strategic vision that do not facilitate knowledge generation/ utilization practices for firms and micro-finance agencies to interpret and evaluate the risk of investment from both the internal and external environment to get products and services to market (faster speed to market). Secondly, it relates to interdependence and processes for sharing vision that proactively encourages cognitive trust.

Cell 4 relates to three factors of interdependence and processes for sharing vision that correspond to a situation that is “knowledge generation/ utilization failure” because of high ineffective buy-in to strategic vision and low cooperation that is observable through poorly conceived assessment of the business plan/ concept. First, it relates to structures and processes that constrain knowledge generation/ utilization practices for micro-finance agencies and SMEs to interpret and evaluate the risk of investment from both the internal and external environment to get products and

services to market (faster speed to market). Secondly, it relates to interdependence and processes for sharing vision that proactively discourages cognitive trust.

This model attempts to capture the type of micro-interactions that occur between the lending officer and a technology-based SME owner (or delegate). However, there are factors beyond the control of the micro-finance agencies and SMEs like market forces and economic trends.

A micro-finance agency provides a means to deal with the complexity of economic development and to coordinate knowledge utilization activities across program management. Internal management expertise within a micro-finance agency is of particular importance in this post-Fordist period (Amin & Thrift 1994; Freeman & Perez 1988; Freeman & Soete 1997) that can be characterized as a period of economic history in which firms are trading in highly complex environments. A micro-finance agency that can mobilize support for trading in complex environments requires having a high range of management expertise, though not all achieve this.

### **RESEARCH QUESTIONS**

From this model four questions are generated to examine the interdependence and shared vision of micro-finance agencies and technology-based SMEs. These are:

Q1: What are the factors that contribute to the interdependence between a micro-finance agency lending officer and a technology-based SME owner or his/ her delegate?

Q2: What are the processes for sharing vision between a micro-finance agency lending officer and technology-based SME owner?

Q3: Does interdependence have an impact on risk assessment?

Q4: Do processes for sharing vision have an impact on risk assessment?

Going beyond the model, there are other related questions that warrant investigation: Does the longevity of the relationship between the lender and borrower matter? Would the shared-vision be achieved through cross-training of the lender about the technology-based business and the borrower about the process of financing? What outcomes should be expected and measured from a shared vision? Does the model have applications to relationships in addition to borrower and lender, such as entrepreneur and equity investor?

Interdependence and processes for sharing vision provide a means to understand how inter-relationships are developed and maintained or not within the environment of a micro-loan for a growing technology-based SME. This understanding of micro-management processes is particularly important in the management of economic development programs. Successful development programs like micro-finance are dependent on how well we understand what processes are occurring at the micro-level of management.

### **CONCLUSION**

Within the above model, interdependencies include dual dimensions between the micro-finance lending officer and the technology-based SME owner (or delegate), namely the psychological and financial transactions dimensions. Further empirical research can examine the nature of these dimensions. This future research is relevant to theory as it contributes to our understanding of the nature of tacit knowledge and decision making. Future entrepreneurs experience the sharing of their vision and interdependence in many business situations. Future research opportunities can focus on the relationships they have with professions like accountants and solicitors, with

investors, with their supply chain, joint ventures and with key customers. The conceptualization outlined in this paper contributes to practice because it informs policy makers and practitioners about the process of interpreting and assessing financial risk in the micro-finance – technology-based SME relationship.

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**Figure 1: Typology of micro-finance agency processes of sharing vision and interdependence for knowledge generation/utilization**

|                 |                         | Processes for sharing vision  |   |
|-----------------|-------------------------|---|---|
|                 |                         | <i>Effective processes for sharing vision</i>   | <i>Ineffective processes for sharing vision</i>   |
| Interdependence | <i>Good cooperation</i> | <b>Cell 1</b><br><b>Knowledge utilization capability</b><br>•Partnership between partners that is smart in interpreting and assessing risks from internal and external environments<br>•Cognitive trust     | <b>Cell 2</b><br><b>Knowledge utilization ad hoc</b><br>•Partnership between partners that is smart in interpreting and assessing risks from internal and external environments<br>•No cognitive trust      |
|                 | <i>Poor cooperation</i> | <b>Cell 3</b><br><b>Knowledge utilization frustrated</b><br>•Partnership between partners that is NOT smart in interpreting and assessing risks from internal and external environments<br>•Cognitive trust | <b>Cell 4</b><br><b>Knowledge utilization failure</b><br>•Partnership between partners that is NOT smart in interpreting and assessing risks from internal and external environments<br>•No cognitive trust |

# **ECONOMIC DEVELOPMENT: A FRAMEWORK FOR ENTREPRENEURIAL NETWORKS AND CLUSTERS**

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## **ABSTRACT**

Given that various types of entrepreneurial network/ cluster relationships are being promoted and researched, this paper fills a void in the literature in that it introduces an entrepreneurship system model for theory building. This entrepreneurship system framework provides a means for the design, implementation and evaluation of entrepreneurial networks.

The model explores a range of different strategic network issues in economic development within an entrepreneurship system. These issues include the network types, participant goal, participant conduct, network type, network system management, learning and culture. The goal of the framework is to explain how businesses organize networks in different commercial contexts. It clarifies issues to explain strategic differences in the networks and clusters that can operate in an entrepreneurship system.

Investigating the strategic differences in the network clusters that can operate in an entrepreneurship system, we develop a set of propositions regarding relationships among strategic issues leading to a viable network. Our model contends the following:

- There are identifiable factors contributing to the quality of network relationships in clusters.
- There are identifiable factors contributing to the structuring of partnerships in clusters.
- Network relationships have an impact on how business organizes in a business context.
- Structuring of partnerships has an impact on how business organizes in a business context.

The framework developed facilitates the analysis and evaluation of an entrepreneurship system. The paper concludes with a typology of the ways in which business organizes in commercial contexts based on network relationships and structuring of partnerships.

**Key words:** Networks, clusters, entrepreneurship system, interdependence, structuring of partnerships

## INTRODUCTION

There has been an increasing focus on entrepreneurial firms networked together in various ways (Florida 1996; Neck, Meyer, Cohen & Corbett 2004). Examples of these are Silicon Valley, Boston's Route 128, North Carolina's Research Triangle, Boulder County and the Italian Emilia-Romania. Network arrangements in an economy are now often seen on a broader scale as a foundation for economic growth. This can be seen specifically at the level of the regional economy (see Brusco 1982; Brusco & Righi 1989) where promotion of entrepreneurial networks and clusters can occur (Kinsella 1989).

Analysis of entrepreneurship has tended to examine informal social arrangements in promoting the creation and growth of new companies, interactivity, knowledge management and knowledge sharing. The literature on entrepreneurship and networks has identified a need for theory building (Hoang & Antoncic 2003; Neck, Meyer, Cohen & Corbett 2004). This paper fills a void in the literature in that it introduces a framework for theory building that can provide clarification that helps explain how well a cluster operates, within networks in an entrepreneurship system.

Network initiatives establish advantages and disadvantages where under certain conditions network links cannot be established, or where certain types of network may be unsuitable. Thus, the importance of creating, maintaining, and developing appropriate networks has increased, making it ever more important to understand the processes involved. The framework in this paper may be useful in the evaluation of network arrangements. The proposed framework may also assist in the design, implementation and evaluation of network arrangements for entrepreneurs within an entrepreneurship system. An entrepreneurship system operates in a region of high entrepreneurial activity (see Neck, Meyer, Cohen & Corbett 2004 for an elaboration of entrepreneurship system).

Networks mean different things to different groups. A rich cross-disciplinary literature accompanies the topic. Through a review of the literature, we attempt a synthesis of issues that may be useful to analyze and evaluate networks in the execution of economic development. There are five sets of theories that can be used in the analysis of networks, ranging from theories of transactions costs, resource dependency, strategic management, social network theory, and the Uppsala school of networks (Varamaki & Vesalainen 2003). These can be reduced to three sets of concepts, based on strategy, network management, and social dimensions. The strategic issues identified and developed from the literature in the proposed framework focus on collective transaction costs, collective action, trust, management of the network, the type of learning and culture. These issues provide a means to explain the forces underlying different types of network clusters in economic development for entrepreneurs.

The cross-disciplinary literature review of this paper builds theory about the nature of variations in networks. Specifically, Porter's cluster theory and modern innovation theory are applied to categorize networks within the two dimensions—"structuring of participants" and

“network relationships”. This review also draws on organizational theory, learning regions literature, knowledge management literature, and innovation literature, to explain variations in network arrangements. The analysis of the nature of networks using this two-dimensional typology may be of use in clarifying networks. The two dimensional framework developed herein purports that, whilst successful entrepreneurial network classifications are likely to be characterized by systemic cooperation, other network types are characterized by formal and linear network relationships—namely hub, satellite networks, state networks, anchored industrial or district networks and virtual networks. On the other hand, Varamaki & Vesalainen (2003) emphasize the fluid nature of network development, in their classification of network, from development circle, through loose co-operative circle, project group, joint venture and finally joint unit. Again, however, their approach is by necessity incomplete, given the acknowledged absence of the social-psychological dimension of cooperation.

Another relevant idea to such networks is that of clusters. Clusters within networks can be seen as a nested relationship. Within this perspective, businesses organize in different commercial contexts in clusters within broader networks. The ways in which clusters can be defined is not clear. What exists in the literature is a set of overlapping ideas. DTI (2001) identifies *six main* types of clusters, from vertical production chains, aggregations of connected sectors, regional clusters, industrial districts, networks, and innovative milieu. In terms of the formal academic literature, Markusen (1996) follows a structures based approach to classification of types of industrial district (from the traditional Marshallian New Industrial District, and its Italianate sub-category, hub and spoke districts, satellite industrial platforms, and the state centered district).

In contrast, Gordon and McCann (2000) concentrate on processes rather than structures, seeing the three basic types of clusters as deriving from agglomeration (from external economies of scale, scope, and complexity), industrial complex advantages (reducing transactions costs through location), and social networks. Indeed, this social networking element has a rich and diverse literature that accompanies it, generating a number of important overlaps with the (generally) more economics-focused cluster literature. This point is expanded upon later in this paper.

Types of advantages of clusters can be seen as basically twofold—that is, cost and knowledge based advantages, with industrial complex advantages existing as a hybrid of the two. These basic advantages (advantages which can also be applied to networks) focus on (i) economies of scale and scope of various types; (ii) industrial complex advantages from close proximity of expertise, finance and innovation; and (iii) information interchange from network paradigms.

The next section of the paper draws on a cross-disciplinary literature review to build theory about the nature of variations in networks. Transaction cost analysis provides a framework to clarify whether a firm internalizes within the individual organization, internalizes within an existing network or externalizes. In situations where the decision is to internalize within an existing network, distinct network types emerge based on the relationship between structuring of participants and network relationships.

For example, transactions costs economics and supply chain strategists would recognize networks as the way in which vertical linkages are established between firms at different stages of the production process, involving issues such as trust, sunk costs, etc. As previously identified analysis of entrepreneurship has tended to look at more informal social networking arrangements in promoting the creation and growth of new companies, interactivity, knowledge management and knowledge sharing, whilst Harrison et. al (1996) have seen technological learning as one of the dynamic agglomeration outcomes to be derived from combining geographical closeness and formal (transactions based) or informal relationships. Van Dijk and Sverrisson (2003), Lechner, and Dowling (2003), Varamaki and Vesalainen (2003), have also illustrated, the interest in the various types of network arrangements that are possible for entrepreneurial firms.

From this examination of the literature, it can be seen that the three basic advantages of networks/ clusters derive from transactions, agglomeration effects and network relationships. Another basic differential that can be observed, however, is between vertical/ horizontal, and formal/ informal clusters and networks.

The vertical and formal networks structures revolve around transactions costs, first expounded by Coase (1937) in his explanation of the firm, built upon by Williamson (1979), and outlined by Jarillo (1988). Firms exist because using the market for activities imposes costs (transactions costs such as opportunism, power, etc.). If these are high enough, then it is cheaper to internalize that activity within the firm itself. Cook and Emerson (1984) also highlight the issues of power and dependence within such market-mediated exchange network activities, issues that often moderate against such networks developing. However, where such transactions costs can be minimized, outsourcing and subcontracting of activities becomes more feasible and desirable, particularly if it allows companies to concentrate on the activity where they have expertise and comparative advantage. Examples in entrepreneurship of this are in high technology where new products are being developed.

From this the importance of vertical strategic networks become apparent, as does the link to the management of such arrangements (see Boyle 1994). In this regard the car industry and Japanese carmakers in particular are instructive, where long-term close relationships with first tier suppliers (of major sub-systems) are the norm, such that they are seen as an organizational network. These vertical networks of small with large firms are clearly therefore of importance to the competitiveness of the firms in the supply chain (Smith, Dickson & Smith 1991; Young, Francis & Young 1994). Larsen (1991) emphasizes such vertical collaborative relationships to SMEs, whilst Borch and Arthur (1995) argue for more analysis of strategically important networks of small firms.

In contrast to the formalized networking arrangements already described, a much larger, informal, often social, vertical and horizontal network phenomenon promotes and enhances entrepreneurial activity and growth generally (Birley 1985; Donckels & Lambrecht 1997; Neck, Meyer, Cohen, and Corbett 2004; Johannisson 1986). Attention has been drawn to the value that social networks and networking add to the creation, sustainability and growth of small firms (Birley & Westhead 1990). In particular, research has shown the importance that different, single elements of an entrepreneurial system may have on the overall macroeconomic development of a region (Kenny & Florida 1988; Stough, Haynes & Campbell 1998). There is however, a failure in research to explain the impact or importance of networks for entrepreneurs (Gibb & Davies

1990). The exception to this is a recent study by Neck, Meyer, Cohen and Corbett (2004) that took a systems perspective in their analysis of a region of high entrepreneurial activity rather than exploring individual issues in isolation. Their investigation of the interaction of many different issues of an entrepreneurial system, including SMEs, while also examining what impact this interaction had on the macroeconomic development of a region, is a useful, early study in the under researched area of entrepreneurial networks. In particular, the study provides insights into the nature of formal and informal network relationships within an entrepreneurial system. Like Neck, Meyer, Cohen and Corbett (2004), the framework presented herein perceives an entrepreneurship system as consisting of formal and informal network relationships.

The literature provides several other examples that support the argument that informal social network relationships are a characteristic of some clusters. What is significant in these examples is how entrepreneurs perceive the importance of relationships whilst conducting business transactions (Johannisson et al 1994; Shaw & Conway 2000). To illustrate this point, Borch & Huse (1993) describe how the networking of entrepreneurial firms' boards can assist such firms in Sweden and Norway (as well as the need for incentives). Indeed, Nijkamp (2003) indicates that modern entrepreneurs, particularly urban and ethnic entrepreneurs, need to be increasingly creative network operators and managers.

Gulati (1998) describes that the most important facet of any organization's market environment is its "social network of external contacts". The argument is that economic transactions take place within an embedded network of social relationships. Social networks normally link people or organizations to a set of relationships such as friendship or business interdependency. Network perspective builds upon the notion that economic actions are influenced by the social context in which they are embedded, which affects the quality of exchange in the relationship and thus whether it generates more or less favorable outcomes (Donckels & Lambrecht 1997).

It is also argued that the actions of those implicated can be influenced by the position of others involved (Gulati 1998). Those involved do not always make decisions based upon individual interest but based upon the strength of a relationship. This can produce mutual gain to continue the social network. The underlying mechanism of social networks is the quest for information and assistance that will reduce uncertainty (Alchian 1950). It has been acknowledged that social networks can assist in promoting behavioral conformity, which can influence the extent to which firms adopt new processes and innovations (Gulati 1998). Organizations or people that are tied are likely to share an understanding of behavior through discussion (Nohria & Eccles 1992). That is, they engage in informal network relationships.

Networks can, therefore, have horizontal/ vertical and formal/ informal aspects, depending on the network in question, as well as the transactions costs, agglomeration and relational advantages from their existence.

Next, network issues are explained. These are the strategic issues that are constant in all cluster types. Following an explanation of a specific cluster element, the second part of the analysis focuses on network categorization. This categorization explains variations in a specific network issues, based on variations in network relationship and structuring of participants. A review of the disparate literature on networks produced the following elements in the network

classification scheme which together provide a framework for analysis — namely, cluster type, participant goal, participant conduct, network type, network system management learning and culture. These are the key strategic issues faced by all clusters within networks in an entrepreneurship system.

The framework for analysis begins firstly with cluster type as a field for analysis. This section fundamentally establishes the rationale for selection of cluster types—that is, whether the relationship will be in the horizontal or vertical: formal or informal. The rationale for choosing cluster type is based largely on cluster theory and Lechner and Dowling's (2003) ideas of the advantages to be derived from the network. Further, it draws on Coase's (1937) transactions costs theory and Cook, and Emerson's (1984) review of management strategies.

Decisions about categorizing the cluster type are based on three factors—return sought, resources and relationships. Returns sought can focus on any one of the following objectives—cost reduction based objectives, knowledge based objectives, or a combination of the two. Decisions around resources focus on whether the resources/ capacity exist within the organization/ network to achieve the returns sought. Finally, decisions around relationship focus on whether a cluster wants to develop these resources internally (organization/ network) or go outside existing structures into new relationships. This decision depends on organizational/ network strategy, as well as transactions costs and related issues. The type of relationship necessary to achieve a cluster's objectives depends on capacity, strategy, transactions costs, and whether there is a perceived (as opposed to actual in some cases) match between the goals of the parties—that is, what they want from the relationship in terms of the type of performance outcome.

The second network issue in the framework for analysis is participant goals as a field for analysis. These can be seen to fall into the following categories, derived from strategy theories (such as Eisenhardt & Schoenhaven 1996; Mowery, Oxley & Silverman 1998). In brief, based on structuring of partnerships and network relationships, participant goals can be categorized as (a) good for me (G1). In this situation, the key goal is individual survival; (b) good for us (G2). In this situation, the key goal is collective survival of the network/ relationship; and (c) good for them (G3). In this situation, the wider survival of the entrepreneurship system is the key participant goal.

Once these cluster types and goals have been established, the third network issue that is of strategic interest in an entrepreneurship system is participant conduct. This issue is derived Ahuja (2000). It falls under three broad headings (with some degree of overlap creating a continuum). In short, participant conduct can be categorized as (a) control. In this situation, the cluster is characterized by transactions based approaches, which succeed if the transaction itself is the only issue (measured in terms of its output); (b) collective action. In this situation, the cluster participant conduct is characterized by an embedded, closed network based approach, which succeeds if the mutual goal is short term and internal capacity to meet this exists in the long term; and (c) co-operative learning. In this situation, an open network approach is adopted. This succeeds if there is a wide mutual goal in the long term, with internal capacity and seeking external capacity to fill gaps in the long term.

The next network issue is network type. Based on decisions about cluster type, participant goal and participant conduct the precise structure of the network type then needs to be established. Categorization of network type is derived from Ireland (1990). It falls into the following categories: (a) Transactions Based. In this situation, the network type is characterized by a formal mode of business. Output occurs via the transaction—for example, old style buyer-supplier relations, research and development; (b) trust based. In this situation, the network type is characterized by social, informal networks where the transaction occurs via the building of trust over time—for example, entrepreneurs; and (c) teamwork based. In this situation, trust is built via the teamwork of the entrepreneurship system participants. Please note that as you move towards a more systematic approach to how businesses organize in different commercial contexts, the categorizations within network type move further away from output as the key goal.

To these network issues and categories, we can then add network management as an issue. Categorization of network management draws on Snow, Miles and Coleman (1992). Their paper categorized the types of people needed to manage the network through different time frames. In brief, network management can be categorized as follows: (a) start. Network management focuses on creating the network in the immediate/ short term; (b) survive. The focus here is on connecting the network over the short/ medium term; and (c) sustain. The focus here is on developing the network over the long term.

The next issue in our framework is learning. In addition to Snow, Miles, and Coleman's (1992) categories, the social-psychological framework developed in this paper assumes that localized learning in clusters represents the best framework for an innovative, learning economy (Lundvall & Johnson 1994; Storper & Walker 1989). In a learning economy technical and organizational change has become increasingly endogenous. Learning processes have been institutionalized and feedback loops for knowledge accumulation have been built in so that the economy as a whole ... is "learning by doing" and "learning by using" (Lundvall & Johnson 1994). Localized learning processes are important in securing innovativeness and competitive advantage. This assumption is consistent with modern innovation theory that implies a sociological view of the process of innovation in which interactive learning is looked upon as a socially embedded process that is fundamental to the process of innovation (Lundvall 1992). The quality of interactive learning in clusters influences their capability to break path dependency and change technological trajectory through radical innovations, so as to avoid falling into "lock-in situations" as a result of weak competition from low cost producers (Asheim & Isaksen 1997). Thus, interactive learning is consistent with the organizational learning literature's concept of double-loop learning in which collective learning is characterized by "doing things differently" or "doing different things" (Argyris & Schon 1978).

The final issue in our framework relates to culture. According to Hofstede's (1980, 1984) research, power distance among workers in the US, Spain and Mexico are in monotonic order, with the US being the lowest, Spain being middling and Mexico being the highest. In particular, it is argued that power distance between cluster members is an indicator of cross-country cultural differences. In high power distance cultures, lower status cluster members are more respectful and obedient to higher status cluster members and visa versa in low power distance cultures.

Based on this literature review, clusters can be categorized within networks in an entrepreneurship system, by applying the issues and categories summarized in figure 1.

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**Figure 1 about here**

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## **DISCUSSION**

The model in figure 1 is now explained. Cell 1 is indicative of the processes required for a successful traditional formal and vertical cluster and network. The strategic focus is narrowly cost and individual firm based, and is thus built on tight transactions based relationships within a hierarchical structure. The network management is thus likely to be focused on short to immediate term network creation. These networks are characterised by single-loop learning to increase efficiency and high power distance between cluster members of differing status. These processes can also be seen as indicative of clusters based around vertical supply chains, such as hub, satellite, R&D and state anchored industrial districts.

Cell 2 is indicative of the processes required for newer more informal vertical cluster and network types, such as Japanese style lean production supply chains, but also entrepreneurial cluster associations where there is a high power dependency. The strategic focus is more widely based around disseminating knowledge and by so doing reducing mutual cost bases. The goals are thus more collective, and are thus built on wider trust based collective action relationships, though still within a hierarchical structure. The network management is thus likely to be focused on medium term network building (though of course initial network creation skills are also important). These processes can also be seen as indicative of clusters based around vertical supply chains, such as some types of Marshallian clusters, but also some types of cluster associations. These networks are characterized by an emphasis on single-loop learning with ad hoc double-loop learning to both increase efficiency and to enable knowledge interchange. Whilst this can be seen in some ways as an improvement of the more rigid networks in cell 1 (for example supply chains), it may not be the most suitable arrangement for cluster associations where innovation outcomes are sought (in which case cell 4 may be more suitable). Like cell 1 these clusters are characterized by high power distance between cluster members of differing status.

Cell 3 is indicative of the processes required for informal horizontal cluster and network types, such as social networks of entrepreneurs with low power dependence, as exist in some cluster associations. The strategic focus is based around knowledge sharing and dissemination, as would be expected where small firms collaborate to generate scale effects. The goals are again collective, but can be wider, allowing for the growth of the network itself, and thus built on wider team based open network action relationships, without hierarchical structures. The network management is thus likely to be focused on long term network growth. These networks are characterised by a combination of single-loop learning and double-loop learning to facilitate the wider survival of the network through knowledge based exchanges. Clearly in this cluster type, network creating, sustaining and building skills are important, highlighting this as an area of particular importance, requiring a capacity-building focus. These processes can also be seen as indicative of clusters based around horizontal relationships, such as some types of Marshallian clusters and urban hierarchies. These clusters are characterised by low power distance between cluster members of differing status.

Finally, Cell 4 is indicative of the processes required for more formal horizontal cluster and network types, such as virtual organizations. The strategic focus is based around specific cost-reducing knowledge, as would be expected where small firms collaborate to generate scale effects. The goals are again collective, and thus built on wider trust based collective action relationships, though still within a hierarchical structure. The network management is thus likely to be focused on medium term network building. These networks are characterised by single-loop learning to facilitate a cost focused knowledge interchange network. These processes can also be seen as indicative of clusters based around vertical supply chains, such as some types of Marshallian clusters. This can be seen in some ways as an outcome of processes from cell 4; it may not be the most suitable arrangement for cluster associations where innovation outcomes are sought. These clusters are also characterised by low power distance between cluster members of differing status.

Clearly, however, this is not a necessarily static outcome. The literature suggests that there is the potential for networks to develop within an entrepreneurship system, moving from one cell to another, as strategic requirements change. The most obvious movements are from cell 1 to cell 2 for networks wishing to develop mutual knowledge bases that ultimately reduce cost, as exemplified by changes in the UK automotive industry as Japanese car makers set up production and supply chains in the UK during the 1990s (see Pickernell 1997). In addition, the loose processes described in cell 3 could develop into more formal structures (to cell 4) if the network participants determine that a virtual organization would best suit their strategic objectives, this formalisation also closing the network in terms of participants to create a much more formalised arrangement. However, movement from cell 2 to cell 3 is also possible, as for example, if the focus of a cluster association requires a greater degree of knowledge sharing and innovation, as opposed to knowledge dissemination through the network. Indeed, cell 1 arrangements may themselves generate creation of cell 2 arrangements, through the creation of supplier clubs of proximate firms at the same stage in the supply chain, often facilitated by larger companies up the production chain, or development agencies for example Source Wales.

Robust strategic decisions that addresses design, implementation and evaluation of economic development initiatives needs to take account of the type of resources required for different types of clusters. By developing an analytical framework that focuses on the design, implementation and evaluation of networks this paper addresses criticisms of the management of networks. The analytical framework provides a means for networks to be designed, monitored and evaluated to ensure resources are appropriately allocated to the different variables of the network. For instance if an economic development initiative for a region is a State Anchored Industrial District (due to declining significance) then the implementation of collective action is required. Appropriate allocation for a complete renegotiation of participation goals and learning could be required.

### **RESEARCH QUESTIONS**

From this model four questions are generated to examine the interdependence and shared vision of micro-finance agencies and technology-based SMEs. These are:

- Q1: What are the identifiable factors contributing to the quality of network relationships in clusters?
- Q2: What are the identifiable factors contributing to the structuring of partnerships in clusters?

Q3: Do network relationships have an impact on how business organizes in a business context?

Q4: Does structuring of partnerships have an impact on how business organizes in a business context?

Going beyond the model, there are other related questions that warrant investigation: How well do network clusters transform themselves to shift the focus of their organisation to fit changing commercial contexts? Are there examples of these arrangements that go beyond the classification system presented here?

Network relationships and structuring of partnerships provide a means to understand how business organizes in different commercial contexts. This understanding of clusters within networks in an entrepreneurship system is particularly important in the management of economic development programs. Successful development programs are dependent on how well we understand what strategic issues drive decisions about how clusters organize.

## CONCLUSION

Within the above model, cluster type includes the dual dimensions between network relationships—formal linear relationships and informal systemic relationships—and structuring of partnerships—vertical linkages or horizontal linkages. Further empirical research can examine the nature of these dimensions. This future research is relevant to theory as it contributes to our understanding of the nature of networks and clusters. The framework developed facilitates such an analysis. It obviously enables initial classification of the network/ cluster type within an entrepreneurship system, and the benefits to be derived from them. However, it also allows the definition of the likely processes to be at work within that type of cluster if the network is to be successful. This is important because if there is a mismatch at the cluster level, then this is likely to signal the potential failure of the network/ cluster to maximize the benefits to be derived from the relationship (or may signal the collapse of the network itself). In addition, however, comparison of the network participants in terms of their own viewpoints with regard to these processes can also provide an early warning to interested parties, of potential mismatches between participants, which could also, if unresolved lead to the failure of part or all of the network. Finally, it allows evaluation of the likely/ required development of the cluster/ network if it is to fulfill the entrepreneurship system's potential from an economic development point of view. In order to verify this, however, additional research is required in the several areas. First, research at the level of the cluster is needed to determine the efficacy of the four-cell model. Case studies of clusters that fall into the various categories are envisaged, with analysis to examine the various factors of importance (participant goal, participant type, network type, network management, and learning). Secondly, research is required at the level of the industry association, to examine processes of learning and innovation.

The purpose of this research could be to undertake a pilot study to examine variation in the innovation climate in which high growth SME general managers and their executive teams operate. The study could involve firms from biotech industry associations and could focus on the hypothesis that there is a relationship between the quality of learning and SME growth, building around a multi-level, multi-variant model of innovation climate to SME growth criteria variables. Examination of the senior executive team could provide insights into how and why firms develop or not develop beyond the start-up stage and why firms grow. Thirdly, research is required at the level of the economy. If the model is found to be robust, analysis of current government policy as

it affects networks within entrepreneurship systems could be carried out, to determine examples of good practice, areas where the model could suggest improvements and changes in policy to increase the effectiveness of government resources.

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**Figure 1: Entrepreneurship system:**

|                                    |                     | <b>Network relationships</b>  |   |
|------------------------------------|---------------------|---|---|
|                                    |                     | Formal and linear relationships   | Informal and systemic relationships   |
| <b>Structuring of participants</b> | Vertical linkages   | <b>Cell 1</b><br><b>Cluster types:</b> Hub/Satellite/State Anchored Industrial Districts<br><b>Participant goal:</b> individual survival through economies of scale<br><b>Participant conduct:</b> transaction based<br><b>Network type:</b> transaction based and cost focused<br><b>Network management:</b> short to immediate term network startup<br><b>Learning:</b> individual<br><b>Country Context:</b> high power distance<br><b>Example:</b> supply chains, R&D   | <b>Cell 2</b><br><b>Cluster types:</b> Marshallian<br><b>Participant goal:</b> collective survival through cost reduction by knowledge interchange<br><b>Participant conduct:</b> collective action<br><b>Network type:</b> cognitive trust based and knowledge interchange focused<br><b>Network management:</b> connecting network over short/medium term<br><b>Learning:</b> interactional<br><b>Country Context:</b> high power distance<br><b>Example:</b> social networks of entrepreneurs with high power dependence- cluster associations |
|                                    | Horizontal linkages | <b>Cell 4</b><br><b>Cluster types:</b> Marshallian<br><b>Participant goal:</b> collective survival through cost focused knowledge interchange network<br><b>Participant conduct:</b> collective action<br><b>Network type:</b> cognitive trust based and knowledge interchange focused<br><b>Network management:</b> connecting network over short/medium term<br><b>Learning:</b> individual<br><b>Country Context:</b> low power distance<br><b>Example:</b> ICT based virtual and network organisations created from groups of enterprises | <b>Cell 3</b><br><b>Cluster types:</b> Urban Hierarchy/ Marshallian<br><b>Participant goal:</b> wider survival through knowledge based network<br><b>Participant conduct:</b> open network<br><b>Network type:</b> teamwork based<br><b>Network management:</b> sustaining network over long term<br><b>Learning:</b> interactional<br><b>Country Context:</b> low power distance<br><b>Example:</b> social networks of entrepreneurs with low power dependence – cluster associations  |

# **An Analysis of Cultural Factors Affecting Entrepreneurship in the Philippines**

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## **ABSTRACT**

The study analyses the cultural factors affecting entrepreneurship in the Philippines. Based on an examination of existing ethnographic studies that look into Philippine culture, a list of values, traits, and beliefs that could affect the conduciveness of the environment to entrepreneurship was drawn. Twenty-five statements are then formulated to associate the list of values, traits and beliefs to Philippine culture. Entrepreneurs are then asked to indicate their level of agreement with the statements using a 5-point Likert scale. A factor analysis was performed on the 25 items to determine if they can be reduced to lesser number but more meaningful set of factors. Lastly, a regression was then executed to determine whether there are significant relationships between these cultural variables and the conduciveness of the Philippine environment towards entrepreneurship. This study indicates that both positive and negative cultural characteristics impact on perceptions of conduciveness. Policymakers need to find ways to adjust policy and programmes to cope with these cultural characteristics. In instances where negative cultural characteristics severely affect the perceptions of conduciveness of the environment, policy makers need to think about long-term ways to change people's values and beliefs.

## **INTRODUCTION**

There is a shortage of research on institutional conditions of SMEs in Asia. Most of what has been done is limited only to formal institutional aspects such as: support services (Sarder, Ghosh and Rosa, 1997; Abdullah, 1999) and SME policy (Moha-Ashri, 1995; Meier and Pilgrim, 1994; Mohd-Yusuf, 1991). Philippine studies have also been limited to formal aspects, mostly on investigations of government macroeconomic policies on SMEs (Theocharides and Tolentino, 1991; Llanto, 1991; Lamberte, 1991; Guevarra, 1991; Koppel, 1990; Gatchalian, 1990, Jose-Nario, 1990; Tecson, et. al., 1989), and credit/financial intermediation (Saldana, et. al., 1993, Quesada, 1996).

It is important to view entrepreneurship from a broader perspective, and not just limit it to the formal institutional framework. Cultural attitudes affect the way individuals perceive and act on opportunities that are created by the institutional environment. Firm creation is a response of the individual to certain institutional conditions that provide incentives to become entrepreneurs. According to Lee and Peterson (2000:403), "There is a need for an entrepreneurship model that acknowledges the individual person without discounting the external environment that is beyond the individual or the firm's control." This study will, hopefully, address the gap in this research area.

## **LITERATURE REVIEW**

Several authors have stressed the potential importance of culture for explaining variations in entrepreneurship and economic development. According to Carsrud and Johnson (1989:26),

the study of social norms, mores and values is an effective avenue of research investigation with respect to the initiation and growth of new ventures. The social and cultural factors that enter into the formation of entrepreneurial events are most felt through the formation of individual value systems. In social systems that place high value on the formation of new ventures, more individuals will choose that path in times of transition (Shapiro and Sokol, 1982:83). Etzioni (1987:175, 183), stated that legitimation is a major factor in determining the level of entrepreneurship that is found in a society. The extent to which entrepreneurship is legitimate, the higher the demand for it; the higher the supply of entrepreneurship, the more resources are allocated to the entrepreneurial function. The immediate sources of legitimation are the values of the society and the relevant sub-societies.

Gnyawali and Fogel (1994:53) believe that socioeconomic conditions and governmental policies play an important role in the "propensity to enterprise". They suggest that factors such as public acceptance and support from family, community, and governmental agencies "create an 'enterprise culture' that enables firms to take reasonable risks and seek profits".

Min (1987) also incorporated culture as an explanatory variable for entrepreneurship. According to Min, some minority groups have cultural characteristics that are conducive to small business development. In a study conducted on Filipino entrepreneurs, Chu et. al. (2002) explored the issue of how Filipino culture affected the manner by which several primary strategic entrepreneurial decisions are made. The study generated several interesting findings. Filipino entrepreneurs enter into self-employment because of the potential to earn money. This is attributed to the poor economic conditions existing in the country and the limited job opportunities for the poor, unskilled, and uneducated population. A large portion of the sample also said they became entrepreneurs because of the need for independence. A second finding was that Filipino entrepreneurs adopt a "friendly attitude" as the primary approach to attract and retain customers while the secondary approach focuses on offering excellent service. The results support the researchers' argument that the relationship between the entrepreneur and his customer is an integral factor in the success of the business. The respondents also identified family as their major source of advice. The opinions of friends and fellow business owners were more valued than those of legal and financial advisors. These results indicate that the Filipino entrepreneur appears to rely on more informal social networks for advice rather than traditional or institutional sources of information. The results prove that the Filipino kinship system causes Filipino entrepreneurs to look towards their family and friends for all types of support including venture financing. Lastly, the study found that many entrepreneurs have parents who were business owners. These parents served as role models for their children to emulate.

Noting the success of Chinese entrepreneurs, Wu (1983: 112) identified some of their cultural values: a high propensity to save and reinvest business earnings; a universally strong desire to secure a better education for their children, who would then be expected to carry on the business and often did (a high N-achievement); and a strong sense of loyalty and mutual obligation within the Chinese extended family.

Min and Jaret (1985) linked cultural characteristics to entrepreneurial success among Koreans in Atlanta. They found a strong correlation between success and adherence to the cultural values of frugality and the work ethic.

Dana (1997) conducted an ethnographic study of entrepreneurs from Lesotho. He found that the culture in Lesotho encourages entrepreneurship inasmuch as it values the accumulation of

wealth; however, the same culture hinders some aspects of entrepreneurial activity through value-laden perceptions of property.

Entrepreneurship prospers if society views it with a favourable attitude. Societies and cultures that value entrepreneurship tend to develop societal systems to encourage it (Vesper, 1983). It has been noted that, among the Chinese, entrepreneurial role models encourage people to go into business, and entrepreneurs are often supported by close networks of family members and relatives (Kao, 1993; Siu and Martin, 1992). Programmes that develop societal awareness of entrepreneurship have a positive effect on small business development and growth.

Much previous entrepreneurial research has focused upon how others perceive entrepreneurs, or on comparisons between entrepreneurs and others in their society who are not entrepreneurs (Sexton and Bowman, 1985; Schere, 1982). These studies demonstrate that there are higher rates of firm formation in countries that have positive perceptions of entrepreneurship and that perceive entrepreneurship as a desirable occupation.

## **RESEARCH METHODOLOGY**

### **Selection of Respondents**

The probability method of stratified random sampling was used. The sampling of the entrepreneurs used the list of establishments from the National Statistics Office (NSO). The researcher requested the NSO to randomly generate a sample of 400 SMEs using employment size as criteria. Only the following four industry sectors were included in the survey of entrepreneurs—manufacturing, wholesale and retail, finance, real estate, insurance and business services, and community, social and personal services. These industries were selected as almost 90% of all SMEs in Metro Manila belonged to these industry sectors. The samples for each industry sector were then proportionately stratified according to the distribution of all firms per industry sector and size of the firm.

Table 1 presents the distribution of establishments based on employment size and industry sector. The total figure of 23046 firms was used to compute for the sample size, which were 376. Hence, 400 names were requested from NSO. Of the 400 only 350 responded (response rate 87,5%). However, only 290 of the 300 responses were usable.

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Table 1 Here!  
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The survey is cross-sectional (ie. the survey information was collected at one point in time). Research assistants were instructed for two (2) two-hour sessions on how to distribute and collect the questionnaire. The assistants were assigned to distribute the questionnaires to SME owners all over Metro Manila. All questionnaires had a cover letter introducing the researcher, explaining the objectives of the study, and contact information about the researcher.

## **DATA ANALYSIS**

All questionnaires returned to the researcher were checked. In cases where at least half of the questions were not answered, the researcher discarded the questionnaire. After all unacceptable questionnaires were discarded, the questionnaires were edited. Answers to questions that are related were checked in case there were errors (i.e. if answer to a question is no, then the related question should be disregarded/not applicable).

- Factor analysis was performed on variables indicating cultural values as well as problematic policy areas to identify underlying factors that explain the pattern of correlations within a set of observed variables. The objective of the principal components analysis was to generate a first factor that would have the maximum explained variance. Then with the first factor and its associated loadings fixed, principal components located a second factor maximising the variance explained in the second factor. The procedure was then repeated until there were as many factors generated as variables. Varimax rotation was the rotation scheme used.
- Regression analysis was conducted to determine the relationships between conduciveness of the environment and cultural variables. A model was generated in this analysis. The variables in the regression were not dichotomous. The variables were ordinal in nature (i.e. strongly agree, agree, neutral, disagree, strongly disagree).
- Reliability was tested using Cronbach's coefficient alphas. This statistic determined the internal consistency of the items on the scale.

## RESULTS

### **Factor Analysis of Cultural Factors**

A factor analysis was performed on the questions related to culture. Findings from the factor analysis illustrated in Table 2 show the emergence of a nine-factor solution that accounts for 65,571 percent of the variance.

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 Table 2 Here!  
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The nine factors identified in the factor analysis are - Filipino values, child rearing practices, attitude towards work, attitude towards entrepreneurship, Filipino traits and culture, attitude towards responsibility and failure, entrepreneurial environment, social status, and values from childhood.

#### **Factor 1. Filipino values**

This factor had four item loadings and included the following items: compassion, loss of face, debt of gratitude, and friends and family expect different treatment. This factor deals with the entrepreneurs' perception of how the entrepreneurs' dealings and decisions can be affected by the above-mentioned values. The component loadings ranged from 0,564 to 0,817. In Philippine culture, family and friends expect to be treated differently in terms of transactions in the business. This could entail special discounts, extended credit or utilising the organisation's resources for personal use.

#### **Factor 2. Child-rearing practices**

This factor had four item loadings ranging from 0,511 to 0,868, and included items such as discourage exploration, questioning, taking initiative, and blind acceptance of authority. This factor related to the entrepreneurs' perception that Filipinos still use traditional authoritarian parenting methods that do not encourage independence in children.

#### **Factor 3. Attitude towards work**

This factor had two item loadings ranging from 0,877 and 0,882 and included the following items: entrepreneurship is morally and ethically acceptable, and honest and productive work is valued. This factor deals with the entrepreneurs' attitudes towards work. The work ethic is

valued highly in Philippine society. People who are industrious and honest are admired and idealised.

**Factor 4. Attitude towards entrepreneurship**

This factor had three item loadings ranging from 0,382 to 0,946 and included items such as entrepreneurship is legally acceptable and trading is acceptable in Filipino culture as well as positive environment for starting a firm. This factor emphasizes that entrepreneurs in the Philippines perceive that being an entrepreneur and a trader is acceptable.

**Factor 5. Filipino traits and culture**

This factor had four item loadings and included items such as: risk-taking, strong-hearted, God for compassion and man for action, and family support. This factor deals with the respondents' perceptions of what traits are needed by entrepreneurs. Family support is also very important in Filipino culture as they are the main source of moral and financial support. The component loadings range from 0,482 to 0,729.

**Factor 6. Attitude towards responsibility and failure**

This factor had three item loadings ranging from 0,587 and 0,686, and included the following items: existence of all-powerful forces, love for self, and fatalistic. Filipinos do not take failure and responsibility well. They tend to blame other forces such as God, the fates, and other people. This stems from their love for self and not being able to accept that they can make mistakes.

**Factor 7. Entrepreneurial environment**

This factor had three item loadings ranging from 0,413 and 0,820, and included the following items: upholding the ideals of competition, long range planning and the anticipation of future trends are practiced, and the conferment of social ranks is based on achievement. For an environment to be conducive for entrepreneurship, it must possess the above three attributes. It must have a competitive atmosphere that continuously challenges its participants. The entrepreneur should also plan for the future and anticipate future trends to ensure that s/he will always be at the forefront of the competition. Lastly, social ranks must be conferred based on achievement to encourage people to constantly improve on themselves.

**Factor 8. Social status**

This factor had two item loadings. It included the following items: lack of ease of movement between social classes, and colonial mentality. This factor deals with social issues affecting entrepreneurs. Another hindrance to entrepreneurs is the idea that anything foreign is always better than domestically made products. This hinders the development of local innovations. Lastly, the ease in moving across social classes also fosters entrepreneurship. Individuals can aspire to climb up the social ladder even though they are in a lower class at present. The component loadings ranged from 0,384 to 0,614.

**Factor 9. Values from childhood**

This factor had two item loadings ranging from 0,511 and 0,772 and included the following items: can aspire to be rich and famous, and traditional authoritarian child rearing practices. This factor deals with the entrepreneurs' perceptions of how the different values from childhood affect his or her decision to become an entrepreneur. Having the freedom to aspire to be rich and famous can be a stepping stone to becoming an entrepreneur. Traditional child rearing practices tend to stifle creativity, innovation and initiative, and can be a deterrent to entrepreneurship.

The four factors and their relative contribution to variance are presented in Table 2. It can be seen that all the nine factors have an eigenvalue of above 1, ranging from 1,068 to 4,640. Factor 1, Filipino values, contributes a variance of 16,571 percent, followed by factor 2, child rearing practices, which contributes 13,044 percent. Attitude towards work, factor 3, contributes 7,397 percent of the variance, while factor 4, attitude towards entrepreneurship, explains 6,393 percent of the variance. Factor 5, Filipino traits and culture, contributes 5,071 percent in explaining the variance while factor 6, attitude towards responsibility and failure, contributes 4,818 percent. Entrepreneurial environment, factor 7, contributes 4,462 percent, social status, factor 8, contributes 3,999 percent and factor 9, values from childhood, contributes 3,816 to explaining the variance. The total cumulative variance explained by the nine factors is 65,571 percent (refer to Table 2).

The data collected were also subjected to item analysis. The Cronbach's alpha coefficient ( $\alpha$ ) was calculated to determine the internal consistency of the items on the scale. The alpha value for the entire cultural factors scale was found to be 0,7649, which indicated that the internal consistency was quite high. Cronbach's alpha coefficient for each factor of the scale were as follows: factor 1 = 0,7943; factor 2 = 0,7822; factor 3 = 0,9629; factor 4 = 0,6476; factor 5 = 0,6452; factor 6 = 0,5184; factor 7 = 0,5231; factor 8 = 0,2549; and factor 9 = 0,3281.

### **Regression Analysis of Cultural Factors**

Table 3 presents the results of the multiple regression analysis on the perceived conduciveness of the environment against cultural factors. The results indicate that only six of the 26 variables entered in the analysis were significant predictors of perceived conduciveness. These six variables are: strong-heartedness (positive relationship), God for compassion and man for action (negative relationship), elders know what is best (positive relationship), acceptance of trading (positive relationship), can aspire to be rich and famous (positive relationship) and risk-taking (positive relationship).

The regression model is presented below:

$$Y_i = 1,164 + 0,394X_1 - 0,340X_2 + 0,114X_3 + 0,143X_4 + 0,096X_5 + 0,103X_6$$

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 Table 3 Here!  
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The results of the multiple regression analysis indicate that perceived conduciveness is positively affected by strong-heartedness, elders know what is best, acceptance of trading, can aspire to be rich and famous, and risk-taking. Clearly, emphasis on cultural traits such as strong-heartedness and risk taking encourage entrepreneurship by taking advantage of opportunities but being mindful of the corresponding risks at the same time. Attitudes towards trading also encourage individuals to become entrepreneurs by respecting and admiring people who start small (i.e. through trading). Being able to aspire to be rich and famous also generates a more positive view of conduciveness. If people are allowed to aspire for richness, they will try to become rich (through entrepreneurship). Being able to accept that elders know what's best also fosters a positive entrepreneurial environment. Elders can be used as role models and can provide advice as to the desirability of entrepreneurship as a career. Only one variable had a negative effect on conduciveness - God for compassion and man for action. In instances where individuals rely too much on God to work things out for them (rather than working them out on their own), this discourages the individual from becoming more entrepreneurial and takes away the initiative in making decisions and choices.

## DISCUSSION

The results indicate that cultural traits such as courage and risk taking encourage entrepreneurship. Positive attitudes of respect and admiration towards trading also encourage individuals to become entrepreneurs. Being encouraged to aspire to be rich and famous also generates a more positive view of entrepreneurial propensities. If people are encouraged to aspire to be rich, some will try to become rich by starting their own businesses. Being socialised to respect elders' wisdom also tends to generate a positive entrepreneurial environment. Elders can be used in specific instances as entrepreneurial role models, and can also provide advice as to the feasibility of entrepreneurship as a career.

Only one variable was found to have a negative effect on perceptions of conduciveness viz: "God for compassion and man for action". In instances where individuals were found to rely on God to work things out for them (rather than working them out on their own), this was found to discourage the individual from becoming more entrepreneurial and tended to take away their initiative in making decisions.

## RECOMMENDATIONS

It is very difficult to change institutional factors such as culture, norms, traits and values. A slow but realistic way to do this is to **expose children to independence, free-thinking and exploration at an early age**. Schooling can be used as a conduit to do this.

Various activities can be used to foster entrepreneurial thinking. Universities can also start **offering courses in entrepreneurship**. These courses can help students gain the skills they need to start their own businesses. They can also clarify and allay students' fears about entrepreneurship. Career counsellors can also **discuss the merits of entrepreneurship as a career option** to graduating students.

**Successful entrepreneurs can also be identified and promoted as role models for budding entrepreneurs to emulate.** This initiative has been started by a few Philippine television stations with their programmes featuring successful small business owners being interviewed. Articles in newspapers featuring these entrepreneurs can also encourage others to become more entrepreneurial and perceive entrepreneurship as a viable career option.

**Table 2. Rotated Factor Matrix for Cultural Factors**

| Item   | Filipino values | Child rearing practices | Attitude towards work | Attitude towards entrepreneurship | Filipino traits and culture | Attitude towards responsibility & failure | Entrepreneurial environment | Social status | Values from childhood |
|--|-----------------|-------------------------|-----------------------|-----------------------------------|-----------------------------|---|-----------------------------|---------------|-----------------------|
| Loss of face (Hiya)  | 0,817           |                         |                       |                                   |                             |   |                             |               |                       |
| Compassion (Awa)   | 0,815           |                         |                       |                                   |                             |   |                             |               |                       |
| Debt of gratitude (Utang na loob)  | 0,813           |                         |                       |                                   |                             |   |                             |               |                       |
| Friends and family expect different treatment                              | 0,564           |                         |                       |                                   |                             |   |                             | 0,434         |                       |
| Discourage exploration   |                 | 0,868                   |                       |                                   |                             |   |                             |               |                       |
| Discourage taking initiative   |                 | 0,828                   |                       |                                   |                             |   |                             |               |                       |
| Discourage questioning   |                 | 0,733                   |                       |                                   |                             |   |                             |               | 0,335                 |
| Blind acceptance of authority  |                 | 0,511                   |                       |                                   |                             | 0,382                                     |                             |               |                       |
| Entrepreneurship is morally and ethically acceptable                       |                 |                         | 0,882                 |                                   |                             |   |                             |               |                       |
| Trading is accepted  |                 |                         | 0,877                 |                                   |                             |   |                             |               |                       |
| Entrepreneurship is legally acceptable                                     |                 |                         |                       | 0,946                             |                             |   |                             |               |                       |
| Honest and productive work is valued                                       |                 |                         |                       | 0,931                             |                             |   |                             |               |                       |
| Positive environment for starting a new firm                               |                 |                         |                       | 0,382                             |                             |   |                             |               | 0,333                 |
| Risk-taking (Pakikipagsapalaran)   |                 |                         |                       |                                   | 0,729                       |   |                             |               |                       |
| Strong-hearted (Malakas ang loob)  |                 |                         |                       |                                   | 0,673                       |   |                             |               |                       |
| Family support   |                 |                         |                       |                                   | 0,620                       |   |                             |               |                       |
| God for compassion and man for action                                      |                 |                         |                       |                                   | 0,482                       | 0,478                                     |                             |               |                       |
| Love for self (Amor propio)  |                 |                         |                       |                                   |                             | 0,686                                     |                             |               |                       |
| Fatalistic   |                 |                         | -0,310                |                                   |                             | 0,591                                     |                             |               |                       |
| Existence of all powerful forces   | 0,329           |                         |                       |                                   |                             | 0,587                                     |                             |               |                       |
| Competition idealised  |                 |                         |                       |                                   |                             |   | 0,820                       |               |                       |
| Long-range planning  |                 |                         | 0,359                 |                                   |                             |   | 0,537                       |               |                       |
| Confer social ranks according to achievement                               |                 |                         |                       |                                   | 0,382                       |   | 0,413                       |               |                       |
| Ease of movement between social classes                                    |                 |                         |                       |                                   |                             |   |                             | 0,614         |                       |
| Elders know what's best  | 0,327           |                         |                       |                                   |                             | 0,443                                     |                             | 0,487         |                       |
| Colonial mentality   | 0,336           |                         | -0,303                |                                   |                             |   | 0,325                       | 0,384         |                       |
| Can aspire to be rich and famous   |                 |                         |                       |                                   |                             |   |                             |               | 0,772                 |
| Traditional authoritarian child-rearing practices                          |                 | 0,332                   |                       |                                   |                             |   |                             | 0,318         | 0,511                 |
| <b>Eigenvalue</b>  | <b>4,640</b>    | <b>3,652</b>            | <b>2,071</b>          | <b>1,790</b>                      | <b>1,420</b>                | <b>1,349</b>                              | <b>1,249</b>                | <b>1,120</b>  | <b>1,068</b>          |
| <b>Cronbach's Alpha Coefficient (<math>\alpha</math>) (Overall 0,7649)</b> | <b>0,7943</b>   | <b>0,7822</b>           | <b>0,9629</b>         | <b>0,6476</b>                     | <b>0,6452</b>               | <b>0,5184</b>                             | <b>0,5231</b>               | <b>0,2549</b> | <b>0,3281</b>         |
| <b>Percent of Variance Explained (Total 65,571%)</b>                       | <b>16,571</b>   | <b>13,044</b>           | <b>7,397</b>          | <b>6,393</b>                      | <b>5,071</b>                | <b>4,818</b>                              | <b>4,462</b>                | <b>3,999</b>  | <b>3,816</b>          |

Extraction Method: Principal Components Analysis. This table is based on Varimax Factor Rotation. Only items that loaded with absolute values > 0,35 are shown.

**Table 1. Number of Establishments by Employment Size and Industry**

| <b>Industry</b>                                       | <b>Small</b> | <b>Medium</b> | <b>Total</b> |
|---|--------------|---------------|--------------|
| Manufacturing   | 6880         | 524           | 7404         |
| Wholesale and Retail                                  | 8025         | 269           | 8294         |
| Finance, Real Estate, Insurance and Business Services | 5343         | 261           | 5604         |
| Community, Social and Personal Services               | 854          | 36            | 890          |
| <b>Total</b>  | <b>21956</b> | <b>1090</b>   | <b>23046</b> |

**Table 3. Regression of Perceived Conduciveness of the Environment against Cultural Factors**

|                         |       |
|-------------------------|-------|
| Multiple R              | 0,602 |
| R <sup>2</sup>          | 0,363 |
| Adjusted R <sup>2</sup> | 0,348 |
| Standard Error          | 0,648 |

| <b>Analysis of Variance</b> | <b>DF</b> | <b>Sum of Squares</b> | <b>Mean Square</b> | <b>F</b> | <b>Sig.</b> |
|-----------------------------|-----------|-----------------------|--------------------|----------|-------------|
| Regression                  | 6         | 63,858                | 10,643             | 25,328   | 0,000       |
| Residual                    | 267       | 112,194               | 0,420              |          |             |

| <b>Variables in the Equation</b>           | <b>B</b> | <b>Standard Error of B</b> | <b>Beta</b> | <b>t</b> | <b>Sig.</b> |
|--|----------|----------------------------|-------------|----------|-------------|
| Constant                                   | 1,164    | 0,175                      |             | 6,646    | 0,000       |
| Strong-heartedness (X1)                    | 0.394    | 0,037                      | 0,943       | 10,566   | 0,000       |
| God for compassion and man for action (X2) | -0,340   | 0,037                      | -0,816      | -9,172   | 0,000       |
| Elders know what is best (X3)              | 0,114    | 0,041                      | 0,138       | 2,744    | 0,000       |
| Acceptance of trading (X4)                 | 0,143    | 0,055                      | 0,130       | 2,594    | 0,010       |
| Can aspire to be rich and famous (X5)      | 0.096    | 0,040                      | 0,120       | 2,388    | 0,018       |
| Risk-taking (X6)                           | 0,103    | 0,044                      | 0,118       | 2,358    | 0,019       |

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# CREDIT CARDS AS A SOURCE OF START-UP CAPITAL AND ONGOING CAPITAL MANAGEMENT

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## ABSTRACT

This paper presents the results of a survey of businesses established between 2001 and 2005 in Rutherford County, Tennessee. Business owners or partners were asked about their sources of start-up capital, including personal and business credit cards, personal savings, home equity loans, bank financing (with or without collateral), venture capital, and funds from angel investors, friends, relatives, or other sources. In instances where credit cards were used as a source of start-up capital or to meet ongoing capital needs, additional questions were asked to explore the motives, attitudes, and other behaviors associated with entrepreneurs' use of credit cards. Findings portrayed a compelling picture of the use of credit cards by entrepreneurs. Credit cards are being used relatively frequently for starting businesses as well as managing ongoing operations in actual practice, and they should therefore be formally acknowledged as a mainstream business practice among entrepreneurs. Although members of the business press have already acknowledged the phenomenon, except to an extremely limited degree, scholars have not as yet demonstrated a reciprocal level of interest.

## Introduction

Traditional sources of new venture financing tend to be emphasized in text books and constitute mainstream thought; however, bootstrapping (Roberts, 2003) and other non-traditional methods are commonly used by start-up entrepreneurs. Many start-ups report a lack of access to venture capital and bank financing, especially when that latter form of financing is labeled a business loan (line of credit, et al), as compared to a personal loan. Given the typical criteria of many banks for granting a business line of credit, which may include an already established positive cash flow, three or more years in business, and good business as well as personal credit (Parchois, 2000), the reasoning behind the adage "banks only lend money to those who don't

need it,” is easy to understand. It is also apparent that the terms “bank funding” and “start-up” go together about as well as oil and water: they simply do not mix.

*U.S. Banker* cited industry sponsored research commissioned by MasterCard, which reported that 57% of small business owners use personal credit cards for their business (de Paula, 2003), and added “credit cards of all kinds are quickly gaining in popularity as a method for small business owners.”

Further readings in the business press highlight numerous instances where business founders have used multiple cards for start-up funding. Indeed articles appear frequently in *Inc.*, *The Wall Street Journal*, and other non-academic journals, magazines, and newspapers. Hise (1998) in *Inc.* magazine concluded that despite the horror stories that result from the use of credit cards to finance new businesses, personal credit cards remain a fast, cheap, and easy way to obtain much needed start-up capital. In a *Wall Street Journal* article, author T. J. McCue (1999) reported that it was not unusual for people seeking money for new businesses to accumulate a “myriad of credit cards for this purpose—possibly 14 or 15!” (p. 6). In another *Wall Street Journal* article by Selz (1994), entrepreneurs were reported to use their credit cards for start-up capital and continue to use their cards to pay operating expenses.

Meanwhile, scholarly research into the use of credit cards as an initial source of capitalization by entrepreneurs has been too infrequent and insufficient to provide an understanding of this phenomenon. A search of databases used by *ProQuest* resulted in only three articles, which examined the behavior of credit card users published in scholarly peer-reviewed journals during the past four years. Research by Swift-King (2004) examined the use of credit cards to pay cash all at once and use the float, or to simply use credit cards as an easy form of borrowing. Yarett (2004) examined a new variant of structured financing called “whole-business” or “operating-asset” securitization. Credit cards were considered by Yarett to be passive assets like mortgages. The third article by Zopounidis and Doumpos (2002) used credit cards as a means to study multi-group discrimination using multi-criteria analysis.

Beyond the topic of usage itself, limited scholarly research has been conducted as it pertains to the motives of entrepreneurs and other factors that may drive their behaviors when opting in favor of personal credit cards for business financing. Hence, the purpose of this present research study was to identify and analyze the use of credit cards (both business and personal) as a source of business capital as well as owner motives and rationales. Given the aforementioned paucity of existing scholarly attention to the topic, despite the widespread use of credit cards for funding business start-ups and ongoing operations (as well as the apparent importance of the strategy from the point-of-view of actual practice), we anticipated that our study might serve as a pilot for additional research, and we began in the Rutherford County, Tennessee market area as a matter of convenience. This paper will present our review of the existing literature, research methods, findings, implications, and recommendations for further research.

## **Review of Literature**

As noted in our introductory remarks, academic research on the use of credit cards by entrepreneurs and small business owners is scarce. A search of several internet databases

indicates that the issue of credit card use by small business owners is a research stream that has not been tapped by academics.

Although commercial loans may enjoy a “hallowed reputation for respectability” (Rosenfeld, 1999, p. 1), “more and more small business owners are turning to credit cards for funding...because they are easy to come by and the credit limits are high” (Scully, 2002, p.1). In its *2002 Report to the Congress on the Availability of Credit to Small Businesses*, the Federal Reserve Board indicated that overall 46% of small businesses utilized personal credit cards in connection with their start-up or ongoing operational costs (Report to the Congress, 2002). Categories were reported under the headings of organizational form, years under current ownership, sic code, and number of employees. The most frequent users of personal credit cards among small businesses were: proprietorships; 0-4 years of age under current ownership; professional services firms; or those with 10-19 employees.

The aforementioned report further posited that personal credit cards may be used as a substitute for business credit cards. Publications in the popular business press such as *Entrepreneur* magazine seem to concur, suggesting that “good, old-fashioned plastic” is a source of capital that remains “plentiful even in tough times” (Prince, 2003, p. 1).

Financial advisors, who write regular commentaries in newspapers and magazines, have on occasion recommended the use of credit cards as one of several sources of start-up cash. Williams (2005) goes so far as to say that credit cards provide small business owners with an easy source of cash and are an option that allows entrepreneurs to avoid the controls that can be placed on a small business owner by banks, angels, relatives or other investors.

However, a writer for *Credit Control* magazine (2002) reports that the federal government is worried about a trend toward replacing traditional bank loans (for less than \$100,000) with the use of credit cards by small-business owners in the US. Hence, the federal government feels that credit cards are a riskier vehicle for financing the activity of a business, according to reports issued by the US Small Business Administration (SBA).

Additional observers would agree that the practice is riskier than other ways to finance a business (Hise, 1998). Despite the risks involved, Hise reported that according to the *Survey of Small and Mid-Size Businesses* by Arthur Andersen’s Enterprise Group and National Small Business United, the top two methods for financing small companies were bank loans and credit-cards, which were used by 38% and 34% of the respondents respectively. What is even more interesting is that the same survey reported that 25% of the companies that used credit cards were using them “often or routinely.” Shermach (2004) reported that “holders of cards for small businesses use their cards more often than consumers do, and their average transaction is bigger than the average consumer’s” (p. 24).

What makes the use of credit cards so risky? Primarily, it is the large bill that arrives each month, which cannot be juggled as easily as if there were several small bills coming in. Another risk is the violation of most personal consumer-cardholder agreements, which state that personal credit cards cannot be used to fund businesses. Hise (1998) reported that it is standard practice for thousands of entrepreneurs to use their personal credit cards to provide initial capitalization.

Additional observers note that minority and women entrepreneurs are at an even greater disadvantage with regard to having the means to acquire capital through traditionally accepted sources (Brush, Carter, Gatewood, Greene, and Hart, 2004). An article by Thomas (2001) stated that, as compared to men, many women entrepreneurs avoid the sale of equity in their businesses and “are more likely to rely on credit cards and personal loans” (p. B.2) to finance a business.

## **Research Methods**

### Population

The population in this study consisted of 830 businesses in Rutherford County, Tennessee. These businesses were listed on *Reference USA* as having been started between 2001 and 2005. In addition, the primary contact person was listed as “owner” or “partner.”

### Instrument

A survey was developed that identified sources of start-up capital typically associated with the creation of new businesses. Respondents were asked to identify sources of start-up capital in relative percentages of total capital. The instrument also probed the manner in which credit cards were used in two separate sections, usage related to the start-up phase of respondents’ businesses, and usage related to the ongoing capital needs of businesses. Additional demographics were also identified.

### Data Collection

An invitation to participate in the study was sent to all members of the population by mail, utilizing a post card. Respondents were asked to go to an online survey, or to make other arrangements to participate by mail, fax, or telephone. Of the 830 cards that were mailed, 70 (11.86%) were returned as undeliverable. 32 completed instruments were collected, inclusive of both paper and online surveys. At the time of this writing, surveys are still being received.

## **Results**

Demographics for survey respondents showed that the breakdown in terms of legal entity of the responding businesses were 56.3% proprietorships, 15.6% S-corporations, 15.6% C-corporations, and 12.5% as limited liability corporations. Franchises made up 6.25% of the respondents with the remainder independently-owned businesses. Gender breakdown was 37.5% female and 59.4% male – the remaining 3.1% representing individuals who chose not to identify their gender. Of the businesses that did respond, 38.5% had been in business about four years, 15.4% for 3 years, 15.4% for 2 years, with 30.8% in business for one year or less. Approximately 87.1% of the businesses currently had one to four employees, 9.4% had five to nine employees, and 6.3% had ten to nineteen employees. No business had more than nineteen employees.

Responses from the survey portrayed a compelling picture of the use of credit cards by entrepreneurs. Entrepreneurs tend to use credit cards extensively in the funding of start-up capital, ranking second only to personal savings among the most commonly used forms (Table 1). Among respondents to the survey, 37.5% indicated that credit cards played a role in the collection of start-up capital, and provided 26.2% of the capital needed to those individuals.

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Table 1 about here

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Personal savings was mentioned less than twice as often (68.8%), but it provided more than twice the capital (56.0%). Overall, personal savings provided an average of 39.8% of the funding needed by entrepreneurs to start-up a business – the clear leading source based on average percentage of funding overall. Interestingly, although credit cards and personal savings were most commonly used, the funds provided were less as a percentage of total capital generated than would be expected based on the frequency of their usage. In fact, credit cards provided less funding (based on average percentage of funding if used) than any other source besides loans from friends. Based on this information, it may follow that credit cards are seen as a necessary source of funds in terms of access but not in terms of magnitude of funds. Another additional important finding from Table 1 is the lack of identification of venture capitalists and angel investors as sources for start-up capital – not a single respondent acknowledged either as a source for start-up capital.

External sources such as banks were relied upon heavily by those that tapped into those sources. Based on the survey, 46.9% of the respondents specifically identified a bank or some other formal arrangement such as a home equity loan as a source for start-up capital. A full two-thirds of the respondents indicated some sort of collateral usage when formal external sources were engaged. Moreover, banks (with and without collateral) provided some of the highest percentages of capital funding when those sources were utilized.

In analyzing our data, we also observed that start-up capital obtained from sources based on personal wherewithal was utilized by 84.4% of the respondents and accounted for 82.4% of total start-up funding on average. For purposes of our analysis we defined personal wherewithal as the aggregate total of credit cards, borrowing from relatives and friends, personal savings, and home equity loans. Our logic in doing so was to glean a view of the data in such a way that we might discern the value of social capital, personal assets, and borrowing power.

Of those that used credit cards for start-up capital, 25% of the respondents indicated that one or more business credit cards were utilized compared to 91% who identified personal credit cards as the source. Those using personal credit cards borrowed over a quarter of all startup capital from their personal credit cards on an average of 2.55 personal credit cards per person.

Table 2 shows the association between users of personal savings and credit cards for start-up capital. Based on those that identified either source as a basis for funding, the table indicates that it is relatively rare for someone to tap into credit cards when personal savings are not used (or non-existent as the case may be). The preference appears to be for the use of personal savings alone, with the secondary choice of credit cards to complete the funding, although the exact nature of this relationship could not be confirmed within the survey. Additionally, it appears that

those that use personal savings are more likely to utilize credit cards than those that do not use personal savings.

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Table 2 about here

Fifty percent of respondents using credit cards indicated that the associated debt from start-up had yet to be paid off. This is not surprising in that 75% of those utilizing credit cards for startup capital named “Ease of acquiring un-secured capital” as their primary purpose for their use; another 17% indicated it was their only source of capital. Indeed, the results of the survey identified instances of entrepreneurs “floating” their borrowing using one credit card to pay off another. Table 3 shows the satisfaction and recommendations of that group concerning the use of credit cards for start-up capital. Clearly, those that had somewhat or more satisfaction with their use tended to recommend their use to emerging entrepreneurs as a source of start-up capital whereas individuals that were neutral or less satisfied tended to not recommend their use. Overall, 46.2% of individuals who used credit cards would recommend their use while 53.8% would not.

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Table 3 about here

Table 4 shows the relative uses of credit cards in terms of purchases made during the start-up phase and on-going business. Not surprisingly, purchases during the start-up of the business tended to include more goods and equipment, whereas ongoing purchases tended to favor operational needs. Conferences/Seminars/Workshops/Training and Business Travel, Meals, and Entertainment became integral on-going credit card expenses, while small pieces of equipment and major equipment went to zero. An interesting yet clarifying view can be seen in the shift from “cash for survival” in start-up to “office rent” and “advertising” when the business is ongoing.

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Table 4 about here

## **Discussion and Implications**

This study examined approaches to initial capitalization of start-up businesses as well as the use of personal and business credit cards to meet ongoing capital needs. We were interested in exploring the use of capital sources beyond those that are often emphasized in entrepreneurship text books, such as investment bankers, venture capitalists, and angel investors. Given the dearth of existing scholarly research related to the use of credit cards for the above purposes, our efforts were envisioned as a pilot study to guide future inquiry to be undertaken by both ourselves and other scholars.

Moreover, since credit cards are being used relatively frequently for starting businesses as well as managing ongoing operations in actual practice, they should be formally acknowledged as worthy of additional study. Although members of the business press have already acknowledged the phenomenon, except to an extremely limited degree, scholars have not as yet demonstrated a reciprocal level of interest.

Some of the more interesting implications of our study became visible after we began to combine sources under other logical typologies, such as “personal wherewithal,” discussed above. According to our findings, approximately eight out of ten start-ups, and eight out of ten start-up dollars, can be linked to personal wherewithal. This finding suggests important implications for the classroom, for scholars, for practitioners, including the lending community. In particular, additional emphasis should be placed upon educating would-be business founders on the role, risks, and rewards of using personal savings, credit cards, social capital, family and friends, home equity loans, and other personally leveraged strategies to capitalize business start-ups. We would also note some irony as it relates to bankers’ reputations for being reluctant to become involved with unsecured transactions for new businesses: in some cases, they are funding unsecured loans for start-ups through credit cards, anyway!

### **Limitations and Future Research**

The results of this study must be interpreted in light of several limitations. First, the response rate to the survey was low. The methodology used to collect the data directed participants to go to an online site to complete the survey, or to make other arrangements that would require additional efforts on the part of respondents to participate by mail, fax, or telephone. It could not be determined how many nonrespondents did not have online response capability (i.e., a computer, time, or both); respondents who lacked a fax capability would have faced analogous impediments. Second, because of the exploratory nature of this study, the survey instrument was the first to gather data used in this kind of research. Further refinements of the instrument will lead to improvements in the quality and clarity of responses. Third, this study was not designed to identify the reasons why entrepreneurs use credit cards for initial capitalization in place of other sources (e.g., personal savings, relatives, venture capitalists). Fourth, entrepreneurs and small business owners subject to the same set of circumstances may decide differently on the use of credit cards. This study was not designed to examine how individual entrepreneurs and small business owners would behave under similar (and dissimilar) circumstances. Fifth, the current study was primarily designed to examine the use of credit cards as a source for initial funds for start-up businesses; thus, the study did not attempt to examine the impact which personal savings, investment bankers, venture capitalists, angel investors, and other sources of capital have on the use of credit cards.

Despite the above limitations, the study provides some of the first evidence that connects entrepreneurial credit card usage with founders’ motives. The study’s measures included credit card usage in the context of competing choices (including “no other choice”). Further, the study probed entrepreneurs’ satisfaction, or lack thereof, with the use of credit cards for start-up purposes or ongoing capital needs.

Future research opportunities abound because of the scant amount of research in the area of credit card use for initial capitalization or ongoing capital needs. The impact that alternative sources of capital for start-up (e.g., personal savings, investment bankers, venture capitalists, and angel investors) have on each other is an interesting question that can be answered by future research. The study’s findings have provoked additional questions about entrepreneurs’ attitudes toward the use of credit cards, by suggesting other possible attitudinal variables to examine, such as: “sensible in moderation” or “never” a good idea. Another opportunity for further research

lies in examining the relationship between perceptions of credit card use and behavioral characteristics such as risk aversion, personality, performance, and gender. Thomas (2001) identified women entrepreneurs as showing a preference for credit cards and personal loans for financing purposes compared to the use of equity funding for the same purpose. Thomas' results suggest behavioral variables may exist which may explain why credit cards may be used before (or after) other alternative financing devices.

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## TABLES

**Table 1. Start-Up Capital Sources and Percentage Frequency (n=32)**

|                     | Percentage Used <sup>A</sup> | Average %<br>Funding Overall <sup>B</sup> | Average % of<br>Capital<br>Funding if<br>Used <sup>C</sup> |
|---------------------|------------------------------|---|--|
| Credit Cards        | 37.5%                        | 10.1%                                     | 26.2%  |
| Relatives           | 28.1%                        | 12.7%                                     | 43.8%  |
| Friends             | 3.1%                         | 0.8%                                      | 25.0%  |
| Bank w/ Collateral  | 18.8%                        | 11.8%                                     | 60.8%  |
| Bank w/o Collateral | 18.8%                        | 10.9%                                     | 56.1%  |
| Venture Capitalist  | 0.0%                         | 0.0%                                      | N/A  |
| Angel Investor      | 0.0%                         | 0.0%                                      | N/A  |
| Home Equity Loan    | 18.8%                        | 8.3%                                      | 43.1%  |
| Personal Savings    | 68.8%                        | 39.8%                                     | 56.0%  |
| Other Sources       | 6.3%                         | 5.6%                                      | 87.0%  |
|                     |                              | 100%                                      |  |

<sup>A</sup> - Percentage used will not sum to 100% as multiple sources are used by most respondents.

<sup>B</sup> - Average of percentage of funding reported by all respondents.

<sup>C</sup> - Average of the reported percentage of funding for those who utilized that source.

**Table 2. Frequency of Credit Card Use and Personal Savings for Start-Up Capital (n=26)**

|              |     | Personal Savings |       | Total  |
|--------------|-----|------------------|-------|--------|
|              |     | Yes              | No    |        |
| Credit Cards | Yes | 28.1%            | 9.4%  | 37.5%  |
|              | No  | 40.6%            | 21.9% | 62.5%  |
| Total        |     | 68.8%            | 31.3% | 100.0% |

**Table 3. Satisfaction with and Recommended Use of Credit Cards for Start-up Capital (n=13)**

| Satisfaction <sup>A</sup> | Recommend Use <sup>B</sup> |       |
|---------------------------|----------------------------|-------|
|                           | Yes                        | No    |
| Extremely Satisfied       | 15.4%                      | 0.0%  |
| Somewhat Satisfied        | 15.4%                      | 7.7%  |
| Neutral                   | 15.4%                      | 23.1% |
| Somewhat Dissatisfied     | 0.0%                       | 23.1% |
| Extremely Dissatisfied    | 0.0%                       | 0.0%  |

<sup>A</sup> - Satisfaction with use of credit cards for start-up capital.

<sup>B</sup> - Whether respondent would recommend the use of credit cards for start-up capital to emerging entrepreneurs.

**Table 4. Primary Uses of Credit Cards during and after Start-Up Phase (n=32)**

| Use                                       | Purchases             | On-going  |
|---|-----------------------|-----------|
|   | during Start-Up Phase | Purchases |
| Business Supplies                         | 69.2%                 | 81.3%     |
| Small pieces of equipment                 | 61.5%                 | 0.0%      |
| Business travel, meals, and entertainment | 38.5%                 | 81.3%     |
| Inventory                                 | 15.4%                 | 12.5%     |
| Major equipment                           | 15.4%                 | 0.0%      |
| Insurance                                 | 7.7%                  | 6.3%      |
| Cash advance for survival                 | 7.7%                  | 0.0%      |
| Maintenance contracts                     | 7.7%                  | 0.0%      |
| Conferences/Seminars/Workshops/Training   | 0.0%                  | 50.0%     |
| Memberships                               | 0.0%                  | 18.8%     |
| Publications                              | 0.0%                  | 12.5%     |
| Advertising                               | 0.0%                  | 6.3%      |
| Office Rent                               | 0.0%                  | 6.3%      |

When Do Liabilities of Age and Size Dissipate? Searching for the Financial Legitimacy  
Threshold

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## Abstract

This exploratory work adds to the literature by attempting to identify the point, as measured by age and size, at which investors bestow some level of legitimacy among small firms. To test these hypotheses, we draw from two large databases: the 1993 NSSBF and the 1998 SSBF. Each of these databases, collected by the Federal Reserve Board, contains over 4,000 SMEs with detailed information on their financing behavior. We employ a purely exploratory technique (cluster analysis) to determine, with no a priori assumptions, the relationship between size, age, growth, and attainment of the various types of financing. Our research shows that a threshold may indeed be identifiable—at least in general terms. However, the SMEs were much larger and older at the threshold than expected.

## INTRODUCTION

When do small firms achieve legitimacy in the eyes of investors? It is widely held that firms must reach certain size (termed liability of smallness) and age (termed liability of newness) thresholds before investors will consider them viable candidates. This exploratory work adds to the literature by attempting to identify the point, as measured by age, size, and growth at which investors bestow some level of legitimacy among small firms. While we recognize that it is unlikely that all firms will experience this threshold at the same time and place, there appear to be enough similarities surrounding the phenomenon that looking for generalities will provide value.

Numerous authors argue that small firms are not simply large firms scaled down (Scherr and Hulburt, 2001; Welsch and White, 1981; Pettit and Singer, 1985). It is likely that there are issues specific to smaller firms that make it necessary to consider them as a different class of firms replete with their own principles, especially when considering financing issues. For example, SMEs typically have greater growth options, shorter asset maturity, occupy different industry sectors, and have higher failure rates than larger firms (Scherr and Hulburt, 2001; Diamond, 1991; Pettit and Singer, 1985). In addition to assisting SME practitioners, policy makers, and lenders, the study of SME financing decisions may also provide interesting insights to existing financial principles and theories.

We draw from the rich literature on legitimacy, the developing literature on small firm legitimacy, and the SME finance literature. The intersection of these literatures allows us to make theoretically grounded propositions regarding the nature of a financial legitimacy threshold. We begin with an overview of legitimacy and the general notion of a threshold in the small and young firm. Next, we discuss the nature of legitimacy with regard to financing decisions. Finally, we submit and test propositions.

### The Legitimacy Threshold

The legitimacy threshold is defined as the point where the organization first moves from an untenable collection of resources to a sustainable enterprise as perceived by the entrepreneur. In life cycle parlance, it can be thought of as a firm moving from the birth stage to the growth stage. Scott and Bruce (1987) term this the “inception to survival crisis”. This, however, is only for descriptive purposes, as it is not the intent here to get involved in the debate surrounding the appropriateness of stage models. This work will focus only on transitions—specifically the legitimacy transition.

Although other researchers (Downs, 1967; Steinmetz, 1969; Scott and Bruce, 1987) have alluded to an LT, Zimmerman and Zeitz (2002) were the first to explicitly use and operationalize this term. They define the LT as: “[The point] below which the new venture struggles for existence and probably will perish and above which the new venture can achieve further gains in legitimacy and resources.” The authors do not venture a prediction as to when or where the event may happen, but they do state that: “An organization must achieve a base level of legitimacy that is dichotomous—it either does or does not meet the threshold” (Zimmerman and Zeitz, 2002).

It is worth mentioning an alternative here. Based on our research, all SGEs will not encounter a threshold. Just as some SGEs will be able to avoid (or not perceive) the early stage punctuation, it is also unlikely that all firms that do experience the LT will do it at the same time and place. That being stated, there appear to be enough similarities surrounding the LT that looking for generalities will provide value. There are two related theory bases that provide support for a universal LT. The first is, clearly, legitimacy. The second is the related concepts of liabilities of newness (LON) and liabilities of smallness (LOS).

The idea of early stage legitimacy essentially holds that external stakeholders accord the firm the clout to grow. Legitimacy cannot be taken, rather it must be granted by influential stakeholders (e.g. financiers, employees, suppliers, and/or consumers). These stakeholders, either analytically or tacitly, at some point decide that a given firm has the necessary influence to interest them, and most stakeholders want to have a feeling of relative permanence from an organization—a feeling that it is not teetering on the edge of extinction (Aldrich and Fiol, 1994). Regardless of the stakeholder under consideration, the key antecedents to achieve legitimacy are largely the same (e.g. historical financials, reliability, size, etc.) (Singh, Tucker, and House, 1986). So, even though SGEs are all very different, the environment (stakeholders) judges them on similar criteria. As a result, the idea of legitimization makes it unlikely that a given firm will be very small or very young when stakeholders confer their favor upon it.

This leads us to the LON and LOS literature. LON occurs because new firms do not yet have the systems established internally or externally that are required to compete effectively against larger firms (Carroll and Delacroix, 1982). LOS describes a condition in which small firms are more susceptible to environmental forces because of limited debt capacity, internal cash restrictions, and a limited product line (Morris, 2001).

To illustrate, in customer terms LON and LOS are accounted for in the concept of taken-for-grantedness (Hannan and Freeman, 1989). This describes a situation whereby the less a customer actually thinks about the source of legitimacy before legitimizing an organization, the better. This has also been termed cognitive legitimacy, and generally requires social actors to become so comfortable with an organization that they do not actively think about it (Shepherd and Zacharakis, 2003; Fiol and Aldrich, 1994). In a similar fashion, prospective employees will not choose a small firm without some level of employer legitimacy. This manifests itself as the problem of lack of familiarity and the problem of low levels of influence on population norms (Williamson, 2000). Lack of familiarity simply describes the fact that if a prospective employee is not sufficiently aware of a given organization, he or she is unlikely to legitimate that firm. In a similar manner, illegitimate firms cannot affect the current state of HR practices in a given population. In terms of financier stakeholders, these liabilities are manifested in adverse selection and moral hazard problems. Adverse selection describes a situation where a high quality firm may not be able to attain funding simply because the financier is unable to discern its quality (Akerlof, 1970). Moral hazard is an agency issue, which deals with the possibility that a SME owner/manager mismanages resources for personal gain and, because of opaqueness; investors may be unable to detect this behavior (Gerler, 1992). It is these financing stakeholders that this manuscript will address.

Just as a SME is unlikely to be very young or very small when legitimized, the fact that small firms are subject to liabilities of smallness and liabilities of newness makes it also unlikely that a given firm will be very large or very old when it is legitimized. Because of LOS and LON, small firms face much higher failure rates than their larger counterparts (Stinchcombe, 1965; Singh, et al., 1986), therefore if these firms are not legitimized relatively quickly after formation they will fail and will not have the opportunity to face the LT.

These conditions drive small firms (more than larger firms) to develop similarly and adopt similar configurations that Mintzberg (1979) and Miller (1984a) term: the entrepreneurial configuration. “In fact, most new organizations seem to adopt [the same] configuration, whatever their sector, because they generally have to rely on personalized leadership to get themselves going—to establish their basic direction, or *strategic vision*, to hire their first people and set up their initial procedures.” When organizations grow quickly they “make a relatively quick transition to another configuration” (Mintzberg, 1979). Mintzberg (1979) holds that factors surrounding the organization’s situation will influence the choice of structure. In particular he describes an entrepreneurial configuration, which fits most small organizations because situational factors (age, size, and environmental stability) drive them to the same general form. This leads us to believe that there is a relatively narrow “window” where a SME is likely to be initially legitimized.

It may add clarity here to provide some contrast—that is to discuss what the legitimacy threshold is not. The legitimacy threshold is not managerial capacity (MC). Introduced by Penrose (1959), managerial capacity essentially describes a situation where an organization reaches a limit on its ability to pursue additional entrepreneurial opportunities. This situation, or problem, is caused by a lack managerial acumen. There may, in fact, be a managerial capacity threshold, but this threshold would occur later in a firm’s development and has a different set of antecedents and characteristics. For example, managerial capacity issues are triggered internally, while legitimacy issues are triggered externally (Singh, Tucker, and House, 1986). The MC threshold occurs later in the life of a SGE and is generally a result of rapid growth. This is in contrast to the LT, which occurs earlier and is the predecessor of growth. We view the LT as a necessary, but not sufficient, condition for growth.

## THE LEGITIMACY THRESHOLD AND FINANCING

For this work we draw on Berger and Udell’s (1998) widely used financial growth cycle for small businesses which describes a situation where the financial needs and financing options change as the business grows, becomes more experienced and less informationally opaque (Figure 1). They further suggest that firms lie on a size/age/information continuum where the smaller/younger/more opaque firms “lie near the left end of the continuum indicating that they must rely on initial insider finance, trade credit, and/or angel finance” (Berger & Udell, 1998: 622). Their growth cycle predicts that as the firm grows it will gain access to venture capitalists as a source of intermediate equity and mid-term loans as a source of intermediate debt (Berger & Udell, 1998). In the final stage of the growth paradigm, as the firm becomes older, more experienced and more informationally transparent, it likely will gain access to public equity (PE) or long term debt financing (LTD).

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Insert Figure 1 about here

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General Proposition: SME's will organize into two distinct groups. One that is older and larger utilizes venture capital, trade credit, financial institution loans, and line of credit; another that is younger and smaller and utilizes insider finance, angel equity, and equity from owners.

## **METHOD**

### Sample

The sample in this study was taken from two different National Survey of Small Business Finances (NSSBF). The first NSSBF conducted the survey during 1994-95 for the Board of Governors of the Federal Reserve System and the U. S. Small Business Administration, and second was conducted during 1999-2000. The target population was all for-profit, non-financial, non-farm business enterprises that had fewer than 500 employees and were in operation as of the year-ended 1992 and 1998 respectively. The sample was drawn from firms listed on the Dun's Market Identifier file.

### Analysis

We employ an exploratory cluster analysis for the first portion of the analysis. The idea here is to use a methodology with little a priori bias to allow the data to organize into two groups based on our variable of interest. After deriving two groups from the cluster analysis, we subject the result to a multivariate analysis of variance to test for significance on the overall model and individual variables. Table \*\* shows the variable grouping for both 1993 data and the 1998 data.

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Tables 1 and 2 about Here

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### Measures

Per the Berger and Udell (1998) model we employ the following measures: age, size, growth, angel equity, family equity, owner equity, public equity, personal credit card, credit line, loan from owner, loan from institution, trade credit. We also include industry membership.

## **DISCUSSION**

The goal of this research was to provide some insight into the existence of a financial threshold for SMEs. While this is a broad, macro investigation we can provide some commentary and implications in our research and the nature of a threshold. The largest implication with regard to a threshold is that firms are surprisingly large and old before they begin using the more desirable forms of financing. However, in our opinion, the most interesting result is the membership in each of our clusters. Specifically the fact that there were a large number of SME's in the pre-threshold stage and small number in the post-threshold stage indicates that interesting things are occurring. Judging by the variability in this pre-stage this appears to be a very heterogenous group of SMEs, while the second group is relatively homogenous.

This is logical as firms at this stage have many different reasons for not pursuing the threshold. Some may wish to stay small or maintain control, while others simply cannot convince financiers to legitimize them. Romano, Tanewski, and Smyrniotis (2001) state that the only way to truly understand the SME capital structure process is to take the entrepreneur into account because, unlike larger firms, owner-managers control the majority stake in the firm and most would like to keep it that way (Scherr and Hulbert, 2001). Therefore many authors view the key characteristics of the entrepreneur as the desire to maintain control. While these individual characteristics are not yet well understood, it is important to understand that 'ulterior' motives do exist for SMEs owners making the financing decisions.

### **LIMITS**

The limits to this study are inherent to the broad exploratory nature of the topic. The identification of this threshold is preliminary since there are almost certainly a host of mediating factors that must be investigated. As mentioned above, intention is among the most important issues to be examined but experience, planning, and strategic posture are other internal issues to be examined.

We view the exploratory nature of this work as both a strength and a weakness. While many authors have stated that there exists a legitimacy threshold in SME development, these studies have been largely anecdotal. An equal number of researchers hold that the vast heterogeneity that exists among small, young firms precludes any identification of such a threshold. Instead of interpreting this as a final work on the threshold, it should be viewed as the first step in identifying this potentially exciting construct.

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Figure 1. Financial growth cycle

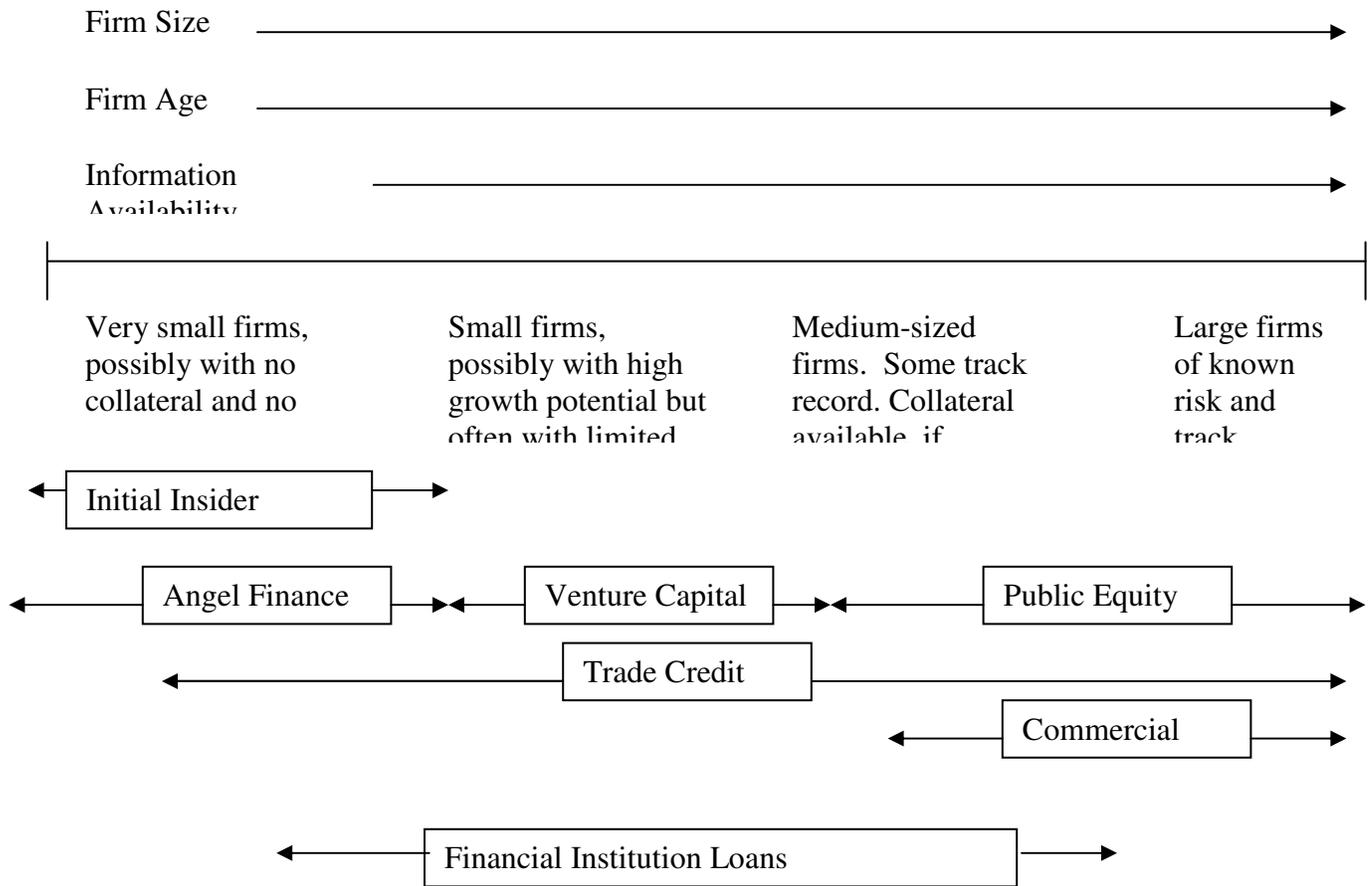


Table 1. Final Cluster Centers 93 Data and MANOVA results

|                       | <b>Cluster1</b><br>n = 3358 | <b>Cluster2</b><br>n=152 | <b>F</b> | <b>Sig.</b> |
|-----------------------|-----------------------------|--------------------------|----------|-------------|
| Firm age              | 16                          | 28                       | 99.40    | .000        |
| FTEs                  | 23                          | 185                      | 1528.62  | .000        |
| Sales                 | 2,193,759                   | 43,870,993               | 4383.13  | .000        |
| Sales Growth          | 4.72                        | 15.01                    | .23      | .631        |
| credit card-personal  | .38                         | .22                      | 15.74    | .000        |
| Loan from owners      | .22                         | .28                      | 3.28     | .070        |
| trade credit          | .69                         | .86                      | 19.43    | .000        |
| angel equity          | .00                         | .03                      | 12.93    | .000        |
| vc equity             | .00                         | .01                      | 4.13     | .042        |
| other equity          | .00                         | .03                      | 16.64    | .000        |
| loan from institution | .36                         | .78                      | 108.14   | .000        |
| credit line           | .35                         | .83                      | 146.16   | .000        |
| equity from owners    | .19                         | .23                      | 1.69     | .193        |
| Mining/construction   | .13                         | .09                      | 2.10     | .147        |
| Manufacturing         | .13                         | .24                      | 17.32    | .000        |
| Transportation        | .04                         | .05                      | 1.23     | .267        |
| Wholesale/retail      | .30                         | .50                      | 27.30    | .000        |
| Financial Services    | .06                         | .03                      | 3.33     | .068        |
| Services              | .35                         | .09                      | 43.57    | .000        |

Wilks' Lambda = .432 (F = 241.93; p < .000)

Table 2. Final Cluster Centers 98 data MANOVA results

|                       | <b>Cluster1</b><br>n = 3246 | <b>Cluster2</b><br>n = 92 | <b>F</b> | <b>Sig.</b> |
|-----------------------|-----------------------------|---------------------------|----------|-------------|
| Firm age              | 15                          | 26                        | 81.803   | .000        |
| FTEs                  | 20                          | 163                       | 759.381  | .000        |
| Sales                 | 1,825,224                   | 53,253,855                | 4846.369 | .000        |
| Sales Growth          | .09                         | .29                       | .495     | .482        |
| credit card-personal  | .44                         | .36                       | 2.189    | .139        |
| Loan from owners      | .18                         | .33                       | 13.059   | .000        |
| trade credit          | .66                         | .93                       | 30.444   | .000        |
| angel equity          | .00                         | .00                       | .142     | .706        |
| vc equity             | .00                         | .00                       | .113     | .736        |
| other equity          | .00                         | .00                       | .142     | .706        |
| loan from institution | .27                         | .53                       | 18.933   | .000        |
| credit line           | .36                         | .88                       | 108.304  | .000        |
| equity from owners    | .06                         | .10                       | 2.131    | .144        |
| Mining/construction   | .11                         | .25                       | 18.308   | .000        |
| Manufacturing         | .04                         | .01                       | 2.020    | .155        |
| Transportation        | .26                         | .52                       | 32.265   | .000        |
| Wholesale/retail      | .06                         | .01                       | 4.043    | .044        |
| Financial Services    | .43                         | .08                       | 45.682   | .000        |

Wilks' Lambda = .404 (F = 272.41; p < .000)

# **Resisting the Giants: Small Retail Entrepreneurs against Mega-Retailers – An Empirical Study**

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## **ABSTRACT**

Mega-retailers are widely criticized as causing devastation among smaller retailers, particularly in mid-sized markets in the United States. Others argue that small retailers can survive “in the shadow of the retail giants”, by offering levels of customer service that the mega-retailers can’t provide due to their very size. This paper reports the findings of an empirical study of the perceived impact of the recent opening of box-retailers, such as Costco and Home Depot on locally owned/operated small retailers in the North-Eastern Ontario city of Greater Sudbury, Canada from 1999 to 2003. The sample included 78 smaller store owners, on average in operation for the last 21 years.

Aggregate results confirmed the hypotheses that small retailers suffered lower sales and clientele since the arrival of mega-retailers, and could clearly identify their and mega-retailers' respective competitive advantages and disadvantages as compared to each other. Respondents had a significant perception of having an advantage over their mega-competitors in the areas of Store Cleanliness, Value for the Customer, Products' Quality, and Store Layout. While a number of respondents suffered lower sales, about one-third of them (the Resisting Retailers) had average sales growth of over 21%. Differentiation and Niche Marketing were the main aspects of a successful competing strategy adopted by resisting retailers against mega-retailers. Some of the strategic moves adopted by resisting retailers amounted to a “Vacuum Strategy”, which includes the refusal to carry brands available at mega-stores, and the refusal to service such brands or to have anything to do with mega-retailers, refusing any alliance with them and making it known to customers.

## **INTRODUCTION**

This paper reports the findings of an empirical study of the perceived impact of the opening of mega-, or box-, retailers on locally owned/operated small- to medium-sized retailers in North-Eastern Ontario, Canada. The study focused on the City of Greater Sudbury (CGS). A Census Metropolitan Area (CMA), the CGS is located in Northern Ontario, the region is known for its spectacular lakes, forests, and fauna as well as for its frigid winter weather, the region used by

most North American and Japanese motor vehicle manufacturers as a cold weather testing ground. The CGS has also been a Canadian market test city for several decades.

With a market of approximately 550,000 people, relatively isolated from large urban centers such as the Greater Toronto Area (GTA), Northern Ontario and the adjacent North Western Quebec area represent an ideal real-life size laboratory enabling the observation of the emerging battle between established local small retailers and the large mega-retailers such as Costco and Home Depot. The former opened in the CGS in 1999 and was quickly followed by Home Depot in an adjacent location. Subsequent openings of a number of similarly large stores continue in that location, resulting in the emergence of a significant North-Eastern Ontario power center involving around thirty stores. As the results below will show, some local smaller entrepreneurs have decided to fight, and a good number of them are resisting the giants with varying degrees of success.

The researchers also tried to identify what competitive advantages smaller retailers reported to be attempting to develop or maintain as they were confronted with the entry of mega-retailers into their immediate vicinity and within the regional market. The questions related to the impact of mega-retailers on specific categories of retailers and the issues related to the respective location of mega- and small retailers were also examined, as well as the positive, neutral, or negative financial impact of mega-retailers upon small retailers. The characteristics of those retailers who were successfully competing or resisting against mega-retailers as well as those of the unsuccessful ones so far were examined.

## **Definition**

A number of terms are attached to retail “super” store operations including "hypermarkets" in Europe (Gonzalez-Benito, 2001), and in North America “box retailers”, “discount retailers” and “mega-retailers”. These terms generally apply to stores which are 2,500 m<sup>2</sup> in surface and over (or 26,900 sq. ft.), but many new stores are 7,500 m<sup>2</sup> and more (80,700 sq. ft.). In this study the term “mega-retailer” is used since this appears to be the more common generic title and includes four types of large retail operations: discount stores such as Wal-Mart, category killers such as Home Depot, warehouse clubs such as Costco, and outlet stores such as The Shoe Company.

## **LITERATURE REVIEW**

Although there are numerous anecdotal press reports regarding the effects of mega-retailers, Wal-Mart in particular, empirical research reports are limited. Noteworthy U.S. and Canadian studies, including Beaumont (1994), Stone (1995 and 1997), Shils (1997), Jones & Doucet (1998), Doucet & Jones (1999), and Stone & Artz (1999) have concluded that the opening of mega-retailers in a community has the potential to impact on existing smaller merchants in two ways. Firstly, there will be an effect on the retail sector in terms of changes to sales levels; increasing in outlets in the immediate area carrying different product categories to the mega-retail outlets, a result of increased traffic. However, decline occurs in the overall market area in outlets carrying similar categories (Stone & Artz, 1995). Secondly, there will be changes in the way the merchants conduct their business in terms of competitive strategies: reduction in number of employees due either to lower sales levels or to increased efficiencies and changes in marketing practices in terms of pricing, product mix and store positioning, location of outlet and recognition of customer service as being central to survival. Others also point out that retail's

success is entirely dependent on a local economy's ability to generate purchasing power for the customers, while large retailers drain wealth away from an area (Fruth, 2000).

Shils's (1999) comprehensive study identifies both social and economic effects, the social effects being the physical and social decline of neighborhoods and town centers as pre-existing retailers fail to survive. The more serious economic effects include, firstly, retail closures as traditional retailers fail to compete, with the consequent loss of jobs including the employment of the owners themselves. Secondly, reduced numbers of employees was noted; a result of Shils's "drain away" effect caused by the presence of mega-retailers shifting activities from various geographic traditional retail centers or clusters.

In seeking community approval to locate stores, mega-retailers have promised increased job numbers. In several cases it is reported that the number of jobs have not materialized to the extent promised, a situation exacerbated by the fact that, according to the Shils study, each new part-time job in a mega-store eliminates about one and a half full time job in smaller stores. Further, most jobs in the mega-retail stores are "minimum wage" with little opportunity for improvement or promotion. Most are non-union with all the ramifications implicit in such situations (i.e. absence of provision of health and fringe benefits to large numbers of employees). In some situations, they report, the mega-retailers have closed down operations after several years. Having forced the closure of much of the local retail trade, the closures leave a retail vacuum and an increased unemployment problem (Dalal, Al-Khatib, DaCosta, and Decker, 1994).

Shils pointed to the erosion of “free retail market” choice for consumers both in terms of choice of retailer, shopping location and brand and other choice issues. Citing a 1996 statement of Wal-Mart’s CEO, David D. Glass, at their annual stockholders meeting of that year, “We are going to dominate North America!” Shils points to the “decimation of communities’ “main street” retailers, unable to compete (p.6).

Conversely, Archer & Taylor (1994) argue that small retailers can survive “in the shadow of the retail giants”, the key being levels of customer service that the mega-retailers can’t provide, their very size limiting their abilities in this area. More specifically, Berry (1999, 2001) contends that by using five well-documented retailing best practices, the “Five Pillars of Retailing”, survival and success can be achieved. Berry’s “Five Pillars” of retailing, components of his “retail model”, are:

1. Solve Customers' Problems
2. Treat Customers with Respect
3. Connect with Customers’ Emotions
4. Set the Fairest (not lowest) Price
5. Save Customers’ Time

Berry argues that all five of these practices must be implemented in order for the concept to be effective. For the purpose of this study, the authors have developed the five scales described below in the “Methodology” section.

Studying the impact of mega-retail mainly in the Toronto area in Canada, researchers at the Ryerson University Centre for the Study of Retail Activity (Doucet and Jones 1999) found that employment and sales had increased among mega-retailers, and decreased among their smaller

competitors located in storefront retail strips. They also found that stores located closer to mega-stores suffered the most.

## **SETTING OF THE STUDY AND MEGA-RETAIL BACKGROUND OF THE REGION**

### **Expansion of Mega-retailers into Ontario:**

While mega-retailing can be traced back to the creation of the first department store by Aristide Boucicaut in Paris in 1852 (Chirouze, 2003), and to the opening of a first Woolworth store in 1879 in Lancaster, Pennsylvania (Perry, 2001), the arrival of mega-retailing in Canada generally, and Ontario in particular, has been the result of the expansion of U.S. mega-retailers into the country since the late 1980's. Insofar as Ontario is concerned, until 1999 expansion was confined largely to the more populous southern part of the province. The greatest expansion of mega-retail outlets is occurring in the Greater Toronto Area (GTA). Jones and Doucet (1998) record 93 outlets of this form (a total of 418,000 m<sup>2</sup>, or 4.5 million square feet) in the GTA area by 1990 increasing to 268 stores (1 million m<sup>2</sup>, or 11.1 million sq. ft.) by 1998. Expansion has continued with 2002 data showing 614 outlets (2.7 million m<sup>2</sup>, or 29 million sq. ft.), (Hernandez, Biasotto, and Jones, 2003; Hernandez, Jones, and Maze, 2003; Simmons, 2003).

### **Setting:**

The setting of the study is the City of Greater Sudbury, occupying a key location on the Trans-Canada (East-West) main highway and a hub for access to much of North-Eastern and North-Western Ontario from either Toronto or Ottawa. Located 385 km (240 miles) north of the GTA, the city has a population of over 160,000 people.

### **Mega-retail background in the CGS:**

With the exception of Business Depot – Staples, who opened a modest-sized store in 1993, and Wal-Mart, who acquired a small Woolco store in 1994, mega-retailers' real expansion into northern retail market areas beyond Barrie, a sleeper town some 100 km (60 miles) north of the GTA, occurred in 1999 with the opening of the approximately 13,000 m<sup>2</sup> (140,000 sq. ft.) Price/Costco Warehouse Membership Club store in the City of Greater Sudbury (CGS) in Northern Ontario. This was quickly followed by the opening of the 14,000 m<sup>2</sup> (150,000 sq. ft.) Home Depot adjacent to the Costco location in Sudbury. With the subsequent opening of other mega-retailers, including Pier 1, Danier Leather, Homesense, ShoeSource, Mark's Work Warehouse, Chapters-Starbucks, and a large Sears Home furniture and appliance outlet in the same location, a significant "power center" was being created in the north-east of the city.

Winners and Wal-Mart have also opened stores in other locations, both in the north-end of Sudbury, in recent years. Wal-Mart are building a 10,000 m<sup>2</sup> (105,000 sq. ft.) plus second store in the south-end of the City with capacity expansion potential for a further 3,250 m<sup>2</sup> (35,000 sq.ft.) A further 14,000 m<sup>2</sup> (150,000 sq. ft.) of added retail space in the South End was occurring with the expansion of a mall anchored through an existing but much expanded Zellers discount department store (a Canadian-based chain, formerly a subsidiary of the U.S.-based chain, K-Mart, purchased by the Hudson's Bay Company retail chain in 1996) targeted against Wal-Mart. It is expected that Greater Sudbury would host about 50 mega-retail stores by the end of 2005.

### **Mega-retailers' Market Area:**

The designated market area (Malone, Given, Parsons, 1996) from which the mega-stores in the CGS attract customers comprises much of North-Eastern Ontario and parts of the Western Abitibi-Temiscamingue region located on the Western part of the Province of Quebec. Greater Sudbury forms the pivotal center of an area containing a total population of over half a million people all within 350 km (220 miles) of Sudbury. The market area embraces a number of small- to medium-sized rural communities and cities including Parry Sound to the south-east, French River to the south, Elliot Lake and Sault St. Marie to the west; Hearst, Kapuskasing, Rouyn-Noranda (Québec), Kirkland Lake and Timmins to the North and New Liskeard, Temagami, and North Bay to the East-North-East. More detailed discussions of the economic structure of the region have been published elsewhere (Cachon *et al.*, 2001; Mulholland, R. *et al.* 1998).

Two aspects of the issue of the impact of mega-retailers on the economy in the CGS and area are important to note. Firstly, the region is vast and is considered to be relatively remote from the major population centers of the GTA and Barrie, where the nearest mega-retail outlets are located. This aspect is discussed further in the “Methodology” section below. Secondly, in many cases, particularly in the United States where individual rural regions are in constant competition to save local jobs, mega-retailers, have been attracted into regions by low-cost land and promises of property tax exemptions offered by local authorities in the belief that permitting such developments would increase opportunities and improve general economic conditions. This did not occur in Sudbury where the local authorities have made the companies responsible not only for property taxes, but also for infrastructure modifications including roadways, drainage and other municipal or utility-provided services.

## **RESEARCH METHODOLOGY**

### **Hypotheses:**

Drawing on the results of the earlier research cited in the literature review, the following hypotheses were formulated:

1. Small retailers have seen a drop in gross sales since mega-retailers came to the city;
2. Small retailers have seen less out-of-city clientele since mega-retailers came to the city;
3. Small retailers can identify clearly their competitive advantages and disadvantages as compared to mega-retailers;
4. Small retailers can clearly identify the competitive advantages and disadvantages of the mega-retailers;
5. Small retailers are involved in planning innovative competitive strategies to enable them to better compete against mega-retailers;
6. Small retailers located within eight km (five miles) of the mega-retailers have seen a significantly stronger decrease in gross sales, as compared to retailers located further away;
7. Small retailers located within eight km (five miles) of the mega-retailers have seen a significantly stronger decrease in profits, as compared to retailers located further away;

### **Secondary Data Sources:**

In addition to the reports noted in the literature review, secondary data included municipal retailer and product/service category data on a local basis. Copies of market review and impact studies conducted on behalf of Costco and others were obtained; such studies are required by the local municipality's planning authority and provide a useful perspective.

**Primary Data Sources:**

Primary data were collected using a cluster sampling approach involving 180 retailers within a 30 km (20 miles) radius of the center of the CGS and in the primary retail clusters described above; 78, or 43.3% of the retailers contacted participated in the survey, a proportion similar to that obtained in earlier studies involving personal interviews with retail store owners (Cachon and Cotton, 1997). Retailers trading in product categories directly affected by the box stores were identified on the basis of the Statistics Canada 1980 Standard Industrial Classification system. They included food, liquor, and prescription drug stores, shoe, apparel and fabric stores, household furnishing, electronics, and appliance stores, automotive parts stores, general merchandise stores and other retail stores such as book and stationery stores, florist shops, lawn and garden centers, hardware, paint and wallpaper stores, sporting goods stores, musical instrument and record stores, jewelry stores, camera and photographic supply stores, toy, gift, hobby and novelty stores, opticians, art galleries, artists' supplies stores, luggage stores, pet shops, and discount retailers.

**Sample:**

Four geographic cluster samples were used and included the four primary retail activity areas in the CGS area: the City Center, the area in the south end of the CGS known as The Four Corners, the North-end of Sudbury (New Sudbury), and the suburban areas of Nickel Center, Rayside-Balfour and Valley East, all within a 30 km (20 miles) radius from the center of the city. The sample included 78 smaller store owners, on average in operation for the last 21 years, with an

average business surface of 300 m<sup>2</sup> (3,230 sq. ft.) - as compared to 4,650 to 14,000 m<sup>2</sup> - 50,000 to 140,000 sq. ft. - for mega-retailers.

**Instrument:**

A semi-structured, 22-question instrument was developed and pre-tested by the authors. It was reviewed and approved by Laurentian University's Ethics Review Board. The questionnaire included a scale comprising 18 items covering the 5 sets of retail practices proposed by Berry, based upon store image variables previously developed and used by the authors (Cachon, 1990; Marks, 1976). The questionnaire was administered during the summer and fall of 2003.

The scales used to measure the five components of Berry's model included the following variables:

1. Solve Customers Problems:
  - Competence of salespeople
  - Availability of salespeople
  - Service quality to clients
2. Treat Customers with Respect
  - Treating customers with respect
  - Courteous salespeople
3. Connect with Customers' Emotions through the retail experience
  - Cleanliness of the store
  - Choice/variety of products
  - Suppliers/supply chain
  - Value/value chain (any advantages given to clients as compared to competitors)
  - Quality of products
4. Set the Fairest (not lowest) Price
  - Fair pricing
  - Avoiding hidden charges for customers
5. Save Customers' Time

Store location  
Short cash waiting lines  
Convenient shopping hours  
Easy to figure, non-confusing store layout  
Easy access by road  
Easy parking

### **Data analysis:**

The data were analysed with versions 11.5 and 12 of SPSS for Windows. Descriptive as well as other statistical analyses were performed.

## **RESULTS**

### **Descriptive statistics:**

The GCS small retail shops are typically family-owned businesses often involving more than one generation of entrepreneurs. In terms of location, 17 small stores were located within three km (two miles) of the mega-retailers in New Sudbury, 18 were located in the City Center area, less than five km (three miles) from the mega-stores, 22 were located in the Four Corners, approximately eight km (five miles) from the mega-stores, and the remaining 21 respondents were located in suburban areas between 15 and 30 km (ten and twenty miles) away from the mega-stores.

On average, the 78 entrepreneurs surveyed employed 4.75 full-time employees in 2003, as compared to 4.92 in 1997, two years before the opening of the first mega-store. They also had 3.39 part-timers working with them in 2003, as compared to 3.27 in 1997. Between 1999, year of the opening of the first mega-store, and 2003, smaller store owners reported an average decline in sales of 7.51% for the period, an average decline in profits of 2.94%, and an average

decline of customer traffic of 7.51% from Greater Sudbury and of 0.71% from outside the Greater Sudbury area. These results confirm hypotheses 1 and 2.

In terms of competition, 53 respondents (67.9%) identified large discount retail chains as their competitors, and 25 of them named Home Depot and Costco as being these competitors. The remainder of the respondents saw themselves more in competition with other smaller retailers, or considered that a niche marketing strategy prevented them from having real competition to speak of within their perceived target market area.

#### **Unsuccessful Retailers:**

37 of the 78 respondents (47.4%) reported that their sales volume had decreased since the arrival of the mega-stores, in a range from 6% to 50%, with an average decrease of 21.3%. As a consequence, they had to reduce their average number of full time employees from 7 to 5.75, and their average number of part-time employees from 4.33 to 3.78, even if their stores were, on average, slightly larger than the overall average, 325 m<sup>2</sup> (3,477 sq. ft.) vs. 300 m<sup>2</sup> (3,230 sq. ft.). In terms of profitability, the average decline among this group was 12.35%, almost half the decline in sales, suggesting that adjustment measures had already been taken in order to stem the damage caused by the new competition. 36 of the 37 respondents identified discount retail chains as their competitors, with Costco and Home Depot cited by 20 of them; also cited as discount chain competitors were Wal-Mart, and the furniture, appliances and electronics chains Future Shop, The Brick, and Leon's.

The decline in clientele traffic was also more pronounced among unsuccessful retailers, as compared to the general respondent population: a decrease of 18.24% for clients from Greater Sudbury, and 9.2% for out-of-region customers. The categories of businesses who saw declining sales mostly include hardware, paint, and wallpaper stores, food stores, discount stores, stationery and book stores and general merchandise stores. These categories of stores were affected regardless of their location, as t-tests comparing means across locations showed no significant difference for the variables above. The average number of 23 years of existence of unsuccessful retailers was not significantly higher than that of resisting retailers.

### **Resisting Retailers:**

While 8 respondents declined to answer the question about their sales volumes, another 33 respondents, or 42.3% of the total, reported stable sales in 17 cases, and average increases of 21.6% in 16 cases, for an overall increase in sales average of 10.5% over the years following the arrival of the major box-retailers. These figures are consistent, even if substantially higher, with those reported by Stone (1995) for specialty stores' sales in cities with a Wal-Mart store in rural Iowa after five years, of +5.5%. The higher figure observed in Sudbury is likely related to the size and population of the market area described above, as compared to rural Iowa.

Profitability was reported as being up by 7.3% by these 33 retailers, and up by 20% on average by the 16 respondents who had net sales increases. In contrast with their unsuccessful counterparts, resisting retailers both increased their full and part-time personnel since the mega-stores arrival, respectively from 3.67 to 4.33 on average for full-time employees, and from 2.82 to 3.42 for part-time employees. The absolute numbers of full and part-time employees were not

significantly different between resisting retailers and the overall respondent population.

Similarly, store sizes were not significantly different from the overall average of 300 m<sup>2</sup> (3,230 sq. ft.). In the case of resisting retailers, customer traffic from outside Greater Sudbury had increased by 11% since the mega-retailers arrival, while local traffic had increased by 6.4%.

These retailers cited most often (60.6%) local stores as their competitors, and were of the opinion that mega-retailers offered “low-end, inexpensive products” they were not interested in competing against. Only 18% of them cited Home Depot, Wal-Mart, Leon’s, Rona Cashway, Sears, and Home Sense, as their primary competition. Meanwhile, Costco was only cited by five respondents, as a second main competitor (one case), or as a third main competitor (four cases).

The categories of businesses represented among the 33 resisting retailers include specialty shops such as opticians, prescription drug stores, shoe, apparel and fabric stores - including higher end men’s and women’s clothing stores and specialty shops -, household furnishing, electronics, and appliance stores, book and stationery stores - with an established institutional and corporate clientele -, florist shops, lawn and garden centers, sporting goods stores, musical instrument and record stores, jewelry stores, camera and photographic supply stores, toy, gift, hobby and novelty stores, artists’ supplies stores, luggage stores, and pet shops, and discount retailers. Only two hardware, paint and wallpaper stores appeared in the group of resisting retailers. Four small general merchandise retailers, or corner stores, appeared in this group, and one discount store. Again, location in one area of the city or another had no incidence on being part of this group, which invalidates hypotheses 6 and 7, and, with an average of 21.6 years in operation, these retailers were not significantly different in terms of business longevity from their unsuccessful peers.

### **Strategic Variables:**

The scale results comparing the smaller store owners' perceptions of their retail strategy as compared to the mega-box retailers' strategic variables are summarized in Table 1. T-tests comparing the perceptions of resisting entrepreneurs as compared to unsuccessful ones showed no significant differences between the two groups on mean strategic variables scores, except for Convenient Shopping Hours. There was a significant difference at  $p < 0.005$  level between unsuccessful and resisting retailers' mean scores (77.1 vs. 58.6) for this variable, perceived as less important by the resisting group. While the scores are self-reported by the respondents, they show a strong awareness from their part of their respective position of strength or weakness as compared to mega-retailers on the 18 variables, thus confirming Hypotheses 3 and 4.

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Table 1 about here

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In terms of the respondents' perceptions of using Berry's best retailing practices, the Solving Customers' Problems (P1), Respect for Customers (P2), and Fair Pricing (P4) subscales were the areas where they felt having a strategic marketing advantage against mega-store competitors. On the Connecting with Customer Emotions Through Retail Experience (P3), and Saving Customers' Time (P5) subscales, respondents had a significant perception of having an advantage over their mega-competitors in the areas of Store Cleanliness, smaller stores being cleaner than the larger ones, Value for the Customer, Products' Quality, and Store Layout, smaller stores being non confusing in their layout relatively to mega-stores.

On the latter two subscales, the respondents did not see themselves significantly different from the mega-retailers on the six following strategic variables:

1. Choice and Variety of Products
2. Suppliers/supply chain
3. Store location
4. Convenient shopping hours
5. Easy access by road
6. Easy parking

#### **Planning Innovative Competitive Strategies against Mega-retailers:**

The fifth hypothesis was more qualitative in proposing that smaller retailers were involved in planning marketing strategies that would allow them to compete effectively against the mega-retail competition. Three qualitative questions were used to verify this hypothesis: What strategies, if any, have you taken to compete against other retailers? How can you compete with the large discount retail chains? Have you considered: a) Associating with other retailers in your area in order to compete against box retailers? b) Starting a joint venture with other retailers in your area in order to compete against box retailers? c) Associating with a box retailer who is not in direct competition, but rather complementary to your business?

Most of the resisting retailers, as well as a few unsuccessful ones, did not respond directly to the questions above, but described specific strategies they were using to compete as successfully as

possible. Below are a number of them, but first, these two statements made by resisting respondents provide some background on their state of mind towards mega-retailers.

#### Statement #1

Many of the box retailers that have come to Sudbury have not affected our business in a typical sense. We are a small mid-to-high end furniture store and therefore the product in many box stores does not compete with our business. However, I do feel they have had a very negative effect on business because of the mentality of the consumer as a result of box stores. The small business has been forced to advertise on a constant basis with the word "Sale". It means we are forced to spend more money on advertising and in truth the product is probably on sale every day of the week. I have seen box and mattresses advertised at chain stores at \$ 2,200 for half price (\$ 1,100), when the exact same product is in our store every day at \$ 995. This is a result of the consumer just needing to see the word "Sale", what I refer to as the box store mentality. I only hope that the consumer becomes smarter when reading advertising of box stores.

#### Statement #2

Sudbury's non-growth and the loss of small competitors have helped the strong survive. Sudbury is the Toronto of the North, which brings in people for the weekend from out of town, for the theatre, hospitals, schools, Science North and box stores. In return, hopefully the money spent at restaurants, gas stations, accommodations will gradually sift through the system and get to the small retailer. The small retailer has to find their niche to survive. Toronto is our biggest competitor.

### **Brand and product/service strategies**

To improve their financial situation, resisting retailers had dropped lines of products and/or brands sold by big box stores to replace them with others, sometimes more exclusive and expensive, or likely to deliver higher margins and sell faster. Others reduced costs and increased

prices on more exclusive products or decided to stop discounting major products, limiting sales and quantity deals to accessories such as belts and jewelry, thus securing a more exclusive store image and a better emotional connection with high income customers' self-image.

Solving customers' problems meant emphasizing a specific service, important to one or more significant segments of clientele, such as enhanced delivery services. For example, a building supply store offers on-roof shingle delivery, a service not offered by the competing mega-retailer and worth more in time and wages to roofing contractors than the extra cost to them. It also meant offering better repair services, faster, done on a local basis and for longer periods. A local computer store offers three-year warranties on several products, thus securing a loyal clientele.

Other retailers reported giving customers more discretion in their choice of a specific product. Smaller lumber retailers allowed their customers (building contractors) to choose each individual plank, while mega-retail stores oblige their clients to take delivery of whatever planks handled by their sales personnel, regardless of knots or imperfections. Hardware store owners reported having a competent and better paid sales force to retain customers and secure repeat business as well as word-of-mouth publicity from loyal customers: competent and well-experienced personnel will provide clients with invaluable advice on how to replace obsolete plumbing with proper-fitting supplies, saving clients the frustration of having to submit to multiple visits to the store in order to find the proper replacement product.

In terms of products offered, some retailers increased their store size in order to expand product lines which are not fully available at mega-stores: in given product categories, mega-stores often

carry only one or two items: for example musical instruments, compressors, seasonal clothing, vacuum cleaners, ladders, office and home furniture. Other retailers said they advised customers they would refuse to service or repair brands sold exclusively by mega-retailers.

### **Promotional and communication strategies**

One store owner said it would be important to educate customers and make them realize what Big Box stores foster: a low wage, low cost economy with no job security, which is the opposite to what local consumers keep asking for from their large local employers: higher wages and job security. These employers are branches of large national banks, mining and paper companies, other local branches of large multinational and global corporations, governments, hospitals, schools and public sector institutions.

Some of the food stores, which are affiliated with larger national wholesale chains, had developed promotional material attacking Costco directly, with point-of-purchase slogans suggesting to customers they could pay similar prices and get a better deal: "No Membership Required"; "Buy Large Packs and SAVE"; "Count on us for More". At the same time, these same stores paid attention to limit waiting at cash outlets and to customer satisfaction by asking, for example, whether customers found all the products they were looking for that day and providing them with some form of meaningful answer in case they did not. Such practices are consistent with recent research findings on improving customers' retail experience (Berry, Carbone, and Haeckel, 2002; Walsh, 2003; Rosenblum, 2004), particularly with respect to the fact that many consumers are ready to sacrifice money for time saved up to a certain limit.

## **Supply chain strategies**

Regarding supply channels, some retailers developed or joined contractual channels such as purchasing retail groups, wholesale chains and national franchises. Others were seeking the engagement from as many manufacturers as possible to guarantee that products supplied to mega-retail stores would be different from those sold to smaller retailers in terms of quality and product attributes.

By their mere presence, mega-retailers significantly disrupted the supply chain of several categories of retailers. This appeared particularly important in the hardware and food products categories. Consider cordless power tools such as saws, routers, drills, and other small hand tools: in the pre-mega-retail era, hardware store owners would buy them from a contractual national supplier at a price of, let us assume, \$ 59.99, and sell them at retail for \$ 79.99. The same tools are available now at a local mega-store for \$ 39.99 each, thus undercutting both the retail and wholesale former prices. Smaller retailers were left with limited choices, including dropping the whole product line (not a viable choice for a hardware store on such a staple product line), dropping the brand in cause and seeking another competitive one, or convincing the national supplier to create a new product line under an existing national private brand or under a new brand name altogether, with all the development and promotion costs associated to such a move.

## **General strategies: the Vacuum Strategy**

In general, differentiation and niche marketing were the main aspects of a successful competing strategy adopted by smaller retailers against mega-retailers. Some of the strategic moves

adopted by resisting retailers amount to what can be called a “Vacuum Strategy”, the components of which include:

- 1) The refusal to carry as many brands as possible that are carried by mega-stores;
- 2) The refusal to service such brands, and
- 3) The refusal to have anything to do with mega-retailers, any kind of alliance or cooperation with them.

These moves were clearly not concerted from the part of the smaller retail entrepreneurs, but those who defended and advocated these moves made it clear that it was also important for them and part of their strategy to inform their customers of these actions. These retailers were deliberately turning their backs from mega-retailers in an attempt to isolate them from the local customer base on as many product lines as possible. Better sales and profits would be secured through appropriate branding, pricing, customer experience, and product/service differentiation among their specialty product categories.

While it is too early to say whether such strategies will keep a significant core of successful smaller retailers in the Greater Sudbury area, it is important to understand that retail wars do not occur in a vacuum, but within a larger economic and social-political context in constant evolution. That context is not only influenced by private industry competition, but also by decisions taken by the various levels of government. Meanwhile, the overall economy of the region has been affected by international demand, particularly for metals, which are the main exportable by-product of the local economy besides agricultural products such as beef, deer, buffalo, meat, and cereals. These issues are the subject of the following discussion on mediating factors.

## **MEDIATING FACTORS**

The economy of the CGS and Northern Ontario has been described as involving two groups of major employers, large corporations on one side, and local, provincial, and federal governments on the other (Cachon et al., 2001), both groups providing average incomes more than twice those obtained within firms of less than twenty employees (Mulholland et al., 1998, p. 26). The relative importance of small business and entrepreneurship in the economy of the region has yet to be determined, but it is almost certain that both large corporations and governments, who provide a strong employment base to the area, play a major role in sustaining local small businesses, particularly within the retail sector. Retail sales involve store sales to the general public as well as procurement contracts for institutions and corporations.

The local economy of the CGS suffered setbacks between 1996 and 2001: Statistics Canada data issued following the 2001 Census showed a decline in the population of the Greater Sudbury area of about 10,000 people over those five years. It is likely that a large proportion of the population decline resulted from the loss of employment in three key levels of government which all implemented personnel reduction programs during the period 1996-2001. Meanwhile, there are indications that, in the private sector, areas such as the mining services industry gained jobs and were still expanding through 2004 and 2005 due to the high level of metal prices. A total of twelve metals are mined in the Sudbury, which is still considered the largest nickel-cobalt ore basin in the world: nickel, cobalt, copper, gold, silver, the six platinum group metals, and iron.

It is certainly likely that these two phenomena had an impact on retail sales in the region, in addition to the arrival of mega-retailers. It is also possible that the long-term effects of the mega-retailers presence in the Greater Sudbury area will take more than a few years to show themselves clearly, at least on some sectors: Stone (1995) has shown that mega-retailers continued to have a negative impact on Iowa rural communities' restaurants after five years of presence.

### **CONCLUSION AND OTHER CONSIDERATIONS**

The overall results showing declining sales, particularly among general merchandise and hardware stores are consistent with findings from other empirical research in Canada (Doucet and Jones, 1999) and in the U.S. (Stone, 1995 and 1997). Secondary data showing an increase in sales per capita in Sudbury are also consistent with the literature.

Smaller retailers were well aware of their competitive position and, at least some of them, believed they were adopting adequate strategic marketing responses to their new competition. Two facts observed among resisting retailers might represent a risk for them: 1) Taking the attitude that convenient shopping hours may not be as important can have severe consequences on customer traffic in the long run and 2) Informing customers that brands sold by mega-retailers shall not be serviced could be interpreted as trying to force customers' hand, resulting in backlash behavior on their part, i.e. choosing the cheaper mega-retailed brand instead.

Many of the respondents were not properly informed of the role played by local and other levels of government in relation to the mega-retail entry into the CGS market. A number of them were

convinced that mega-retailers had been receiving tax incentives and various types of “tax breaks” for which local small owners were not being compensated; they were also questioning the local support provided by mega-retailers in terms of charities, sponsorships, giveaways and other demonstrations of good corporate citizenship. There seemed to be a deficit of information between some of the small retailers and the various levels of government about what is being done to sustain and promote local business while keeping a healthy level of competition within the retail sector in the region and the country. It can certainly be assumed that similar ignorance is present among a majority of customers and the general public.

Resisting, or successful retailers were concentrated mostly in the specialty shopping categories, including corner stores with vast assortments of products available at hours where the mega-stores are closed and located in residential neighborhoods. Unsuccessful retailers were more likely to be confronted by mega-retailers on identical product lines and brands, or on products perceived by customers as being homogeneous in nature rather than differentiated.

With regards to locating the retail business, the relatively small size of the city, coupled with the ease customers can drive from one shopping zone to another, rendered the fact of being located nearer or farther apart from the mega-retailers not significant in being successful as a Resisting retailer. It is more likely that successful advertising in the local media would ensure customer visits from both local and out-of-town people, as long as the proper market strategies are also put into practice.

It is likely that mega-retailers also affect the supply chain for many smaller retailers in the North-Eastern Ontario and North-Western Quebec areas, including those located in smaller towns and in rural areas. As in one of the aforementioned examples, some respondents indicated that some prices obtained at Costco and Home Depot were lower than their wholesaler's prices: this prompted some of them to switch from a former wholesaler to mega-retailers as their primary supplier. Shils (1997) reported similar moves in the U.S. However, these strategic moves are not necessarily available to all retailers, many of them being members of exclusive distribution channels such as franchises, which prevent them from seeking alternate supply sources.

### **Other issues**

There are other issues related to the development of mega-retail power centers which were not within the scope of this research but are nonetheless important. They are particularly revolving around community planning, social, and environmental issues. Studies and reports such as Beaumont (1994), Duerksen and Goebel (1999), and Perry (2001) provide examples and guidelines on how community leaders and planners should establish relevant legislation and control mechanisms in order to limit the potentially negative effects of mega-retail. Perry reports a series of regulatory strategies adopted across the United States, including Mequon (Wisconsin), St. Petersburg (Florida), Fort Collins (Colorado), and the states of Vermont and New Jersey; the report provides specific recommendations for public authorities at the local and regional (state) level: coordinate the planning of retail development and review its impacts at the aforementioned levels.

The mega-retail phenomenon has reached all continents, particularly as the result of expanding multinational retail firms such as Wal-Mart, Carrefour, Ahold, and Metro. The impact of mega-retailing on smaller independent retailers is likely to be similar across continents and cultures, unless governments develop mechanisms supporting smaller retailers in their resistance. Further research would be required to examine the international "battlefield" between mega- and smaller retailers.

The authors thank the Certified Management Accountants Association of Canada - CMA Canada for financially supporting this research, and the Certified General Accountants of Canada - CGA Canada for providing funding to attend the I.C.S.B. World Conference in Washington.

Table 1

## COMPETITIVENESS SCALES DATA:

Small retail store owners self ratings as compared to their ratings of mega-retailers

| Berry's Pillars | Variable                    | Mean small Retailers self ratings | Mean ratings of mega retailers | t-test significance |
|-----------------|-----------------------------|-----------------------------------|--------------------------------|---------------------|
| P1              | Competence of salespeople   | 81.47                             | 34.93                          | .000                |
| P1              | Availability of salespeople | 76.19                             | 36.59                          | .000                |
| P1              | Service quality             | 88.41                             | 34.64                          | .000                |
| P2              | Respect for customers       | 91.76                             | 41.32                          | .000                |
| P2              | Courteous salespeople       | 89.85                             | 40.75                          | .000                |
| P3              | Store cleanliness           | 80.90                             | 50.15                          | .000                |
| P3              | Choice/variety of products  | 73.38                             | 66.76                          | .257 n.s.           |
| P3              | Suppliers/supply chain      | 69.77                             | 59.22                          | .072 n.s.           |
| P3              | Value for customer          | 73.79                             | 53.1                           | .000                |
| P3              | Products' quality           | 82.00                             | 55.46                          | .000                |
| P4              | Fair prices                 | 78.28                             | 59.92                          | .000                |
| P4              | Avoidance of hidden charges | 79.84                             | 50.16                          | .000                |
| P5              | Store location              | 61.94                             | 67.42                          | .339 n.s.           |
| P5              | Easy access                 | 71.31                             | 69.67                          | .738 n.s.           |
| P5              | Easy parking                | 70.97                             | 67.74                          | .573 n.s.           |
| P5              | Shopping hours              | 70.00                             | 70.97                          | .823 n.s.           |
| P5              | Store layout                | 81.31                             | 62.46                          | .000                |

NOTE : Each scale was from 0 to 100. The t-tests were paired-samples tests.

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# A Proxemic Approach to Small Business: the Case of Business Ethics.

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“A *small business is not a small big business*” This is almost certainly the most commonly quoted sentence in introductory chapters to books and articles on the management of SMEs. Over time, the postulate of the SME as an entity governed by specific laws of management has established itself as a genuine paradigm structuring research in the field, giving legitimacy to the creation of scientific journals and research associations like the ICSB (*International Council for Small Business*) in the English-speaking world or the AIREPME (*Association Internationale de Recherche en Entrepreneuriat et PME*, International Association for Research in Entrepreneurship and SMEs) in French-speaking countries.

This theory of the specificity of SMEs has now been widely accepted. It nevertheless has one major drawback. It does not precisely define the specificity of SMEs. If SMEs are specific, it must also be admitted that large companies are, too. Using the same term, *specificity*, to define two such fundamentally different realities is clearly unsatisfactory. The two types of specificity thus need to be qualified and given a more precise term.

The theory that we put forward is that the specificity of the management of SMEs is proximity. We use the term *proximity* as an ambivalent concept that refers to both what unites us and brings us together (*closeness*), as well as what shuts us in and isolates us (*closure*). Proximity refers to the classic concepts of family<sup>1</sup>, friendship and neighbors, as well as to more modern concepts such as “link” and “social capital”. All these concepts have the particularity of revealing the same ambivalence between closeness and closure.

As regards *family proximity*, Bridge, O’Neill and Cromie (1998:129) note that a “family business can produce a permanent, solid family atmosphere and *esprit de corps*, which can often encourage both a closeness among staff and long-lasting relationships with customers, suppliers and other contacts”. The family can also, however, become a very closed circle and the source of clan-like management techniques, particularly in terms of human resource management (giving positions of responsibility exclusively to members of the

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<sup>1</sup> It should be noted that originally the word proximity, from the Latin *proximitas* and *proximus*, was used in the 15<sup>th</sup> and 16<sup>th</sup> centuries in its legal meaning of family relations in deeds of inheritance (Le Boulch, 2001).

family) or of setting objectives (a refusal to accept growth as a means of maintaining family control of the business). Denieuil (1992) mentions this type of phenomenon several times. The family business is often seen as “the universe of continuity, certitude and trust, as opposed to the faceless company which is exposed to the dangers of chance and subjected to the unpredictable decisions made by associates”: “If he is not a member of your family, you can expect him to be capable of doing anything to you, good or bad. A member of your family will try to do his best and to develop, with all the benefits coming back to the family, through my sister’s children. The metaphor of the closed circuit (“will come back”) and autonomy sanctioned by being a member of the family structure should be noted”. Once again, this is the closeness/closure ambivalence.

The same can be said for friendship. Firstly, “sociologists have especially noted that the value of friendship increases as the closeness of the family declines” (Bell, 1981 *in* Yager, 1998). This means that friendship is a strong link for proximity that can sometimes replace family ties. But this friendship can also become a form of exclusion and closure. “The two-person nature of the Great Friend Approach is implicit. So all-encompassing and exclusive a relationship would be hard to sustain in a three-way (triad) or a group (network) setting. Such an idealized and intimate friendship thus cancels out other friends or friendships. The Great Friend relationship is hence as exclusive and as binding emotionally as marriage is legally” (Yager, 1998). Friendship is a type of proximity that can insidiously become a form of exclusivity.

As regards neighbors, a neighbor is someone who occupies the closest place, someone at a relatively short distance and someone we frequent. But in legal terms, a neighborhood is often understood to be a place of potential nuisance and disorder. A neighbor is thus also someone who can disrupt daily life, someone with whom we are in disagreement and someone separated from us by some kind of enclosure. The term neighborhood thus also refers to the ambiguity of proximity, between closeness and closure.

The concepts of links and social capital are more recent. They both have their foundations in sociology (Granovetter, 1973; Bourdieu, 1980). Regarding links, although many authors have highlighted their function as a means of making contact (*the link that links*), it is also important to note the negative dimension of the *link that binds*<sup>2</sup> (Laplantine, 2003). This ambivalence can also be seen in terms such as *bound*, giving “*bound up with*”, meaning *connected* or *linked to*, as well as *boundary*, meaning a limitation. Similarly, although *bond* is a synonym for *link*, it also suggests *bondage* (slavery and submission).

The same can be said for social capital, which Bourdieu (1980) defines as “the sum of the resources, actual or virtual, that accrue to an individual or a group by virtue of possessing a durable network of more or less institutionalized relationships of mutual acquaintance and recognition”. Although social capital is often seen to be a strength, it can also be a weakness, especially when it leads to phenomena of withdrawal and imprisonment. The title of the article by Grabher (1993), written to contrast that of Granovetter, “The weakness of strong ties: the lock-in of regional development in the Ruhr Area” is quite explicit on this subject. This article “describes the troublesome attempts to transform the close interfirm linkages into loosely coupled networks” (Grabher, 1993: 256). He identifies a threefold “lock-in” of regional development : functional lock-in, cognitive lock-in, and political lock-in. If the social capital is

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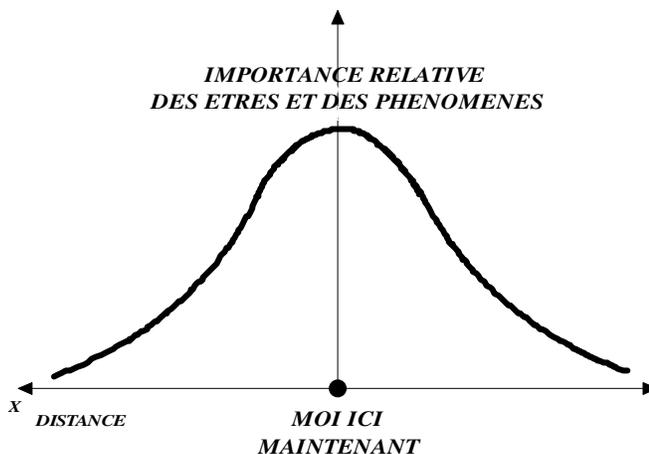
<sup>2</sup> According to Laplantine (2003: 186): “The French language of the 12<sup>th</sup> century used the word “lien” to designate a *lead* (for a dog) and, a little later, in the Gascon language, the term meant *chain*”. It is thus easy to understand a “link” is something that links, but also something that ties. Once again, this is the ambivalence of proximity.

too strong, it can even lead to *corporatiste*<sup>3</sup> phenomena as we have shown in the Californian Mondavi's failure to set up his business in the small village of Aniane in France (Torrès, 2004). "The relation between positive and "negative" social capital can be viewed in a similar light. Capital (except financial capital) is timebound. The social capital of groups and regions that is considered negative from society's standpoint came into being once upon a time as a rational solution intended to safeguard and strengthen the group's interests (...) By creating strong networks, actors/groups have shut others out from the resources and markets to which they have access" (Westlund and Bolton, 2003: 81).

All these concepts reveal the ambivalence of the concept of proximity.

Of all the works on proximity, the psychology of space described by Moles and Rohmer (1978) gives an ideal summary of this ambiguity by introducing two concepts, that of proxemics<sup>4</sup> and that of partition. They propose a subjective and "egocentered" conception of space which corresponds to the "Here and Now" point of view of the individual in a given situation (living space), perceived as being the center of the world: "Me, Here and Now, I am the center of the world and everything is organized in relation to me in a discovery that is a function of my audacity. A world that is focused on Me is only peopled with beings and events to the extent that I perceive them. This is what is known as proxemics, with the importance of beings, things and events necessarily diminishing with distance to the extent that their perception itself diminishes" (Moles and Rohmer, 1978).

This is how Abraham Moles and Elisabeth Rohmer define the notion of proxemics. According to them, "fundamentally and axiomatically, what is close is more important than what is far, all things being equal, be it an event, an object, a phenomenon or a being." (Fig. 1). The Law of proxemics appears as a principle of organization that creates a hierarchy in the degree of importance of the actions and reflections of the individual<sup>5</sup>.



**Figure 1. – Moles and Rohmer's Law of Proxemics (1978)**

<sup>3</sup> *Corporatisme* is both a preference granted to oneself and one's own (peers, relatives and friends), and a form of protection against others (those on the outside and strangers).

<sup>4</sup> Here, we do not use the term "proxemics" in the sense of E. Hall (1981), referring to the study of perception and the use of space by Man.

<sup>5</sup> This idea of growing function can be seen again in Campbell (1978): "feelings of inequity are a function of the perceived closeness".

For those interested in the management of small-sized companies (Small Entreprises and Very Small Entreprises), the value of this axiomatic is twofold: on the one hand, it is founded in psychology (Moles, 1976; Schwach, 1993), which is a particularly appropriate field for understanding the strategic and organizational behavior of small-sized companies<sup>6</sup> (Gervais, 1978; Parent, 1978). On the other hand, it is also based on the centrality of a single point of reference (the *Me, Here and Now*). This last aspect is perfectly suited to the situation of SMEs, as it is generally recognised that one of their specificities is the important role given to the director-owner, a central reference point *par excellence* (Marchesnay, 1991; D'Amboise, 1993; Julien, 1998). This is reminiscent of the famous expression from Gumpert and Boyd (1984), “*The business is the ‘ego’*”. Moles and Rohmer’s egocentered conception of space seems very apt for explaining the mechanisms that govern how a highly personalized management system functions.

The remainder of this article will aim to demonstrate to what extent the effects of proxemics and the effects of partition make it possible to explain in a unified and coherent manner a considerable number of existing results. The aim of this article is to propose a general theorization for the smallness of companies based on the concept of proximity.

#### 1.- The relevance of the proxemic model in understanding the specificity of SMEs

It is in this sense that proximity management, as we see it, is not confined to simple metric measurement. It is the choice-making principle for owner-managers. All other things being equal, the SME manager will opt for what is both geographically and temporally closer to him. This preference for proximity, and the management style that results from it, is a strategic and organizational construction enabling the SME manager to keep control of his firm and its development.

Several theoretical advances in the field of SME management reveal the existence of hierarchical mechanisms of this type, based on proximity:

- *In the choice of country for export*: attacking international markets seems to be governed by a proximity principle, as shown by the Swedish school in Uppsala in its concept of psychic distance (Johanson and Vahlne, 1977). Similarly, the 6-stage exportation model developed by Bilkey and Tesar is based on proximity: “firms at early export stages should focus on psychologically close countries and firms at later stages should focus on psychologically more distant countries” (Bilkey and Tesar, 1977: 95). As Joffre (1987) remarks, “we often insist on the geographical rigidity of small- and medium-sized companies. The presence of small-sized companies decreases as the commercial distance increases, with

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<sup>6</sup> In terms of spatial decisions, Koenig and Joffre (1985: 194) note that “the satisfactions of a psychological nature in the choice of a particular site are more important in individual companies than in large companies, where power is more spread out and where there is greater rationalisation”. It is precisely this aspect that makes Deshaies (1998) say that in SMEs, it is preferable to talk of *reasons* for localization (in reference to the entrepreneur) than of *factors* of localization: “The entrepreneur becomes the obligatory source of information. You should start with him, rather than with a uniform space as in traditional localization theories. Instead of drawing up a list of theoretical postulates concerning space, you should replace them with a set of hypotheses on the representations, attitudes and behavior of entrepreneurs”. We believe that Moles and Rohmer’s Proxemics Law is the response to this desire.

exportation on a large scale remaining the specialty of large companies". Similarly, the concepts of "glocalization" (Johanisson, 1994) and "internationalizing milieus" (Torrès, 1999; Fourcade and Torrès, 2001) have made proximity an active principle in the export strategies adopted by SMEs.

- *In the choice of successor-buyer*: despite the fact that "in the minds of company directors, the alternatives are neither exclusive nor part of an unchanging order" (Haddadj and D'Andria, 2001), the director of an SE who wants to make over his company is often subjected to what we could refer to as an "*organization into a hierarchy of his choice of successor*": a preference for the family, then the employees, clients or suppliers and finally for a third party. In this way, "when choosing a buyer, company directors often adopt a system of concentric circles, starting with the closest contacts and relations and progressively widening their search" (Bah, 2002). This organization into a hierarchy can be broken down into three segments: the *internal segment* (the director's heirs and close family, the executives or all or part of the employees in the company), then the *immediate segment* (the clients, suppliers, colleagues, accountant and so on) and finally the *external segment*, which corresponds to a market open to unknown third parties. According to Bah (2002), the first two segments make up the "closed" market that operates essentially in a trust-based manner and by "word of mouth". Only the third segment is a truly "open" market, although it has a bad reputation as companies that are on the market are often seen as "lame ducks" by potential buyers. We thus find ourselves returning to the classic problem of asymmetry of information and the well-known article, "The Market for Lemons" by Akerlof (1970).

- *In strategic choices*: Ansoff's product/market model also provides an implicit organization into a hierarchy for the way in which companies develop. Development axes must first of all be established within a single sector, within a single activity in the company. Once this axis has become saturated, it then becomes possible to envisage diversification, either in terms of profession or in terms of mission. Total diversification is a last resort solution, as it is the most subject to risk. "Bearing in mind that synergy gives companies the advantage of a higher consolidated return on investment than any group can hope for, at first sight it could seem that diversification should be made according to the principle of maximum synergy. That is, preferring changes that are the least different from the normal experience and internal resources of the company" (Ansoff, 1989: 132). This model brings us back to an implicit order, which goes from horizontal growth ("the most normal, the most common and the most habitual type of growth for companies", [Parent, 1978]), to vertical and finally to conglomeral growth. The smaller the size, the more the company has a vested interest in remaining within its field, as Penrose developed quite clearly in his theory of interstices. Who cannot see, here too, that these strategic principles are further proof of a proximity rule that indicates that a company's growth must go from what is closest (its niche or its interstice) to what is most distant and most subject to risk (diversification). The stagist models of growth can be interpreted as being part of a proxemic design.

- *In recruitment choices*: generally speaking, the smaller a company, the more it tends to prefer proximity in its management of human resources. In a survey conducted recently in France on the management of human resources in small companies, Chassard (2003) demonstrates that acquaintances and word of mouth are the top responses, well ahead of temping agencies or recruitment agencies. Directors of small companies do not like

intermediaries and prefer to make use of their own lists of contacts when they must take on new staff. This type of behavior is perfectly rational, as a recommendation from someone you know is a vote of confidence. It is for this reason that when directors of SMEs hire someone new, they prefer to start with their spouse, then turn to their family in general or circle of friends. Looking on the job market, which is much more anonymous, is only a last resort. Family, friends and an immediate circle of acquaintances are thus a strategic resource when the director says that he uses them as his main source for recruitment purposes. It is the very importance of these proximity human resources that made Letowski (2003) say that the concept of Human Resources is meaningless in very small companies, unless “non staff” human resources are taken into account, such as spouse, children, associates, peers and so on.

- *In the choice of means of financing*: many empirical validations of Myers’ pecking order theory (1984) for financial choices as applied to the field of SMEs stipulate that the growth of SMEs is essentially financed by self-financing, then by bank loans, rather than by issuing share capital (opening the capital) (Norton, 1991; St-Pierre and Baudouin, 1995; Mahéroul, 1999). Similarly, Belletante’s concept of “*financial territory*” (1991) or Crevoisier’s concept of “*proximity capital*”<sup>7</sup> (1998) support our theory of a hierarchical principle of proximity in financing. This *financial proxemic* also makes it possible to explain why SMEs prefer short term financing to long term (temporal financial proximity), or why, according to Hirigoyen (1984), SMEs pay more attention to maintaining the profitability of a company in the short term than to future profitability<sup>8</sup>. This once again reminds us of the concept of proximity in the relations the director-owner has with his banking partners. Effectively, “the results of certain surveys show that directors tend to do business with only a few financial institutions (sometimes only one). It is more profitable to develop a good relationship with a banker, who ends up understanding the personality of the owner-director and accepts his own, personal way of making decisions” (St-Pierre and Baudouin, 1995). Binks and Ennew (1997) go even further, recommending *participative behavior* between SMEs and their bank: “Clearly, perfect information is an unobtainable goal, but a *close working relationship* between bank and business can significantly improve information availability”. Later, they add: “While collateral may be one mechanism for reducing the adverse effects of information asymmetries, the development of a *close working relationship* is an alternative. An effective banking relationship, by its nature, must involve two parties. For bank and businesses to invest time and effort in developing and maintaining such relationships requires that there are discernible benefits from so doing. (...) Further analysis suggests that more participative relationship types are associated with benefits to the firm in the form of better financing conditions and better quality of service and benefits to the bank in the form of more favorable customer assessments of bank service” (Binks and Ennew, 1997: 90).

- *In the choice of support networks and backing*: Gibb’s “layers” theory (Bridge, O’Neill, Cromie, 1998) once again bears witness to the hierarchical proxemic relationships

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<sup>7</sup> As further proof of the link between proximity and financing in SMEs, Corpataux (2003) showed in his doctoral thesis to what extent the draining of the regional financing circuit in Switzerland mainly had an impact on SMEs. In his opinion, “the result is that from now on, SMEs can grow in two ways. Either they enter the stock market, with all the technical problems that that entails for small organisations, or they sell out to large, international groups. In the 1990s, for example, all the brand names from the clock-making sector were taken over by large groups” (Corpataux, 2003: 116).

<sup>8</sup> Hirigoyen (1984) wisely states that directors of SMEs turn their companies into *expense centers* rather than *profit centres*.

between the various spheres that make up the director of an SME's support network. According to Gibb, "a small business will be subject to many influences. It is not however always obvious what these influences will be or what will be the interplay between the different influences". "The relative strengths of the influences of different groups of people are indicated in a diagram produced by Gibb to indicate the layers of small business support networks. One implication of this is that the closer, and more personal, layers will always have a much stronger influence than the outer, and more official, layers" (Bridge, O'Neill, Cromie, 1998). Gibb considers that the influence of the support network is organized into a hierarchy in relation to proximity and thus draws the following conclusions: "If friends when consulted are negative in their advice then it will be far more influential than any positive input from government agencies". These opinions and influences are not all equal, but are organized into a hierarchy on the basis of weighting that increases in relation to the closeness of the link with the owner-director.



Figure 2. - The "layers" theory (source: A. Gibb, 1988 in Bridge et al., 1998).

These six examples show that the effects of proximity create a hierarchy of strategic decisions that privilege that which is close to the detriment of that which is distant<sup>9</sup>. The proximity principle is, in our opinion, a response that is adapted to the principles of limited rationality and the asymmetry of information. Proximity is a vote of confidence. This type of behavior, which privileges proximity, is perfectly rational because anything recommended by a close friend or family member, or business relationship with an acquaintance, is trustworthy. Here, proximity plays the role of guarantee as well as a reducer of uncertainty. It reduces the asymmetry of information and broadens the rationality. This recalls Akerlof (1970), who advises someone selling a car in good condition to sell it to someone who trusts him – in other words, someone he knows. Proximity is the most natural response, and the least costly, to the problem of the asymmetry of information.

The aim of the remainder of this paper is to demonstrate the role and importance of the effects of proximity in SME ethics.

<sup>9</sup> There are several counter-examples to this proxemic concept. Studies on INV (International New Ventures), companies that grow rapidly or start-ups, on capital-risk and so on show that certain small-sized companies diverge completely from this conception. It is these companies that we have qualified as managerial SMEs as they tend to be managed like miniature versions of large companies. This type of company is the opposite of the standard SME, and is the illustration of denaturation phenomena (dilution of specificities) (Torrès, 1998).

## 2. – Ethics as a field of application of the proxemic model for SMEs:

### 2.1. - Ethics as a relationship to others:

The search for a unifying definition of ethics, particularly in the field of management, finds itself confronted with the multiplicity of the rules of action adopted and the paths taken by moral conscience. It would seem difficult to try to make a synthesis of these standards as a means of extracting a common concept for acting well. The solution thus lies not in this diversity, but, on the contrary, in returning to the original question of moral sense. Analysis of the major philosophical texts devoted to ethics effectively makes it possible to recall the profoundly individual nature of moral sense on the one hand and, on the other, the role played by morals in the preservation of the social links to which Man aspires beyond (or within the very heart of) his egocentric desires. From this, it is interesting to retain a definition of ethics that comes from an individualistic approach to the relationship with others.

An individual's moral acts, which shape his relationships with others, are a translation of his concept of justice (distributive). "We can [thus] see in any moral act an *attribution* or allocation of something (rights, objects, feelings, intentions, etc.) to someone. Specifying this something comes down to *sharing* [...]" (Moessinger, 1996, 105).

The fundamental moral problem with which the actor is faced is thus focused on the way in which, by using these rules, he consciously tries to reconcile his search for personal interest with the respect of that of others. The quest for morality in action effectively comes up against the limited nature of the means at his disposal, which prevents him from dealing with all the parties concerned by his decision in the same manner, directly or indirectly.

He is thus obliged to choose the partner(s) that he must privilege, morally speaking.

This principle of distributive justice that underlies all moral acts thus leads to a distribution of wealth. In other words, within the company, it leads to a distribution of added value.

- *The intention and power of the actor in the face of others*: It is very widely accepted that morality (the object of which is to give human actions a framework liable to guarantee social cohesion, but which fights the centrifugal effect of each person's search for their own personal interests) tends to limit the ambitions of each individual, who must take his fellow man into account. Morality as we see it in an act is also a function of the consequences that are attributed to it in its satisfaction of the interests of others. It is in this sense that every moral act can be defined as an act of sharing.

The result of this sharing is nevertheless not always enough to make it possible to judge the morality of an act. There must be, in addition, the respect of the interests of others. The notion of respect, as explained by E. Kant (in *Practical Reason*), is the very "moral motive" behind the decision, which pushes the actor to treat others as an end in themselves, and not as simple means. In order to be moral, an act must be *deliberate* and *disinterested*. Deliberate, because the respect of others must be one of, if not *the*, real motive behind the decision. Disinterested, because it must not be a conscious means of pursuing one's personal interests. If this were the case, it would no longer be a question of moral motive but of pragmatic motive (in Kant's sense).

As the actor, by means of both his decisions and his choices, nevertheless irremediably pursues his interests (material interest or moral satisfaction at having acted well), it is thus only the intention or motivation regarding others that gives the act its moral nature, independently of the vagaries of its implementation. It would nevertheless be inaccurate to claim that an act is morally good *because* it satisfies the interests of others, just as it would be inexact to claim that an act is morally condemnable *because* it goes against the interests of others.

The moral qualification of acts thus appears to be very relative, as it is a function, when the actor has (or believes he has) interests opposed to those of others, of the recognized legitimacy of the satisfaction of his own desires. This relativity is double:

The judgement will vary with the identity of the moral judge, his personality, experience and position as regards the act (the judge can be the actor himself or an external observer who is more or less close to the actor).

Furthermore, the judgement, which is based on confrontation and the comparison of alternative interests, can only be expressed in terms of degree in most cases. It is thus generally an appreciation of the ordinal, rather than cardinal, type. Different scales for measuring ethics have thus been proposed (for example, Reidenbach & Robin, 1991; Skipper & Hyman, 1993) to understand the hierarchy established by the referee in terms of the morality of behavior. Certain authors esteem, for example, that it is more serious to deceive a child than an adult, the reason being that a child is, by nature, weaker. For others, on the contrary, as a deception necessarily creates a situation of superiority regardless of the usual nature of the power struggle that exists between the actor and his partner, it should be judged as it stands, independently of the context in which it is placed.

Finally, the question of morals is only raised for the actor who, free in his decision-making, has power over his partners, that is, those involved in his choices. It is a good thing, for example, if a company owner, who has power over his subordinates, can be led to envisage the use of fixed-term contracts and thus make a moral judgement on the precarious nature of the jobs he has thus created.

## 2. 2. – The weight of individual representations:

The recognized moral character of an act is thus based on the representation (which is built up in the course of the act, that is, the ‘enaction’ in the sense used by Varela) that is made of its consequences.

- *The four elements of ethical representation:* This representation concerns four elements.

- It is based on the intention of the actor: judgement is based on the idea one has of the goal being sought.

- It is based on the nature of others, that is, on both the identity (physical and moral) of the different people involved in the decision and on the choice of those in whose interest one esteems oneself obliged to act out of priority. Not only is the decision made in a situation of limited rationality, but also the inextensible nature of the means at one’s disposal force one to abandon the idea of simultaneously satisfying all the identified people involved, as they often have conflicting interests.

- It is thus also based on the idea that one has of the interests of others. What are the needs of others? How can one preserve another's interests in a satisfactory manner? What is the best way of satisfying these interests?

- Finally, it is based on the legitimacy of the actor's self-satisfaction in his own interests when, in the representation that he has of them, it is obtained to the detriment of others to a varying degree.

Morals, or the ideal that guides action, aims for the absolute satisfaction of the interests of others. But the action itself supposes a degree of arbitration.

Ethics are thus the representation that one has of a classification of interests, considered from the viewpoint of their legitimacy. The key question is thus knowing whether or not this legitimacy is sensitive to proximity. The partner can be more or less close, more or less distant. For example, can it be deemed more serious to steal from one's mother, brother or a friend than from a stranger? An affirmative answer would lead to acceptance of the hypothetical influence the proximity link has on ethical judgement. On the contrary, a negative answer would mean that theft should be judged as it stands, independently of the links of proximity binding the thief and victim.

As part of the teleological approach to ethics, where the morality of an act is measured by the yardstick of its consequences on others, it has been possible to demonstrate the influence on moral judgement of the proximity perceived with the partner involved in the decision (Misrahi, 1997; Dupuy, 1999): the closer the partner is considered to be, the greater the sensitivity to his perceived interests. Nevertheless, motivated by the same desire to act well, the actors obey the rules and/or patterns of logic of varied actions. For example, certain, using a Kantian form of logic, would systematically refuse to steal for the reason that, as theft cannot be built up into a universal law, it is intrinsically bad, whereas others would not hesitate, on occasion, to conceal a truth that could hurt someone. It is thus that those who respect the teleological concept of ethics favor the direct respect of the interests of others, whereas those who prefer a more deontological approach come out more in favour of indirect respect. For the latter, morality is born of the scrupulous respect of the rule that is the best guarantee of the respect of the interests of everyone, as it makes all decisions predictable and the standardization of behavior makes anticipation easier. Their approach is reason-based and is less sensitive to the affective dimension of interpersonal relationships than the teleological approach. There is little or no personalization of those involved. That said, the most fervent supporters of the deontological viewpoint are not strangers to cases of conscience caused by finding themselves incapable of respecting exactly these rules, which are necessarily too general to not, on occasion, be contradictory. Being obliged to come out in favor of one side or the other thus forces them to explicitly evaluate the consequences of their act on the interests of others.

As this approach is based on the idea of respecting the interests of others and thus of having a prior definition of the partner(s) to be privileged, it has three advantages:

- it comes within the framework of progress in the concept of company which has moved from the "stockholder model" (which traditionally places the shareholder as the only important partner for a company) to that of "stakeholder model", for which the company has become an "arena" for a much wider community of partners (shareholders, family, clients, suppliers, employees, local groups and so on).

- in methodological terms, it makes it possible to go beyond the questions inevitably raised by the observer as regards the real motivations of those involved by focusing essentially on concrete facts. Moreover, it protects the observer from the temptation to become the judge himself given that, in the end, everyone is simply trying to protect or develop his own needs.

- finally, it makes it possible to include the study of ethics in the framework of the proxemic approach to SME management. Effectively, by identifying the degree of proximity of each partner, it thus becomes possible to test the link between the classification of the interests of others and their degree of proximity. In other words, this ethical approach is the ideal framework for the general model based on the Law of Proxemics (Moles et Rohmer, 1978).

As the fundamental characteristics of ethical judgement thus waver between egocentricity (judgement is made using oneself as the starting point) and alterocentricity (it is made in relation to others), this leads us to wonder whether or not it is a relevant field of observation for the law of proxemics in SMEs. In other words, the question is whether or not the distance between the director-owner of a small company and the various stakeholders is the explanation for the classification of their interests drawn up through the ethical choices made.

Two proposals can thus be made:

P1: There is a distance between the director-owner of the SME and his partners (spatial representation of the partners)

P2: This distance explains the classification that he draws up between the interests present (effect of proxemics).

### 3. - Methodology:

As a means of validating these proposals, we have used the results of a survey conducted in the Languedoc-Roussillon region in France. The director-owners of 194 companies with less than 50 employees (69% of the companies were very small businesses with less than 10 employees) and from all sectors of activity were questioned. The questionnaire was given face-to-face, and its object was to describe the ethical attitudes of the director-owners in relation to organizational and personal contingency factors. For this communication, we will cover only the factors liable to describe the proxemic effect (Courrent, 1998). The operationalization of the concepts was as follows:

- *Proximity*: Identifying the proximity of the parties involved supposes prior classification of these partners, adapted in particular from the works of Trevino (1993), Longenecker (1995) and Goodpaster (1997). Six categories have been retained: clients, employees, State, municipality, administrative department or region, and suppliers (Courrent, 1998).

It can be tempting to want to identify the perceived relative proximity with each of these categories by means of a question of the “with which type of partner do you feel the closest?” type, classifying each category according to the relative degree of proximity. This apparent simplicity in fact comes up against the complexity of the concept of proximity and,

as a result, the difficulty for the questionees to have a very clear idea of this proximity. Does the question, for example, refer to geographical, affective or cognitive proximity?

A summary of these various dimensions can be attempted by identifying, for each category, a common-ground of interests (are the expectations of your suppliers / clients and so on similar to those of your company?)

- *Ethics*: The classification of the interests of the parties involved can be obtained by means of the following question: “given that it is difficult to satisfy the aspirations of all one’s partners, which are the aspirations that, in your opinion, a small company should privilege?” (classify the six categories of partners, starting with those toward whom the company should be the most attentive and ending with those toward whom it should be the least attentive).

#### 4. - Results

##### 4. 1. - Proposal P1:

The proximity identified by the convergence of interests produced the following classification:

Table n°1 : Classification of partners in relation to the convergence of interests

|                    |       |
|--------------------|-------|
| Partners           |       |
| Employees          | 67,9% |
| Clients            | 65,1% |
| Suppliers          | 59,0% |
| Municipality       | 48,2% |
| Other local groups | 36,3% |
| State              | 18,4% |

It should be noted that the differential between the proportion of questionees who feel close to their employees and those who feel close to their clients is low (2.8 points). This is clearly not very significant, and is doubtless the explanation, at least in part, for the results obtained for proposal 2.

##### 4. 2. - Proposal P2:

The hierarchy operated by the directors between their partners is clearly defined if we refer to the opinions given: 1- clients, 2- employees, 3- suppliers, 4- municipality, 5- department or region, 6- State.

Table 2: Distribution of director-owners in relation to the classification they make between their partners

| Proxemic rank | Partners  | Rank1        | Rank2        | Rank3        | Rank4 | Rank5 | Rank6 |
|---------------|-----------|--------------|--------------|--------------|-------|-------|-------|
| 1             | Employees | 41,8%        | <b>46,4%</b> | 8,2%         | 3,1%  | 0,5%  | 0,0%  |
| 2             | Clients   | <b>57,7%</b> | 36,6%        | 3,1%         | 1,0%  | 1,0%  | 0,5%  |
| 3             | Suppliers | 0,5%         | 10,3%        | <b>64,9%</b> | 12,4% | 5,7%  | 6,2%  |

|   |                     |      |      |       |              |              |              |
|---|---------------------|------|------|-------|--------------|--------------|--------------|
| 4 | Municipality        | 0,0% | 4,6% | 18,6% | <b>63,4%</b> | 12,9%        | 0,5%         |
| 5 | Department – Region | 0,0% | 0,0% | 3,6%  | 12,9%        | <b>71,1%</b> | 12,4%        |
| 6 | State               | 0,0% | 2,1% | 1,5%  | 7,2%         | 8,8%         | <b>80,4%</b> |

This classification is clearly defined, given the significant differential that there is between the highest score and the others for each of the five ranks in the hierarchy. The variation in the differential from one rank to another nevertheless corresponds to non negligible nuances.

The State, region and department, and municipality occupy respectively the last three places of the classification with the highest differentials in score. The State is thus classed in last place by 80.4% of those who answered, 71.1% put the region and department in 5<sup>th</sup> place and 63.4% put the municipality in 4<sup>th</sup> place.

On the other hand, although the clear majority of the director-owners questioned placed their attention primarily on their clients (57.7%), there were still 41.8% who “preferred” their employees, which reduces the differential for these two categories to 15.9 points for first place and 9.8 points (in favor of the employees this time) for second place.

Finally, suppliers occupy a median position in the classification for 64.9% of those questioned. This is a considerable majority, and is 46.3 points higher than the next score for this place.

In other words, directors of SMEs agree largely, not to say massively, in their lack of sensitivity to the interests of the State (and, to a lesser extent, those of local groups). They also agree in their affirmation that they are keen to satisfy the expectations of their clients and employees. On the other hand, they are more divided as to the place to be given to these two categories of partner, even though a non negligible majority came out in favor of the clients.

The classification in the satisfaction of the interests of those involved thus corresponds, more or less perfectly, to their classification in relation to proximity. Clients are favored over employees, even though employees are considered to be closer.

Proposal 2 thus seems to be validated.

The general classification of partners, including the apparent dissonance observed between ranks 1 and 2<sup>10</sup>, can no doubt be justified by the instrumental concept of ethics that directors seem to have: as they consider ethics more as a management tool (58.8%) than as a constraint to their actions (24.2%), the relative attention given to their partners is doubtless a means of developing the company’s performances.

Table 3: Distribution of the director-owners in relation to their concept of ethics as either a constraint to action or a management instrument:

| Constraint or means  | Number of answers | Frequency |
|----------------------|-------------------|-----------|
| Always a constraint  | 12                | 6.2%      |
| Often a constraint   | 35                | 18.0%     |
| Don’t know           | 33                | 17.0%     |
| Often an instrument  | 81                | 41.8%     |
| Always an instrument | 33                | 17.0%     |
| Total                | 194               | 100.0%    |

<sup>10</sup> Dissonance caused by the fact that the feeling of convergence of the company’s interests with those of the clients is close to that regarding the employees (see the results for proposal 1).

Preferring clients to employees, despite the fact that employees are considered to be closer, is symptomatic: a decrease in effectiveness no doubt seems less prejudicial for the efficacy and efficiency of the company than the dissatisfaction of the clients, especially as the differential in the proximity index is low (less than 3 points). As for the State and local groups, it is highly likely that within the French context, director-owners expect little in terms of positive feedback for their companies: the legal and regulatory side of their activity, which is considered above all to be a constraint, is generally felt to be more developed than actions judged positive (particularly public orders). It should be noted that the disinterest in, or hostility to, professional bodies is negatively associated with the degree of decentralization of power that it represents.

Another explanation can be found in the lack of formalization of ethics in SEs. As a result, although rather paradoxically, directors of SEs partially adopt a deontological stance by acting like colleagues (as regards the problems identified as universal and common to all) for whom the ethical stance is explicit, and they privilege the teleological approach as soon as the problems seem to them to be particular to their own company.

## 5. - Conclusion:

After presenting the general model that supports this theory, this article has demonstrated how the effects of proxemics are shown in the ethical judgement of the director-owners of SMEs. By fitting in with the stakeholder approach, which is central to current work on ethics and social responsibility in companies, the authors have highlighted the role and importance of proxemics in the classification of the interests accorded to others. They have shown in particular that the degree of proximity significantly affects ethical behavior, depending on the nature of the partner (family, employee, client, supplier, administration, State and so on). From these results, it can be deduced that the ethical judgement of director-owners of SMEs is profoundly *egocentric*.

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***THE SPATIAL EXPANSION OF FRANCHISE SYSTEMS***  
***IN THE UK – AN EXPLORATORY STUDY***

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## ***ABSTRACT***

Franchising is one of the most understudied areas of entrepreneurship despite its economic significance and international scale. This paper aims to redress this neglect by examining business format franchise systems in the UK. The paper focuses on two key questions, namely why firms franchise and how the network expands spatially. Forty in-depth interviews with franchisors across six different sectors of franchise activity have been conducted. The findings suggest that franchise firms undergo a four-stage spatial expansion life cycle: the initial (pilot), roll out, consolidation and maturity stages. Three strategies were used to achieve network growth: (i) a franchisor-led approach; (ii) a franchisee-led approach; and (iii) a hybrid approach (franchisor and franchisee-led). Methods of growth included utilising single, multi-unit and area operators. These expansion strategies illustrate the locational decision making processes of both the franchisor and the franchisee.

## ***INTRODUCTION***

*“Franchising has emerged in recent years as a highly significant strategy for business growth, job creation and economic development both in the US and in world markets” (Preble and Hoffman, 1995, p80).*

Since the 1970s, most developed countries have experienced a significant increase in franchise activity. North America, Europe, Australia and Japan all have extensive franchise markets (Price, 1997). It is estimated that there are 320,000 franchise outlets in the US (one in every 12 retail outlets) which account for 40% of all US retail sales (International Franchise Association, 2002). Franchise activity has also extended into some developing markets such as South America (e.g. Mexico, Brazil), South East Asia (e.g. Indonesia, Malaysia and Singapore), South Africa and Central

and Eastern European countries (e.g. Czech Republic, Hungary and Slovenia; McCosker, 1998; Pavlin, 1996; Scholtz, 1997; Swartz, 1995). In the UK, there are approximately 700 franchisors, employing 330,000 people and turning over £9.65 billion (British Franchise Association, 2004).

Business format franchising consists of a contractual relationship between a franchisor and a franchisee. The franchisor is the owner of a name, idea, product, service, confidential process or specialised piece of equipment while the franchisee is allowed to use, produce or market the name, idea, product, service etc. through a franchised outlet or outlets (which are legally separate entities). A franchisee must operate the outlet in accordance with the franchisor's 'blueprint' or 'format' (i.e. the procedures and regulations relating to the daily operation of the business) devised by the franchisor and set out in the franchise contract (Price, 1997; Stanworth and Curran, 1998; Stanworth et al., 2004). Franchise activity can be found therefore in most sectors of the economy: in both 'blue' and 'white collar' sectors, such as, retailing, hospitality (i.e. fast food and hotels), health and beauty, home maintenance, construction, domestic cleaning, distribution and delivery, professional and business services (e.g. consultancy, recruitment, accountancy), reprographics, printing and photo processing. As Curran and Stanworth, (1983, p9) observe: "*franchising is a widespread business form encompassing a wide and diffuse range of economic activities.*"

The growth of the franchise business form and increasing economic significance and international scale of franchise activity has led to a burgeoning academic literature on the topic with "*this organisational form assuming an increasing importance in a*

*number of academic debates*” (Price, 1997, p90). However, the franchise literature is fragmented and limited in an academic sense and with a narrow disciplinary and topic focus (Elango and Fried, 1997; Hoy *et al.*, 2000; Price, 1997). The majority of the academic franchise literature originates from the business, management and economic disciplines (Stanworth, 1994; Price, 1997). Moreover, there has been a tendency to concentrate on a narrow range of themes within the literature. Many researchers argue, therefore, that the franchise business form is an understudied area of activity given its economic significance and international prevalence (Bates, 1995; Fenwick and Strombom, 1998; Knight, 1984; Withane, 1991).

Indeed, it is argued here that franchising is inherently geographical and that a geographical perspective of franchise activity is a valuable line of academic inquiry: issues of expansion, location, territory and local market environment are central to franchise activity. This article focuses on the first of these which is spatial expansion. As franchising is used as a strategy for firms to achieve expansion, it is something of a paradox that *how* expansion is achieved has not been rigorously examined in the academic literature. In other areas of economic activity – manufacturing and other service based sectors – the expansion process has been well-documented (Chapman and Walker, 1991; Hamilton, 1979; Hayter, 1997; Jones, 1981; 1982; 1988; Jones and Simmons, 1990; Keeble, 1976; Laulajainen, 1987; Mercurio, 1984; Sparks, 1986; Taylor, 1975; Watts, 1980). Spatial expansion of franchise systems has been examined at the international level within the franchise context (e.g. Aydin and Kacker, 1989; Fladmoe-Linquist, 1996; Hackett, 1976; Hopkins, 1996; Hoy and Hoy Echegaray, 1994; Hoy *et al.*, 1998; Kedia *et al.*, 1994; McCosker and Walker, 1992; Preble and Hoffman, 1995; Shane, 1996b; Walker and Etzel, 1973; Walker, 1989).

However, very few studies have examined the expansion process of franchise firms at the *national* and *sub-national* level. This neglect is surprising, particularly as most franchise systems are *not* international operations Price (1997). Therefore, little is understood about how franchise systems expand within *national* boundaries.

This is as a result of the limited research, in both the geographical and franchise literatures, which has examined franchise system expansion at the national level. There have been only two explicitly geographical studies that have examined the spatial expansion of franchise systems - KFC in the UK (Newby and Hardwick, 1979) and McDonalds in the US (Aspbury, 1985). Both studies employed spatial diffusion and central place theories as frameworks of analysis in which to understand the expansion process. Similar to the expansion patterns outlined by research which has examined other service-based activity, these studies also suggest that the two fast food systems expanded in a hierarchical manner, opening franchise units in cities and large towns, thereby colonising the main population centres first. Over time, franchise units were also opened and operated in smaller settlements. However, expansion did not occur in only a hierarchical manner and furthermore, expansion and the pattern of expansion was not determined solely by franchisors. Once established in a location, the local expansion of a franchise system was facilitated by a 'contagious' or 'neighbourhood effect' whereby interpersonal contact and communication spread the franchise concept to the market and to potential franchisees within an area, via existing franchisees. Existing franchisees were also responsible for determining the pattern of expansion in localised areas: Aspbury (1985) found that some of the more successful McDonald's franchisees became multi-unit franchisees and located additional outlets within their localised area.

Attempting to understand the spatial expansion of the KFC and McDonalds franchise systems through the framework of spatial diffusion and central place theories is a useful starting point for offering insights into the franchise expansion process.

However, a major limitation of this approach, as Aspbury (1985) concedes, is that spatial diffusion does not adequately address the question *why* the firms expanded in the way they did. The main weakness of both studies is that neither attempts to fully understand or explain the spatial patterns evident in both networks in terms of underlying *firm decision making processes* and *firm expansion strategies*. For example, Aspbury (1985) contends that the hierarchical expansion evident in the McDonald's network is related to market potential and demand, where the firm may have entered largest markets first because such markets would have proportionally more potential entrepreneurs than smaller markets. This availability of potential franchisees would have facilitated early growth of the system. However, it is difficult to know if a hierarchical strategy was what the firm originally intended, as the firm's underlying reasons and motivations were not addressed by the study.

A further limitation of the Newby and Hardwick (1979) and Aspbury (1985) studies is that both systems used in the research are in the fast food sector. As business format franchising is a heterogeneous activity, the findings from these studies may not be applicable to other sectors. Knowledge and understanding of how franchise systems achieve expansion is therefore limited, in terms of its sector focus.

However, more recent research has attempted to examine the expansion strategies of franchisors in the UK (Forward and Fulop, 1995). Although the franchise expansion process was not the main focus of the research, the findings from this study suggest that firms had either site-led or franchisee-led strategies for achieving spatial

expansion. With a franchisee driven strategy, franchisees were recruited to a network first and then suitable sites were found. With a site driven strategy, sites in which to locate were found first and then suitable franchisees were recruited to a network. Although these findings are insightful and Forward and Fulop (1995) attempt to explain the decision making processes underlying franchise expansion the research was only conducted with a small number of franchise systems (n=9). Thus, such strategies may not be in use in other UK based franchise operations, and generalisations become difficult.

Therefore, in light of the weaknesses of extant literature, there is a need to clearly understand how franchise systems achieve spatial expansion by examining the growth strategies that are used by firms. Undertaking an in-depth examination of this issue, will enable observations of empirical regularities in franchise spatial expansion and from a practical perspective, this could help new firms embarking upon franchising assess and face the challenges and issues associated with the expansion process.

### ***AIMS AND METHODOLOGY***

Two main questions for investigation arise. In order to understand *how* firms expand, it is first necessary to examine *why* firms use franchising to achieve expansion, as this is the first decision making process undertaken by a potential franchisor. One of the dominant themes examined in the academic franchise literature is the question of why firms franchise. One of the main explanations - the resource constraints perspective - is implicitly geographical, as the theory explains the use of franchising as a way to achieve *rapid* spatial growth by accessing vital expansion resources of the franchisee. Therefore, the first question will assess whether firms in the current study use

franchising to achieve rapid spatial growth or use franchising for other potential benefits by asking:

***1.) Why do firms expand by using the franchise method?***

The second question will address how firms achieve growth by examining the strategies which are used to achieve spatial expansion. In so doing, the study offers the first in-depth analysis of the spatial decision making processes of franchisors from across different sectors of franchise activity and from within the UK:

***2.) How do franchisors achieve spatial expansion – what strategies are used to achieve growth within the UK?***

In addressing these questions by means of a survey of a broad range of firms from across the different sectors of franchise activity, this paper aims to understand the underlying firm decision making processes and expansion approaches that are used to embark on and achieve franchise network growth within the UK. It does this by adopting an exploratory qualitative approach - using in-depth interviews with a small sample of firms - which enabled access to underlying reasons, motivations and decision-making processes of key agents (directors/managers/owners) in franchise operations and facilitated an understanding of a firm's behaviour and activities. Forty interviews were conducted with UK-based franchisors (which includes the UK master franchisee for some international franchise systems). The selection of firms was dictated by the issue under consideration: with the focus of inquiry on spatial expansion and rationalisation of franchise systems (part of a wider study, see Cox, 2002) selection of the sample was deliberately restricted to established franchisors who would, by definition, have had some experience of expanding, operating and restructuring franchise systems. Therefore, firms had to have at least ten franchise

units in order to be considered for inclusion. In addition, in order to reflect the diversity of franchise activity, the sample comprised approximately equal numbers of firms across six sectors: retail; fast food; personal services; distribution; business-to-business; and industrial and commercial. In most cases firms were identified from the *UK Franchise Directory*. A small number (n=5) were approached on the basis of recommendation or pre-existing contacts. A total of 80 franchisors were approached: non-responses were related to difficulties in making contact with the Managing Director or Franchise Director and the general 'interview fatigue' amongst the bigger franchisors in particular. Most of the questions were open-ended, and interviews were recorded and transcribed.

#### TABLE 1 ABOUT HERE

The characteristics of the sample are shown in Table 1 (see Cox, 2002, appendix 3, for further details). The absence of franchisors less than five years old reflects the requirement that firms should have at least 10 franchised units. The majority of respondents had between 10 and 49 franchised outlets (37.5%) or 50-99 franchised outlets (35%). However, the size of some of the respondents is understated because these figures do not take into account master franchises which have their own franchisees. For example, one of the retail franchises had 36 area franchises which together operated approximately 1,500 units. The majority of the respondents had their head office in London or the rest of the South East of England.

## ***REASONS WHY FIRMS FRANCHISE***

The majority of firms in the sample franchised operations because the method enabled access to vital resources (the financial and human capital of the franchisee), which facilitated rapid organisational and spatial growth; a finding which supports the resource constraints theory of franchising. The resource constraints perspective contends that franchising is used as a method to gain access to franchisee resources (financial capital, human capital and local market knowledge) which enable a firm to realise growth (Hoy *et al.*, 2000). The firms in the present sample identified financial capital as the most important resource to access. Franchisee funds are an effective source of expansion capital as a franchisee provides capital not only through an initial fee for the franchise format, but also through ongoing royalty fees which can facilitate further expansion of the franchise network (Curran and Stanworth 1983; Dant, 1995). Rapid expansion is therefore possible because a firm is not reliant on financial resources of retained profits or debt-secured finance, as company-owned chains can be, for example (Kaufmann and Dant, 1996).

The alternative theoretical perspective to the resource-base explanation of franchising - agency theory - attempts to explain franchising as an effective way of addressing the classic problem between a principal (an owner of an outlet) and an agent (a manager of an outlet). Principals may not know if an agent is 'shirking' and insufficiently promoting an owner's interest without the aid of costly monitoring mechanisms. Agency theory argues that franchising effectively addresses the shirking problem as it aligns the interests of the agent (the franchisee) with those of the principal (the franchisor) by forging links between franchisee compensation and performance. As a franchisee has a financial interest in the business as an owner-operator of a unit, it is

assumed that they will be more motivated to make the business succeed. This will also lower the propensity to shirk, as any shirking will reduce profit and compensation for the franchisee. Subsequently, the need for supervision and monitoring are greatly reduced, although not eliminated (Kirby and Watson, 1999; Shane, 1995).

Only a minority of firms (7) cited reasons associated with agency as the motivation for adopting a franchising strategy. According to these firms, franchisees were more highly motivated than managers/employees and offered higher levels of commitment and standard of service which, franchisors maintained would have been less evident in manager-run company-owned units. Such benefits arose because a franchisee had invested his/her own capital in the business and was therefore more motivated to make it succeed. Indeed, six of the seven firms had tried company-based expansion before embarking on the franchise route. These firms decided to use the franchise method as a means of overcoming the problem of agency in poor performing company-owned/manager-run outlets.

The remaining 15 firms in the sample stated that their motivations for franchising were *both resource and agency related*. Combining access to financial capital with highly motivated unit owner-operators were key benefits of the franchising method for these firms. Therefore, it is argued here that both theoretical explanations *in combination* can provide greater insights into the reasons why franchising is used as a strategy to achieve growth.

Firms also identified some of the problems, which can occur with franchising. The main disadvantages were lower profit margins and the difficulties of maintaining control over franchisees. For firms in this sample, the disadvantages were a trade-off franchisors were willing to make, as these firms believed the advantages of the franchise method outweighed the disadvantages. In summary, this section has sought to examine why firms franchise. However, the decision to franchise is only the first part of the organisational and spatial expansion process. Therefore, the following section addresses the second research question of the paper, namely how firms expand and the strategies that are used to achieve growth.

### ***THE LIFE CYCLE MODEL OF FRANCHISE SPATIAL EXPANSION***

Current understanding of the spatial expansion issue is limited. Examining spatial expansion strategies has the potential to assist new firms about to embark on franchising with the expansion process and help them anticipate some of the problems and challenges of expansion. However, whilst the original research question proposed to examine expansion strategies, it is evident from the findings that spatial expansion needs to be considered in a 'life cycle' context. In other words, spatial expansion - and the strategies that are used for this - is not a static process (Forward and Fulop, 1995), but rather the expansion process is a dynamic one, occurring over several identifiable stages with strategies altering over time.

Applying life cycles models to business organisations first emerged in the 1960s and early 1970s (McGuire, 1963; Christensen and Scott, 1964; Steinmetz, 1969; Greiner, 1972). According to Bouchikhi and Tornikoski (2001, p382) life cycle theory is where *“each stage of an organisation’s life is characterised by a particular*

*managerial style and a set of management problems. As the key problems change, so should the firm's organisational design configuration.*” Although there have been many different life cycle models proposed in the literature, the models all share some common assumptions. First, different stages in life cycles are sequential in nature; second, stages occur as a hierarchical progression that is not easily reversed; and third, each stage involves a broad range of life stage specific organisational activities and structures (Quinn and Cameron, 1983). For this reason life-cycle models have been criticised as being too deterministic (Kirby, 2003; Miller, 1987). However, others have argued that it is possible to identify common patterns of organisational transition that occur in firms (Kazanjian, 1988), and life cycle models add to our understanding of the complex phenomenon of growth, describing how it happens and the effects that it can have on organisations.

Indeed, life cycle or ‘stage’ models have been one of the most dominant frameworks describing the process of small business growth (Churchill and Lewis, 1983; O’Farrell and Hitchens, 1988; Stanworth and Curran, 1976). However, as Floyd and Fenwick (1999, p33) observe:

*“there has been no attempt to apply such models to franchise system growth and development, nor has any model been developed specifically for franchising. Given the strong interest in franchising at academic and professional levels, a growth and development framework for franchises is urgently needed.”*

Applying a stages model to franchising reveals that similar to small business growth, (and regardless of variation in firm sizes, sectors and capacities for growth), there is a sequence of identifiable stages common to the organisational development of most

franchise systems (Floyd and Fenwick, 1999). The five stages identified by Floyd and Fenwick (1999) for franchise system development were hatchling, nestling, fledging, adulthood and beyond adulthood. The evidence from the present study also suggests that firms undergo different stages in the process of achieving *spatial expansion* (see Exhibit 1). Like other life cycle models, the four stages of spatial expansion were generally characterised by key expansion processes.

#### EXHIBIT 1 ABOUT HERE

The first stage is the initial phase, where firms pilot the franchise concept and establish the first franchises (time phase 1). The second stage is the main 'roll out' phase, where firms embark upon nation-wide expansion and determine the strategies and methods used to achieve growth (time phase 2). The third stage is a period of consolidation where firms strengthen and reinforce their networks (time phase 3). The fourth stage for firms is maturity, a process of managing and maintaining established franchise networks (time phase 4). Some firms also seek non-domestic expansion through internationalisation activities in the consolidation and maturity stages.

The spatial expansion life cycle, like other life cycle models, is sequential and linear in nature. Once the key process of each stage has been achieved (e.g. completion of the roll out process) movement into the next stage occurs (e.g. a period of consolidation). However, the length of time spent in each stage varies from firm to firm with, for example, some firms achieving roll out comparatively rapidly (e.g. 18 months) whilst for other firms roll out was a lengthy process (12 years in one case).

The length of time firms spend in a stage is dependent upon a number of internal and external factors.

First, it is dependent upon a franchisor's strategy and ambition. The reason some firms had slow growth rates (and therefore a lengthy period in one stage) was because franchisors had decided that growth should be achieved at a manageable rate.<sup>1</sup>

Second, this decision was often related to the size of the franchisor's head office operation. If management resources and infrastructure were limited this had implications for the number of franchisees that could be recruited each year as the amount of time and support new franchisees could be given by head office personnel would be limited. Head office support can therefore play a crucial role in the early development stages of franchise networks (Mendelsohn, personal correspondence, 1999). Third, time spent in a stage was also dependent upon a firm's market positioning and level of competition. For example, the four greetings card distribution franchisors in the sample all developed around the same period (1992-1994). However, two of the firms grew rapidly within two-three years in an attempt to establish their systems as market leaders. When these firms entered the consolidation stage, the other two greetings card franchisors were still rolling out their networks.

## ***STRATEGIES AND METHODS USED TO ACHIEVE SPATIAL EXPANSION***

### ***Stage 1 – Initial Stage of Expansion***

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<sup>1</sup> Franchising is often perceived to be a strategy used by firms to obtain *rapid* organisational growth. However, some firms in the present survey found franchising attractive for reasons other than gaining access to franchisee capital to finance rapid growth: it was for agency related reasons also.

The first stage in the spatial expansion life cycle is the initial stage of expansion, where firms set up a pilot operation for the franchise system and embark on a process of establishing the first franchises within networks. Previous industrial location literature (including both the manufacturing and service sectors) has shown that the initial stage of spatial expansion is characterised by growth occurring either in, or locationally near to, the home base or home territory of a firm (Chapman and Walker, 1991; Jones, 1988; Jones and Simmons, 1990; Watts, 1975). Therefore, the question arises whether similar geographical clustering in the early stages of expansion is replicated in franchise operations. Locating a pilot operation and the first few franchises near to a firm's home base may enable a franchisor to monitor progress closely in the early test phase as well as minimise travel costs. Indeed, Newby and Hardwick (1979) found that in the case of KFC, the early test stage and the location of the first four to five units in the mid-late 1960s did occur near to the home base of the franchisor. However, initial locational clustering of an operation may negate one of the key benefits of franchising which is the ability to achieve rapid growth and brand dissemination on a national scale. Therefore, the following section will examine whether locational clustering in the initial stages of expansion is something that occurred in the current sample of franchise firms. The discussion first outlines whether the firms established pilot operations, the reasons for this and where pilot operations were located. The section then moves on to discuss the establishment and location of the initial franchises.

### ***Pilot Operation***

It has been argued that one of the most vital components in the organisational development stage of a franchise network is the operation of one or more pilot units

as this will determine whether the franchise format has the potential for success (Falbe and Dandridge, 1992; Felstead, 1993; Forward and Fulop, 1997; Mendelsohn, 1990; Price, 1997; Stanworth, Purdy and Price, 1997).

Pilot operations were established by two-thirds of the sample, indicating that the majority of firms considered it important to test the franchise concept before embarking upon roll out. In the sample, pilot unit locations were determined by whether the pilot was company-run or franchise-run. The pilot operations that were company-run (20) were all located in the same city/town as the franchisors' head office locations. The remaining seven franchise-run pilots were operated by franchisees who determined where the pilot operation would be located. Thus, in these cases, the pilots were not related to the location of the home base of the franchisor. In half the sample, therefore, an initial geographical clustering occurred with the location of pilot units. However, as Floyd and Fenwick (1999) observe:

*“prospective franchisors should test the concept in another location before embarking on franchising because some concepts are difficult to replicate, and outlet specific factors, such as location or great staff may be responsible for the original business's success” (Floyd and Fenwick, 1999, p36).*

Half the firms in the present sample (20/40) had not tested the franchise concept in another geographical market as only one unit had been operated as the pilot, which was also corporate-run and not *franchise-run*. Additionally, a number of other firms (13) had not piloted the *franchise* operation but instead relied upon previous operating experience of running corporate units. For those firms that did run pilot operations, establishing test units in the same location as the head offices enabled them to be easily monitored and supported. However, whilst these firms had 'tested' the

franchise concept, it is debatable whether they had truly 'tested' aspects of running a *franchise* operation. Firms that established pilots as franchises were the ones to comment that they had mostly learned about operational aspects of franchising, such as managing the franchise relationship. For firms with company-run pilots, learning about running a franchise operation developed at a later stage when the first franchisees were recruited to networks. Whilst this did cause some initial 'teething' problems, it did not affect the long term viability of the firms.

### ***Location of First Franchises***

For the majority of firms in the sample, the first franchises established in networks did not occur in clusters around the home base of the franchisor. Instead, initial expansion occurred on a wider geographical scale. This finding does not, therefore, support the existing literature, which has examined the expansion process in the manufacturing sector and other types of service activity (Chapman and Walker, 1991; Jones, 1988; Jones and Simmonds, 1990; Watts, 1975). However, the lack of initial growth clusters in franchise operations can be explained by two possible factors. First, as the section on why firms franchise confirmed, franchising is often used by firms as a strategy to achieve rapid growth. If expansion is constrained to one area, this is perhaps counter-active to achieving growth *rapidly*. Expanding and operating a more dispersed network can achieve greater and more rapid brand dissemination in the early stages of growth and allow a franchise to become established and known on a broader geographical scale and 'seed' localised markets. Second, in the manufacturing sector or other service activity the expansion process will not necessarily be determined by a second party (the franchisee) and this factor can also explain why expansion did not occur in an initial cluster for the majority of firms. However, the franchisors did admit that an initial expansion strategy which occurred

on a wider geographical basis sometimes caused operational difficulties with, for example, managing and supporting franchisees if they were located across the country.

However, there were a number of firms in the sample (16) in which initial expansion did occur in a cluster around the home base of the franchisor. Although these firms identified a number of operational advantages to locational clustering or controlling growth within an area, there were also trade-offs to this initial expansion approach. Restricting expansion to a specific geographic area could potentially discourage potential franchisees attracted to the system, and franchisors sometimes lost opportunities to develop a territory or a location because of this.

### ***Stage 2 – The Roll-Out Stage of Expansion***

After establishing the pilot operation and the first franchises, the sample firms entered the roll out stage – the main period of expansion. Only ten firms were currently in the main roll out stage; all the remaining firms in the sample (30) had passed through this stage. Roll out is the stage where firms determined the strategies and methods that were used to achieve expansion. Three types of strategies could be identified: proactive, franchisor-led strategies, where firms pre-determined territories or expanded through both the corporate and franchise route (Strategy 1); reactive, franchisee-led strategies where firms waited for franchisees to determine franchise development (Strategy 2); or a mixture of both (Strategy 3). Single unit operators was the main *method* facilitating expansion in this stage. However, a small minority of firms used the area, or master, franchise method.

*Strategy 1 – Franchisor-Led:* Strategy 1 was a franchisor-led approach to growth with franchisors determining the roll out process and deciding where the franchise will develop. Under this approach, franchisors either expanded through both the corporate and franchise route (Strategy 1a) or predetermined the territorial basis of a network (Strategy 1b). Whilst Strategy 1a is self-explanatory, Strategy 1b warrants further explanation. Seventeen of the sample firms predetermined the territorial allocation of their networks before recruiting franchisees in the main roll out phase of expansion. These firms divided the UK into a master distribution plan of territories, with franchisors determining locations/areas where they wished to establish units. Small-scale territories were then allocated around locations/areas where units would be established and based on operational requirements. The majority of this group of firms (13/17) were mobile operations. Therefore, it was a necessary operational requirement for franchisors to allocate franchisees with clearly defined areas in which to work. The remaining four firms (4/17) that used strategy 1b were locationally based firms and not mobile operations. These firms pre-determined the territorial allocation of their networks because of the *method used to franchise*. The method used to franchise was an integral part of the expansion approach used in the roll out phase of growth, as all four firms used area franchising. Therefore, pre-determining the territorial basis of a network was necessary for the establishment of area/regional master licences, which were granted to franchisees. Territories were also large-scale geographical areas compared to the other firms that pre-determined territories. Franchisees would be given the development rights to a territory and have an agreement to open ‘X’ number of units over a specified period of time.

*Strategy 2 – Franchisee-Led:* Strategy 2 was determined by the franchisee. The franchisee determined the ‘roll out’ process of franchise units, deciding when and where the franchise developed. There were two types of franchisee-led strategies. The first strategy was locationally/territorially dependent (Strategy 2a) whereas, the less common, second type, of approach did not entail the franchisee being locationally/territorially dependent (Strategy 2b).

*Strategy 2a - Franchisee-Led: ‘Bespoke’ Approach:* The majority of firms in the sample (20/40) had a ‘bespoke’ approach to growth in the roll out expansion stage. This confirms Forward and Fulop’s (1995) finding that most of the franchisors in their sample had franchisee-driven procedures for achieving expansion. The bespoke approach is a somewhat ‘unplanned’ way of achieving expansion, as franchisors rely on franchisees to determine when and where the franchise develops. The bespoke approach illustrates the differences between corporate expansion and franchise expansion. With corporate expansion, a firm determines when and where the firm will open units. Zellar et al., (1980) have questioned whether franchisees play any role in the locational decision making process of franchise expansion. Clearly for firms adopting this approach the franchisee initially determines where the franchise will develop.

However, whilst the approach is initially determined by the franchisee, franchisors have the ultimate decision determining whether the sites/locations where potential franchisees propose to open franchise units are viable. If locations are not viable (for reasons such as insufficient population, lack of customers, too much competition) the franchisor does not allow the franchise to develop in such locations/areas. However,

suitable alternative locations were sought with potential franchisees. In those cases where franchisors allocated territories, these were then allocated around the location of the unit. In many cases, franchisors had informal plans of locations or areas where they thought there was potential for the franchise to develop. Thus, the dual decision making process of both franchisor and franchisee determines spatial expansion. The types of firms that adopted this approach were not limited to any particular sector or type of operation (i.e. mobile or location based). In fact, the approach was used by firms across the six different sectors of activity and by both types of operation.

*Strategy 2b – Franchisee-led: Locationally Unconstrained Operations:* Two business-to-business franchisors had a locationally unconstrained approach to growth. Both firms did not allocate defined territories for franchisees to operate in and nor were franchisees tied to specific locations. The franchisors did not allocate territories or sites as it was considered an unnecessary operational requirement which would have restricted business. As both franchises operated with franchisees being specialist experts in one area (e.g. energy-cost management or pharmaceutical recruitment) a franchisee's 'market' was not constrained to clients in one geographical area, but was instead spread throughout the country. Franchisees could decide therefore where they 'located' their businesses (i.e. geographically as well as home-based/office-based), which meant that franchisees could be located in the same city or town but working in different specialist fields. However, market overlapping or 'poaching' of customers did not occur within the networks because the franchise operations were structured so that this did not occur.

*Strategy3 – Hybrid: Franchisor and Franchisee-Led:* As Forward and Fulop (1995) observe empirical matters are rarely clear-cut. As with their sample, where franchisors had both franchisee and site driven strategies for achieving growth, so a small number of firms in the sample (4) had a dual approach to achieving growth in roll out, which was determined by *both the franchisor and the franchisee*. The firms in this category first had a bespoke approach for achieving expansion, with franchisees determining the roll out process of franchise units. However, these firms also had a more proactive approach to achieving growth than simply waiting for franchisees to be recruited to the network. Thus, the franchisors also determined growth by expanding through company owned and operated units. For these firms company expansion and a site driven policy for achieving growth was a solution to the difficulty of attracting and recruiting suitable potential franchisees, a strategy firms also used in the Forward and Fulop (1995) sample. Firms used corporate units in two different ways. First, site-led corporate infill was transitory (Strategy 3a). The franchisor identified and bought company-owned shops with the intention of franchising these units when suitable franchisees were found in such locations. Second, corporate ownership in conjunction with a franchise strategy was an intentional part of achieving expansion (Strategy 3b). Company-owned stores were used firstly as a response to the difficulty of recruiting potential franchisees for locations identified as suitable sites for development, and secondly, so that franchisors could access two profit streams.

In sum, roll out is the main stage in the expansion life cycle for achieving growth. The firms in this sample had similar strategies to those identified by Forward and Fulop (1995), where firms had either franchisor or franchisee-led approaches for the

expansion process, or a combination of both franchisor and franchisee-led approaches (hybrid). Single unit operators was the main method facilitating expansion, although a minority of firms used area franchises to expand.

### ***Stage 3 – Consolidation Stage***

Subsequent to the main roll out phase of expansion, firms entered a stage of consolidation. Thirty of the sample firms were currently in, or had undergone this expansion stage (21 firms were currently in consolidation, the remaining nine were in maturity). After the sample firms achieved a certain amount of geographic coverage, networks were strengthened and reinforced. Regardless of the expansion strategies and approaches used in the main roll out stage of development, strengthening and reinforcing networks involved the same issue for firms: filling network gaps that were planned at roll out where franchisors wished to locate and have unit representation. In addition to infilling networks gaps, a second process also occurred for some firms in the consolidation stage. This process helped firms achieve consolidated networks but arose because new market opportunities, which were not planned or predicted by firms at roll out, arose over time. Shifting demographics, competitive pressures and factors internal and external to the system make it difficult for a franchisor to predict the saturation point of a franchise system. Therefore, the second process, which occurred in the consolidation stage, was to fill new market opportunities that arose in networks over time. For some firms, changing levels of market potential and opportunities to develop new units meant that networks had to be restructured and territories altered to accommodate new and existing franchisees/units.<sup>2</sup>

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<sup>2</sup> This issue is discussed in a forthcoming paper, Cox and Mason, 2005.

There was also one further expansion process that occurred with some firms in this stage. Whilst the majority of franchisors, in the consolidation stage attempted to achieve consolidated networks on a UK scale, a number of firms (9) additionally took the opportunity to develop and expand internationally and establish master licences in European countries. For some of these firms this was a reactive strategy to potential master franchisee enquiries, but for others internationalisation was an intentional franchisor-led strategy, where new international expansion opportunities were sought. However, as the aim of this study was to examine expansion on a *national* scale this issue is not discussed further.

As in the roll out phase, the strategies and approaches used to consolidate networks differed. As with the previous phase of spatial development, expansion was determined by the franchisor, the franchisee or a combination of both. The majority of firms continued to be reactive and wait for franchisees to approach the system (a franchisee-led approach). However, marketing, promotion and advertising became more specific and proactive in response to greater locational constraints. Locationally mobile franchisees were also seen as a solution to overcoming the difficulty of infilling, although only in a minority of cases were franchisees willing to relocate. For a minority of firms, more proactive expansion strategies were used in the consolidation phase than were used in the roll out phase of development (a franchisor-led strategy) as they opened and established corporate units to overcome the infilling problem. Altering the method of franchising used in the roll out phase of expansion (i.e. developing existing single unit franchisees into multi-unit franchisees) was a way for firms to fill gaps in their networks (a franchisor and franchisee-led strategy).

#### ***Stage 4 – Maturity Stage***

For the nine firms in maturity, this stage was characterised by managing and maintaining franchise networks. This involved three activities. First, the majority of firms maintained networks by managing the renewal and resale of franchise units, with some firms additionally embarking upon new expansion phases within the UK. Thus, expansion was not restricted to only the initial stages of growth. Second, a minority of firms sold their networks to larger corporations and thirdly, some firms sought new expansion opportunities external to existing networks by developing new franchise concepts and systems or internationalising operations.

### ***CONCLUSIONS***

Franchising is a strategy that enables a firm to achieve rapid spatial and organisational growth. Paradoxically, *how* expansion is achieved has not been examined rigorously or extensively by extant research. Therefore, this paper has sought to understand the spatial expansion process of franchise systems in the UK in order to redress this neglect. Two key questions were addressed: why firms franchise and how franchise firms achieve spatial growth.

The first process of expansion is for a firm to decide to use franchising as a means to achieve growth. In examining this issue, the first part of this paper has contributed to existing theoretical debates, which have sought to understand why firms franchise.

Although agency theory has assumed predominance in extant literature, the evidence from the current study highlights the importance of the resource-constraints theory as an explanation for why firms franchise. A key advantage of franchising identified by this theory, and confirmed by the majority of firms in the present sample, is the ability

to utilise the financial and human capital of the franchisee to realise rapid spatial expansion. However, a number of firms in the present sample also cited that it is because of *both* resource and agency related advantages that the decision to franchise was taken. Therefore, the first conclusion is that whilst, separately, both the resource and agency perspectives can aid explanation of why firms franchise, it is a more balanced view - incorporating both perspectives – which can provide more detailed insights for understanding the reasons franchising is used as a strategy to achieve expansion.

The life cycle model is the conceptual framework – utilised in other areas of organisational literature – which has been developed in this paper to understand the spatial expansion process of franchise systems. Through use of this model, the article has provided new exploratory insights into how franchise operations achieve expansion with the strategies and methods that are used to grow and develop over time.

Four key stages have been identified in the life cycle. The first stage of the spatial expansion life cycle is the initial stage, characterised by the piloting of the franchise operation and the establishment of the first few franchises. The second stage is roll out, the main period of expansion, characterised by firms determining (or continuing from the initial stage) the strategies and methods used to achieve nation-wide expansion. The third stage is consolidation, characterised by the strengthening and reinforcing of networks by filling locational gaps. While the last stage, which only a few firms in the sample appear to have reached, is maturity.

The second conclusion is that the four stages of the life cycle model demonstrate and enable insights into the generalisability and empirical regularities of the spatial expansion process. The firms in the current sample progressed through different stages of growth, characterised by key spatial developments. However, the strategies and methods used to achieve expansion varied inter- and intra-sectorally and few clear trends were evident within the sample. Whether a firm used a franchisor-led strategy, a franchisee-led strategy or a combination of both for achieving expansion was not sector specific nor determined by the type of operation (i.e. mobile/location-based).

The third conclusion is that the lack of clear trends regarding expansion strategies, whilst reflective of the broad sectoral range included in the current sample, demonstrates more significantly that franchising – despite often being treated as a homogenous economic activity (by the academic and practical literatures) – is heterogeneous in nature. The methodological approach used in this study has therefore enabled greater insights to be gained and given a more accurate representation of the nature of franchise activity.

The lack of distinction in understanding which strategy is used by a specific type of firm from a particular sector of activity demonstrates that other factors are responsible for determining the expansion process. Therefore, the fourth conclusion is that it is the *key actors* in a franchise system – both the franchisor and the franchisee – and their underlying decision-making processes that determine the strategies and methods used to achieve expansion. The franchisor may predetermine territories, open corporate units, or simply wait for a franchisee to determine when and where the franchise system will develop locationally. Indeed, it is this factor, that a second

party (i.e. the franchisee) plays a key role in determining the expansion process, which distinguishes franchise expansion from manufacturing and other types of service based expansion.

Therefore, this paper has argued that previous academic literature, which has examined the spatial expansion issue (Newby and Hardwick, 1979 and Aspbury, 1985) is limited, as its emphasis has been to describe patterns of franchise system expansion rather than the *processes* causing these patterns. It is evident from the findings that it is the combined decision making processes of both the franchisor and the franchisee that determine spatial outcomes. More recent academic literature (Forward and Fulop, 1995), which has examined the strategies franchise firms use for achieving growth, is also limited. This research focuses on only one stage (roll out) in franchise system development and does not take account of the dynamic nature of network development. However, the spatial expansion life cycle developed in this paper captures the dynamic element of the expansion process, illustrating that strategies and methods alter over time according to the stage of development.

### ***Practical Implications, Limitations and Future Research Avenues***

The findings from this study highlight a number of management challenges inherent in unit and network growth. There is potential for new or established franchise systems to benefit from these findings. Such advantages have also been highlighted by other types of organisational life cycles (e.g. Churchill and Lewis, 1983). In a practical context, the expansion life cycle model can provide an informative framework to guide firms intending to franchise. Knowledge of each of the expansion stages can enable an existing franchisor, or a potential franchisor, to better understand

the processes and possible problems associated with each stage, as well as anticipate any challenges of future stages. For instance, in the early stages of growth, establishing a pilot can substantially add to the time and financial costs of developing a franchise operation. The advantages and disadvantages of allocating territories and exclusivity will also need careful consideration by new franchisors. In latter stages of network development, franchisors may have to consider more locationally targeted marketing and advertising campaigns, or alter methods used to franchise (e.g. from single-unit franchisees to multi-unit operators) to fill gaps in networks. Network restructuring may also be necessary in latter stages of development but the legal and practical implications of territories and exclusivity - allocated in earlier stages - may have an effect on a franchisor's ability to restructure.

The life cycle model captures the dynamic nature of franchise system expansion over time and space. However, the study has been conducted in only one spatial context - the UK. There is potential, therefore, for the expansion life cycle model to be transposed to other contexts and the model's applicability to different countries and economies could be tested to assess comparability in type and sequencing of expansion stages. As this paper has examined only *national* expansion, the life cycle model could also be tested on a larger geographical scale (i.e. internationally) to explore whether similar or different expansion processes and stages occur in the international expansion process. Such future research would generate further insights and observations of the empirical regularities and irregularities of franchise system expansion.

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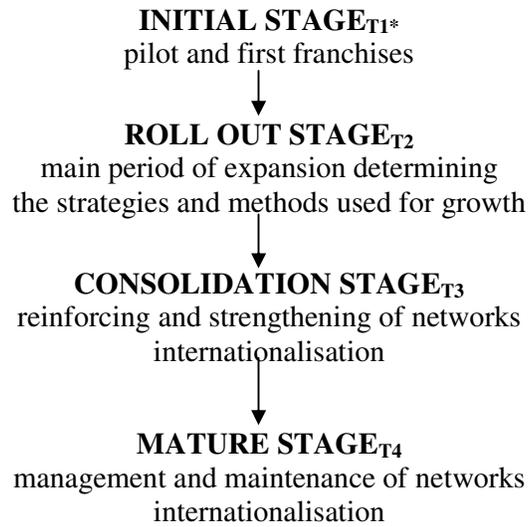
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*Table 1 Sample Characteristics*

| <b>Franchise age (year of first franchise)</b> | <b>N</b>     | <b>%</b> |
|--|--------------|----------|
|  | (total = 40) |          |
| 0-5 years                                      | 0            | -        |
| 6-10 years                                     | 13           | 32.5     |
| 11-15 years                                    | 10           | 25.0     |
| 16-20 years                                    | 8            | 20.0     |
| 21-25 years                                    | 4            | 10.0     |
| 26+ years                                      | 5            | 12.5     |
| <br><b>Sector</b>                              |              |          |
| retail   | 5            | 12.5     |
| fast food                                      | 5            | 12.5     |
| personal services                              | 10           | 25.0     |
| distribution                                   | 10           | 25.0     |
| business-to-business                           | 5            | 12.5     |
| industrial and commercial                      | 5            | 12.5     |
| <br><b>Size (number of franchise units)</b>    |              |          |
| 10-49  | 15           | 37.5     |
| 50-99  | 14           | 35.0     |
| 100-149  | 4            | 10.0     |
| 150-199  | 3            | 7.5      |
| 200+   | 4            | 10.0     |
| <br><b>Location of HQ</b>                      |              |          |
| South East                                     | 30           | 75.0     |
| South West                                     | 5            | 12.5     |
| North  | 2            | 5.0      |
| Midlands                                       | 2            | 5.0      |
| East Anglia                                    | 1            | 2.5      |

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*Exhibit 1 – The Spatial Expansion Life Cycle of Franchise Networks*



\*T1 = Time Phase 1

# ARE SMALL ENTERPRISE DEVELOPMENT STRATEGIES UP TO THE CHALLENGE OF ECONOMIC DEVELOPMENT?

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## ABSTRACT

The paper discusses the future of small enterprise development as a viable tool for economic development and it makes two arguments. First is that small enterprise development as a tool for providing greater economic security for the poor needs to be integrated into the larger economy. Consistent with the theory of property rights we argue that small enterprises stand a better chance of both integration in a value chain and benefiting from such integration when there are opportunities for producer participation in ownership as a product moves up the value chain. Second is that entrepreneurial ventures in developing countries need sources of financing beyond microcredit. There is no doubt that microcredit has an important role to play in improving the lives of the poor. However, as a source of finance for small enterprises, microcredit has at best a tangential role.

We present cases of enterprise development in India and Nepal to illustrate the arguments in the paper. Specifically, we include the experiences of Chamoli Tasar Pvt. Ltd. (value adding activities in the tasar silk subsector), Dev Bhoomi Madhu Pvt. Ltd. (bee keeping and honey processing), Humla Oil Pvt. Ltd. (distills essential oils and markets them), Mallika Handmade Paper (handmade paper and paper products from lokta) which are all producer owned companies, as well as the experiences of Dolaka Cooperative Society (a cooperative involved in the cultivation, harvesting and distillation of wintergreen oil).

## INTRODUCTION

Facing a business environment of increasing globalization micro and small enterprise development models must come to grips with new economic realities if they are to gain relevance as tools for economic development. This means shedding outmoded ideas and strategies, some of which are dearly held, and adopting more progressive ones that can help to level the playing field somewhat, giving small enterprises a stronger opportunity to develop and compete.

If enterprise development is to play a significant role in economic development – making a meaningful contribution to alleviating the problems of pervasive global poverty then it is clear that a new strategy is needed. In his path breaking work The Fortune at the Bottom of the Pyramid, C.K. Prahalad (2005, p. ix) sums up this point concisely. “It was also clear that we have to start with a new approach, a ‘clean sheet of paper’. We have to learn from the successes and failures of the past – development aid, subsidies, governmental support, localized nongovernmental organization (NGO)-based solutions, exclusive reliance on deregulation and privatization of public assets ... has not redressed the problems of poverty”. More and more, economically insecure households and communities are demanding income generating opportunities that go beyond what traditional agricultural and rural development has to offer. Micro and small enterprise development will have to provide many of these opportunities if it is to play a significant role in economic development and poverty alleviation.

This paper looks at two aspects of enterprise development, the need to integrate micro and small enterprise development into the larger economy and the role of financing in this process. There are some major implications here. One is that the promotion of local solutions and local entrepreneurship without linkages to the wider economy has not made much of an impact in reducing poverty. The other, that microfinance (the latest “silver bullet” of the development community) is fine up to a point but does not adequately address the substantial credit needs of small enterprises if they are to graduate from the informal to the formal sector economy in order to make a more sustainable contribution toward the alleviation of poverty and to economic growth.

## **THE ECONOMIC ROLE OF SMALL ENTERPRISE DEVELOPMENT**

Small enterprises have long been recognized as an important component of poverty alleviation and economic development, but attempts to promote them in a systematic and effective manner have not met with great achievement. Successful enterprise promotion programs remain more the exception than the rule. The traditional “livelihoods” model of enterprise development most often viewed enterprises in a vacuum, as entities unto themselves. There was little or no attempt to place the livelihood within the context of the larger economy and no attention was paid to identifying backward and forward linkages that could strengthen the enterprise’s viability and chances of succeeding. In the worst of such cases, livelihoods were developed without even a thought being given to markets. The wisdom prevailing in such cases was that if one could grow or make a product, one could certainly sell it. Far more attention was paid to identifying and transferring technologies and techniques and markets were assumed to be readily available.

The new theories of industry evolution argue that entrepreneurship and small enterprise development<sup>1</sup> contribute significantly to the growth of national economies (Jovanovic, 1982; Klepper, 1996) and that this impact is even more pronounced in globalized knowledge-based economies (Audretsch, 2004). A number of studies in OECD countries examined a link between entrepreneurship and macroeconomic performance showing that in recent decades the entrepreneurial activity had a positive effect on the output growth (Carree and Thurik, 1998; Reynolds et al., 2000). The evidence is less compelling for developing countries. Studies in several African countries point to the reverse and negative relationship: periods of rapid economic growth are characterized by the negative contribution to overall employment from net

firm creation (Liedholm, 2002). Microenterprises in developing countries are often involved in marginal activities that get replaced by higher yield activities in larger enterprises during prosperous times. However, there are high-growth-potential enterprises in both developed and developing countries that should be given special attention in public policy initiatives.

Various national and international approaches attempted to enhance capabilities and performance of SMEs in developing countries. One such example is CEFE (Competence based Economies through the Formation of Entrepreneurs), which is an entrepreneurship development program for developing countries managed by the German organization GTZ (Gesellschaft für Technische Zusammenarbeit). A relatively new approach to enterprise development has been taking shape over the past few years and is known as the Subsector/Business Development Services (SBDS) strategy (Lusby, 2002). The subsector/business service (SBDS) approach is an attempt to combine the strengths of subsector analysis and business service market development. Subsector analysis can help identify constraints to enterprise growth and competitiveness in a given subsector. Business service market development, on the other hand, provides a framework on how to promote and support commercial services that address those constraints for a large number of subsector companies. When pursued jointly, they can result in programs that have significant impact on livelihood income and stability.

The subsector approach gives more focus to the BDS strategy, ensuring that services for enterprises will continue once the program is over and that their impact will be sustained. It also shows how clear links can be established between program interventions and livelihood impact. The SBDS approach is conducive to reaching smaller enterprises, especially in rural areas due to its focus on forward and backward linkages between enterprises at all levels of the supply chain and the commercial relationships between them. It helps to bridge the process through which informal microenterprises enter the more formal economic sector (Liedholm, 2002). The SBDS approach is also instrumental in the identification and promotion of embedded services, often found in the relationships between actors in specific supply chains, which is particularly important for sustainability and efficiency of the achieved sectorial structures.

## **THE NEED FOR FINANCING IN SMALL ENTERPRISE DEVELOPMENT**

The second main area of concern in small enterprise development involves a realistic understanding of what is needed to finance small enterprises. This is the age of microcredit as the silver bullet for financing small-scale endeavors. There is no doubt that microcredit has an important role to play in improving the lives of the poor and disenfranchised and has many substantial accomplishments to its credit. However, as a source of finance for small enterprises, microcredit has at best a tangential role. Loan amounts are too small for enterprise requirements and their interest rates are too high. There needs to be more progressive thinking on how to provide finance to small enterprises with terms and conditions that are affordable.

Microfinance is the range of financial services including savings accounts, loans, and insurance schemes that are available to poor households and microenterprises and are usually managed by NGOs, cooperatives, and specially established microfinance institutions. The microfinance movement came about due to the unresponsiveness of mainstream financial institutions to credit needs of the poor. Microcredit is fine for lending at the household level or microenterprise level

where finance requirements are small and repayment can be made in a relatively short period. But credit requirements for an enterprise that needs working capital or wants to expand its physical plant cannot be met by microcredit. First of all the interest rates on microcredit loans are high, often around 18-24% and sometimes much higher and secondly, given such high rates, payback periods are short. Several recent studies argue that microfinance is more of a band aid solution rather than a policy of macroeconomic importance (Hogue, 2004; Daley and Sautet, 2005).

Furthermore there is the question of fairness. Why should a small enterprise be expected to pay such high interest rates when others are able to access credit at much lower rates? The stock answer of course is the high risk involved in loaning to this sector. But is this based on factual evidence or is it motivated by class bias? One would assume that the notion of risk of small enterprises is supported by statistics, but then if they have never had access to such credit where do these statistics come from? On the other hand the payback rates characteristic of the microcredit industry are so high – anything less than 90-95% is considered a failure – that there seems to be some justification for assuming that these sectors might well be excellent credit risks. What needs to be done is a serious analysis of risk of different economic classes and sectors that looks at hard facts and tries to chip away at class biases. One study in India on why debts go sour found that banks are often as much at fault as their debtors (Desai, 2005).

On a more positive note, the microfinance movement has created one of the most important innovations in the field of economic development in recent times – the Self Help Group (SHGs). These are self-selected associations almost exclusively women with a membership of 5-20 that form the core of the microfinance movement and are the main reason for its success. More to the point here, these SHGs are now becoming a platform demanding attention to the needs of their members for developing more income generating opportunities.

Although microfinance has proven its ability to combat poverty in the short-term, we still need to address a number of fundamental institutional concerns such as (Daley and Sautet, 2005):

- Discriminatory laws, such as those that allow only males to legally own property;
- Excessive regulation, that makes mainstream credit applications a virtually impossible process for the poor;
- Endemic corruption, particularly in the disbursement of loan funds by mainstream financial institutions that significantly increase the cost of borrowing; and,
- The lack of formalized property rights.

The agendas of development programs have to include the goal of improving availability of external financing in the developing countries. In general, start-up companies have restricted access to established funding channels (debt financing from commercial banks or leasing companies), while start-up companies from developing countries face additional challenges due to the nonexistence of equity funding sources (venture capitalists, private investors). Lack of such sources largely reflects the overall level of development in these countries, but their introduction is also hindered by the inadequate systems of property rights.

The theory of property rights focuses on how ownership of assets affects the efficiency of trading relations (Barzel, 1994; Hart, 1995) and how the state protects the benefit streams of the asset

ownership (Prasad, 2003). Systems of property rights are sanctioned behavioral norms upon which “value-creating activities are implemented so that resources can be channeled to higher yield uses” (Kim and Mahoney, 2002, p. 234). Four necessary characteristics of property rights were identified (Tietenberg, 1992, pp. 45-6): (1) universality – all resources are privately owned; (2) exclusivity – all benefits and costs accrued as a result of owning and using the resources should accrue to the owner; (3) transferability – all property rights should be transferable from one owner to another on a voluntary basis; (4) enforceability – property rights should be secure from involuntary seizure by others. All of the above conditions are rarely in place and the analysis of the property rights structure can identify problems in each of these conditions that lead to inefficient allocation of resources. Well-defined property rights are particularly important for developing countries (Prasad, 2003); however, there is often a lack of political will to institute appropriate systems of property rights.

## **RESEARCH PROCEDURE AND METHODOLOGY**

The paper draws from the experiences of a number of successful enterprises in the Indian and Nepal Himalayas taking lessons from four such cases in particular. These are: Chamoli Tasar Pvt.Ltd., Dev Bhumi Madhu Pvt. Ltd., located in Uttaranchal State of India and Mallika Handmade Paper Pvt. Ltd. and Deudhunga Cooperative in a remote western region of Nepal. One important lesson here is that if such undertakings can be successfully launched in such remote rural areas, then there is good reason to believe that these successes can be replicated elsewhere in the developing world.

We used descriptive, case study methodology to examine the two main themes in our paper: integration of small enterprise development (SED) into broader economic development and the role of financing in SED. The first author was involved in the enterprises practically from their inception and continues to be involved until the present. His involvement in these cases varies from a participant observer in the Nepal cases to a project designer, fund raiser and business development services facilitator in the two India cases.

Chamoli Tasar and Dev Bhumi Madhu have been operating for the past ten years and Mallika and Deudhunga for the past five years. 2188 men and women participate in all four enterprises. In all cases the producers/collectors participate in value addition activities beyond supply raw materials. The most pronounced example is Chamoli Tasar in which the producing community is involved at every stage of the value chain from rearing of the silkworms, to reeling and spinning of yarns, to weaving of fabric and finished products. In Dev Bhumi Madhu the producing community has an ownership position in the honey processing plant and will benefit from value addition through the revenues generated by processing, packaging, labeling and also organic certification. In Mallika Handmade Paper the community makes paper from the lokta shrub and efforts are now on to add further value to this paper by transforming it into various consumer items such as notebooks, lampshades, and screens. Finally, in the Deudhunga Cooperative the community owns and operates the distillation plant that transforms the wintergreen leaves into essential oil.

Characteristics common to all four cases<sup>ii</sup>:

- All are community owned but engage trained management for daily operations;

- All are involved in the value chain beyond the supply of raw material and employ the subsector/business development services approach to enterprise development and facilitation; and are organized as formal sector institutions;
- All are hampered by lack of access to affordable credit for both working and fixed capital, which inhibits their growth and potential;
- Women are involved throughout the enterprise and as shareholders and board members of governing bodies;
- All have a clear commitment to sustainable harvesting and use of resources and have detailed systems to assure this is achieved.

## **SMALL ENTERPRISE DESIGN IN DEVELOPING COUNTRIES: FINDINGS AND RECOMMENDATIONS**

The objective of our work is to come a step closer to a realistic and cost effective framework for designing enterprises that have clearly defined goals and activities that complement the dual objectives of conservation and economic security. Based on a systematic examination of field based enterprise activities we abstracted characteristics that are responsible for the successes of these activities and we identified and analyzed those components that did not work or required reworking to try to understand where the failure occurred.

While there are many reasons for their individual success, including highly motivated promoters, selection of subsectors with good growth potential, and adequate funding to cover their development costs, the one important feature common to all is their use of the subsector/business development services (SBDS) strategy which requires looking at enterprises as part of the larger economic landscape and linking them both vertically and horizontally within the subsector. This in turn opens up the potential for increasing the participation of the producers/harvesters/collectors at higher levels up the value chain. While both of these seem to be common sense, they are rarely practiced in enterprise development. Rather the usual practice is to look at an enterprise in isolation of the larger economy and to assume that if something can be grown or made, then it can be sold.

The most comprehensive example of facilitation of a subsector up the value chain is Chamoli Tasar Pvt. Ltd. The value chain starts with the production of eggs in an operation called a grainage (49 people). The eggs are reared (440 rearers) into silk worms which in turn become cocoons. The best quality cocoons are preserved (8 people) as seed cocoons for the next crop, while the rest are spun (179 spinners) or reeled (23) into yarns. The yarn is woven into fabric by 9 weavers, which then is sold on the market. All 708 workers are from 35 villages scattered throughout the region and all are shareholders in the business. Rearers earn on average the equivalent of \$93 for three to four months work; a single spinner can earn \$12 per month for very part time effort and up to \$51 per month for concerted effort, or with more than one spinner in the household. Reelers earn on average \$17 per month again depending on level of expertise and output. An experienced weaver can earn up to \$30 per month. In most cases several members from the same family participate in different functions with the accrued incomes resulting. All functions are decentralized and act as individual enterprises. For example the rearers are divided into 70 groups. They purchase their eggs from the company which also sells other needed supplies such as rearing tents, racks, etc. Each group of rearers is responsible for

selling its cocoons either back to the company as seed cocoon or to a spinning/reeling center. Price is based on quality of product. While reeling is undertaken jointly in centers, spinning has been completely decentralized to the household level. Again, the product is sold to the weavers who set the price based on quality. In order to generate greater economies the company also purchases some cocoons and outsources some of the weaving. The company is responsible for securing information on design and color and garment types required and passing this information on to the weavers. It is also responsible for marketing and distribution of the final product. To date the company is yet to break even so there is no issue of distribution of profits yet.

This pattern is followed though less extensively in all the other cases. In the Deudhunga Cooperative 897 families are involved in collecting wintergreen which is sold to the distillation unit for about \$0.01 per kg and transformed into an essential oil which sells for \$9.00 a liter (300 kilos of raw material worth \$3 = 1 liter of oil). Fuel and other processing costs come out to about \$2 per liter leaving a net revenue of \$4 some of which is returned to the collectors and some is spent on village improvements as decided by the shareholders.

Promoting the participation of the producers/collectors at different levels of the value chain adds to the difficulty of the task and some might argue that it is burdened with potential failures that could pull the whole effort down. However, limiting the role of producers to collecting, harvesting, or producing raw materials or minimally processed materials for sale to others is often not economically attractive for poor households. Certainly in the case of natural resource based enterprises, success depends on the participation of the collectors/harvesters/ producers as far up the value chain as possible, which has to be facilitated by appropriate ownership arrangements. Systems of property rights have to be developed as a matter of developmental public policy, participants have to be educated about various ownership options, and property rights have to be enforced and secured within the system. While this increases the complexity of the strategy, it is by no means an impossible task as is shown in the cases of Chamoli Tasar, Dev Bhumi Madhu, Mallika Handmade Paper, and Deudhunga Cooperative.

The major constraint facing these enterprises is lack of access to capital. Many people assume that microcredit is the answer to micro and small enterprise financial needs. But this is not the case. The experience of these four companies has shown that it is virtually impossible for them and thousands like them to access credit on reasonable terms. Chamoli Tasar needs \$2000 for a product finishing unit. It cannot access mainstream capital so it once again has to turn to an NGO which can find grant money to cover the purchase. The problem is that the NGO does not want to own a fabric finishing unit but it cannot in turn sell it or give it to Chamoli Tasar, a private company. This situation is repeated in many of these enterprises. For example the honey processing plant used by DevBhumi Madhu is owned by an NGO which leases it to the company. In that case when a loan application was made to a development bank, the bank would not lend to the company, but would lend to the NGO. This leads to a 'catch-twenty two' situation for such enterprises. On the one hand the mainstream financial institutions claim the enterprises have no assets for use as collateral, yet, on the other hand, they refuse to assist them in creating such assets. Mallika Handmade Paper needs funds for product development and market intelligence, but again although the company has a solid record of profitability, finance is not forthcoming. In all case these companies must rely on NGOs to find grants. A system that is

clearly not sustainable nor is it advisable for good business practices. All four companies are in need of additional financing that goes beyond the capacity of microfinance.

A comprehensive framework for small enterprise design needs to address concerns of various stakeholders at micro and macro levels: existing and nascent entrepreneurs, local governments and various societal organizations, and international community and aid organizations. These stakeholders pursue a plethora of interdependent goals: business survival and profitability, economic development, social transformation, conservation, the best practices in enterprise development and poverty alleviation.

Through the cases we examined one of the approaches to enterprise development (SBDS strategy) and identified its advantages and analyzed sources of deficiencies in enterprise development process. The majority of problems in the observed companies arise from the fact that their needs have outgrown the capacity of microfinancing and that there are no good alternatives in existence for financing high-growth-potential entrepreneurial ventures in developing countries. In developed countries, these types of companies are largely financed through private investments and venture capital; however, such sources of funds are rarely available in developing countries. Facing the increasing gap between the rich and the poor of the world, a number of current developmental initiatives are calling for 100% debt write-offs for the poorest nations in the world. The problem with this solution is that debt relief by itself is not going to induce the business start-up activities in these nations. Instead, we argue for partial write-offs, along with moratoriums on repayment of the remainder of the debts, where the balance of the available funds is used to build infrastructure for entrepreneurial activity.

## CONCLUSIONS

The paper makes two arguments. First is that small enterprise development as a tool for providing greater economic security for the poor and disenfranchised needs to be integrated into the larger economy with due attention given to backward and forward linkages and particularly to markets. Consistent with the theory of property rights (Hart, 1995) we argue that small enterprises stand a better chance of both integration in a value chain and benefiting from such integration when there are opportunities for producer participation in ownership as a product moves up the value chain. As such, the clustering that goes on to generate economies of scale among individual producers at the production level (clustering often facilitates training, technology transfer, marketing, product development, perhaps financing) needs to be replicated as far up the value chain as possible (federation of smaller clusters into value adding processing, transport, packaging enterprises). One effective way of accomplishing this is the Subsector/Business Development Services model that is concerned with the development of business service markets to support enterprise development within the context of the subsector. Companies in each specific subsector need individually tailored combinations of assistance through a variety of business development instruments (assistance in marketing, new technologies, hiring labor, product development, business advice, access to resources etc.).

The second argument is that entrepreneurial ventures in developing countries need sources of financing beyond microcredit. It is clear that the poor are doing their part in proving their credit worthiness. The development community is doing its part in designing effective business

development strategies. The ball is now in the court of the mainstream financial institutions to devise policies and operational systems that can effectively meet the needs of growing and dynamic enterprises. A parallel system such as the one that came about with the microfinance movement will not come to the rescue of the banks in this case. They themselves must step up to challenge and meet it head on.

### Endnotes

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<sup>i</sup> Audretsch (2004) argues that there are important distinctions between entrepreneurship and SME policies in terms of the policy orientation breadth, instruments, as well as in the formalization of governmental support.

Entrepreneurship policy has broader focus as it aims to stimulate creation of new enterprises beyond the existing stock of SMEs.

<sup>ii</sup> Due to the limited space in this publication, we are presenting a summary of common characteristics in the section Research Procedure and Methodology, and the most relevant findings in the section Small Enterprise Design in Developing Countries: Findings and Recommendations. Cases will be presented in their entirety in separate publications.

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# **FINANCIAL MANAGEMENT AND ANALYSIS PRACTICES IN SMALL BUSINESS : AN EXPLORATORY STUDY IN INDIA.**

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## **ABSTRACT**

“Small is beautiful” which is more relevant in India as small business units contribute nearly 40 p.c. of gross industrial value and 7 p.c. of her GDP. Small business are the only ray to hope for large number of people for survival as because most of the states are industrially backward, having poor infrastructure facilities and subsistence nature of agriculture.

Growing literature on financial management supports the argument that in small business, financial management is one of the key issues. It not only increases the success rate but also affects the level of performance of a business. This research paper reports an exploratory study by raising some queries on the financial management practices of small businesses in India and attempts to find empirical justification on the usual practices by the small business.

The research does prove that there is a wide gap between theory of financial management and in actual practices by the small business in India and show that firms not doing well are less likely to have knowledge on financial management and proper business records. While the exploratory nature of the study does not allow its results to be generalised, but suggest the need for further theory development in the field of financial management for small business and formulation of hypotheses for wider empirical analysis in future.

## **INTRODUCTION**

Small Business development has become increasingly important in recent years in both developed and developing countries (Roy and Hutchinson, 1983). In India, SSI sector contribute nearly Rs. 6.5 lakh crores (40 p.c. of gross industrial value and 7 p.c. of GDP), on the other hand small trading units contribute nearly Rs. 44,200 crores worth of value added in the country's economy (NSSO Report, 1997). Different studies have also shown that most of the new jobs created in this country come from small business. According to the survey of the World Bank in March, 1988, giving encouragement to the growth of small enterprises was the best way to benefit the masses or non-agricultural job seekers in the developing countries.

Establishment of small business units would provide the youth, their fruitful opportunities for self-expression and for increasing their natural well being. Country's younger generation feel frustrated because they do not have assurance that their education and scientific talents would be fully utilised. Therefore, increasing the small and medium sectors of our economy would strength the back-bone of society and also curb, social unrest in the economy (Barpujari, 2002). It is more so in the North-Eastern Region (NER) of India, because the states in this region are industrially backward, having poor infrastructure facilities and subsistence nature of agriculture – where small business is the only ray of hope for large number of people for survival.

Recognising the importance of small business units in the socio-economic development in India, a study was undertaken in NER of India to explore and highlight the status of financial management practices of small business. The existing literature strongly supports the argument that in small business, financial management is one of the key issue. It not only increases the success rate but also affects the level of performance. The major objectives of the study was to assess the level of perceived awareness of the owner-manager of small businesses about the tools and techniques of financial management and to examine the actual uses of financial management tools/techniques and their impact on the survival and growth/well being of the small units. The result of this study is expected to highlight the areas of accounting and financial management that require attention from the private and public organisations interested in development and growth of small business in India. In a nutshell, the study is to enquire, whether small business units which do not have to collect financial information for dissemination to others, have enough information to pursue the goal.

## **REVIEW OF EXISTING LITERATURE**

A substantial body of perspective literature has evolved dealing in whole or part with use of financial tools and techniques by the small business units. In recent times, the books written on financial management for small business emphasise the importance of developing skills in reading and interpreting historical financial statements to monitor financial health and progress (Black, 1950; Barrow, 1988; Harman, 1979; Tungale, 1952; Rauseh, 1982; McMahan, 1986; Meredith, 1986; Walker and Petty, 1986; Scarborough and Zimmerer, 1993; Kuchl and Lambing, 1994). In journals of small business, many articles strongly advocated the use of financial analysis skills for small business units (Mayo and Rosenbloom, 1975; Konstans and Martin, 1982; McMahan and Davies, 1994).

Studies have been undertaken to determine the uses of financial ratios by the small business owner managers to monitor their business performances (Lewis and Toon, 1986; Holmes and Nicholls, 1989; McMahan and Davies, 1991). Attempts have been made in these studies to measure business success as function of knowledge and use of financial information.

Research work on small business at West Midland, U.K. (Nayak and Greenfield, 1994) shows that firms which do not do well, is not because of lack of business records and lack of awareness of key business factors, but due to the lack of adequate accounting knowledge and proper financial records. Comprehensive financial reporting and analysis should generally lead to improved financial control and that this in itself could significantly increase the chances of a small enterprise (business) prospering through growth (McMahan and Davies, 1994).

There is wide gap between theory and practice of management accounting in case of small business. On the other hand financial accounting system is based on the traditional "Mahajani" system and is incomplete in nature (Soral and Jain, 1994). Past experience and intuition plays important role in financial decision making. Among the other factors, the non-use of financial tools and techniques for economic decision-making has resulted in a variety of financial problems, which the small units face (Vinayak, 1987).

Growth can result in financial stresses such as cash-flow difficulties and excessive use of debt. These financial problems create a critical need for improved financial control which can come about through an upgrading of financial reporting and analysis system (Hutchinson and Ray, 1986).

A study by Holmes and Nicholls (1998) concluded that the amount and nature of accounting information prepared or acquired is dependent on number of operating and environmental variables like, business size, age, industrial grouping, owner-managers education etc. Study also shows that there is a big gap between the owner-managers, awareness and the uses of financial management techniques (Siop and Ahmed, 2000). They (owner-managers of small business units) are venturing into business without proper accounting and financial (control) 'know-how'.

Rice and Hamilton (1979) in their study found that small businessman employed a multidimensional, stochastic, non-quantitative decision process, which are primarily informal in nature. The finding was that for a majority of small businessman decision were the result of 'experience', 'intuition', or 'guesswork'. This implies that in small business units scientific decision making process does not take place.

Another study (LeCornu, et.al. 1996) has thrown light on the financial objective of small business units. They found that financial management of small enterprise is or should be qualitatively as well as quantitatively different from that of large enterprises. It also appears that behaviour and decision making in small enterprises are unequivocally attached to the personal motivations of the owner managers.

Efficient and scientific management of finance in an enterprise is of prime importance for achieving the ultimate goal i.e. profit maximisation. In practice, the matter of production or materials quality or marketing, in the ultimate analysis, relates to financial issues (Sen, et. al., 2001).

Therefore, all out efforts are needed for applying the tools of financial management to the enterprises in a scientific manner in the interest of injection of fresh confidence and restoring the financial health of the organisation.

### **OBJECTIVES OF THE STUDY**

- (i) To assess the level of perceived awareness of the owner-manager of small business units about tools and techniques of financial management.
- (ii) To examine the pattern of managerial use of the financial management tools and techniques by the small businesses.
- (iii) To evaluate the impact of financial management practices on the survival and growth of the small business units.

### **RESEARCH METHODOLOGY**

***Tools of data collection*** : The present research work being exploratory in nature called for field data from the natural setting. The data were collected with the help of a structured questionnaire along with a loosely structured personal interview schedule (guide) for the entrepreneurs. A pilot

survey was conducted by the Researcher within small group of small business units in Silchar town of Assam state of India to know the tendency of the entrepreneurs (owner-managers) in answering the questions and the type of data which were made available by them. Consequently, the questionnaire was modified suitably and a set pattern of question was emphasised through the questionnaire as well as in the in-depth interviews.

**Population / Universe of study :** For the present research the working definition of “Small Business units/firms”, which fulfilled the following quantitative characteristics were considered :

- (I) All Small Scale Industries (SSI) registered and unregistered (as defined under SSI Policy, 1991 as amended in 1998)
  - Manufacturing unit – investment limit in plant and machinery upto Rs. 10 million.
  - Ancillary unit – investment limit in plant and machinery upto Rs. 10 million.
  - Tiny sector including service sector – investment limit upto Rs. 5 lakhs.
- (II) Small Trading units (Whole seller/retailer) who run firms with under fifty (50) employees (with full time/part time; skilled/unskilled labourers).

**Selection of Sample :** Non-random judgement sampling was used so that data are representative and purposive in nature. Due care has been taken to include in the sample different segments of the small business population. The segments are (a) Manufacturing units, (b) Service units (c) Trading units.

**Size of Sample :** As the gamut of small business is very large, it was decided to take a sample size of around 220 from the entire region keeping in mind the different business segment and different states involved. However, finally 208 duly filled in questionnaire were collected and out of which 191 duly filled in correct questionnaires were processed for the purpose of analysis. The researcher collected field data through interviewer assisted questionnaire from seven states of NER of India viz., Assam, Meghalaya, Tripura, Mizoram, Arunachal Pradesh, Manipur and Nagaland. Small business units were selected from seventeen (17) major commercially important places of the region.

**Statistical tools for analysis of data :** Since it was not possible to meet the assumptions underlying parametric statistical testing, the study used appropriate non-parametric tests of association. Chi-square is an important non-parametric test. We require only the degree of freedom for using this test. Chi-square ( $\chi^2$ ) can be used (i) as a test of goodness of fit, (ii) as a test of independence.

## **LIMITATION OF THE STUDY**

The study is likely to have following limitations inspite of our best efforts :

- (i) As the widely-acknowledged authority on exploratory research Tukey, pointed out, it is still true that exploratory methodology can only be a beginning, a base from which subsequent confirmatory research can begin. With this in mind, the present research might be judged on the basis of the questions it raises regarding potential significance for further investigation, rather than upon answers it may provide.
- (ii) A further limitation of the present research work is that the methodology used could not gauge all the factors influencing the responses, such as the moral standing and social

- beliefs of owner-manager. These considerations on financial management and reporting practices, limits the internal and external validity of the study.
- (iii) The present study was conducted in a relatively economically backward region of India, (i.e. North-Eastern Region of India) hence due care should be exercised in generalising the result in terms of the entire country.
  - (iv) The dynamics of small business enterprise growth are inevitably complex and affected by many factors other than financial management. It was not possible to control for these other influences in the exploratory study with a limited sample size.
  - (v) Given small sample size and the lack of homogeneity among small business population and the selection bias, there is a need for caution in making generalisation based on its findings.
  - (vi) As no official definition was there for small businesses in India, a working definition for the study was framed taken into consideration – qualitative and quantitative parameters/characteristics.
  - (vii) The sampling and data collection methodologies employed inevitably impose limitations on interpretation of the results of this study. The accuracy and completeness of the data collected relied heavily on the ability and skills of interviewers and also the co-operation of owner-managers interviewed.

## **STUDY FINDINGS**

### **(I) Profile of owner-managers and their business :**

Demographically, 97 p.c. of the owner-managers of small business under study were male and only 3 p.c. were female. More than half of the businesses (65 p.c.) were over 5 years of age. Majority (92 p.c.) of the businesses were one man business i.e. sole proprietorship business; only 8 p.c. of the units were found partnership firms (more than one owner); and no company form of business were there in the study. Majority (57.6 p.c.) of the respondents were employing more than one employee. Nearly 60.7 p.c. of the respondents had a family background other than business, while 32.5 p.c. operated family-oriented enterprises. The majority of the owner managers had educational credentials not relevant to their enterprises' activity, as all of the owner-managers under study had general educational qualification, like graduation (36.6 p.c.), Inter/HS (36.6 p.c.) and upto HSLC (27.7 p.c.); no technically qualified professionals were found in the survey.

The small business units of North-Eastern Region of India mostly (92 p.c.) operate in the local market i.e. to meet the local market demand. Nearly 88 p.c. of the respondents were registered units (Registered under local authority i.e. Municipal Corporation, Municipal Board, Sales Tax etc.). It was observed from the study, that principal activity of the small businesses were trading (70.2 p.c.) in North-Eastern region of India. In relation to size, more than half (52 p.c.) of the business enterprises reported monthly sales revenue of upto Rs. 10,000/-; only 4 (2 p.c.) enterprises where monthly revenue earning was more than Rs. 5 lakhs.

### **Analysis according to the features of the business :**

To see the relationship between different features of the small business under study, chi-square test was employed. (i) The result of test revealed that the age of the business and their (perceived) level of performance/achievement were independent. (ii) On the other hand, when

we test the relationship between different business sector and the performance level, it was observed that there has some relationship with business sector and their performance. (iii) The test also revealed that there has some relationship between size (in terms of monthly sales turnover) of the business units and their respective age. We can conclude that, the size of the business increases with relation to their ages. (iv) Chi-square test also observed that business experience (in terms of years) of the owner-manager of small business has no relation with their business performance/achievement. This two attributes are independent.

## II. Level of awareness :

The present study has identified 28 (twenty eight) most commonly used financial management tools and techniques and tried to judge the level of awareness of the owner-manager of small businesses (Table – I) .

**Table – I**  
**Awareness level of owner-manager of small business of North-Eastern region of India**

| Financial management tools in practice   | Awareness level<br>(N=191) |
|--|----------------------------|
| Purchase Ledger  | 20%                        |
| Sales Ledger   | 11%                        |
| Cash Book  | 100%                       |
| Debtors Book   | 100%                       |
| Creditors Book   | 100%                       |
| Depreciation   | 15.7%                      |
| Trial Balance  | -                          |
| Bank Reconciliation Statement  | 5.2%                       |
| Profit and Loss Statement  | 34%                        |
| Balance sheet  | 34%                        |
| Sales / Purchase Budget  | -                          |
| Capital Budgeting  | -                          |
| Cost-volume-profit (CVP) Analysis  | -                          |
| Job Costing System   | -                          |
| Process Costing system   | -                          |
| Beak-even analysis/point   | -                          |
| Inventory Control Method (EOQ, ABC analysis, FIFO, LIFO etc.)  | -                          |
| Stores Ledger  | 11.5%                      |
| Liquidity measures through Ratio analysis (Financial Ratios), Liquidity Ratios, Quick Ratio, Capital gearing ratio, debt-equity-ratio etc. | -                          |
| Fund flow analysis   | -                          |
| Comparative financial statement analysis   | -                          |
| Working capital management   | -                          |
| Calculation of cost of capital   | -                          |
| Pay back method of analysis (NPV) and Internal rate of return (IRR)  | -                          |
| Auditing   | 5.7%                       |
| Tax matters  | 77%                        |
| Investment management  | -                          |

The result of the study observed that only 12 (twelve) financial management tools/techniques were known to owner-manager and out of these 12 known instruments barring cash book, creditors book and debtors book (100 p.c. aware), the awareness level on other techniques were very low. This result was consistent with Mirze's (1979) findings that the degree of awareness and uses of budgeting was low ..... and the firms size affected its use. This finding of the present study on the level of awareness of owner-managers of small business units in North-Eastern region of India, tends to confirm the findings of Grablowsky and William (1980) that small business owner-managers, do not use these business financial appraisal techniques because they find these highly quantitative. According to Holmes (1986), the responsibility for using financial management tools, generally rests upon owner-manager of a small business. But as the owner-managers level of awareness was very low on financial management, therefore, proper and judged use of those instruments for analysis did not apply to small business of North-Eastern region of India.

### III. Financial Reporting and analysis practice :

Running a business effectively require an awareness and good/proper knowledge of how the business is doing by the owner-manager of a small business on a day to day basis. Apart from legal requirement there is a practical necessity to keep sufficient records to ensure that business activities can continue without problem and in proper direction. However, the fields of accounting and finance have yet to provide an accepted normative theory indicating which financial reports are most valuable in financial management and how often they should be used (McMahon and Davies, 1994).

The question in the survey which related to Basic Record keeping were :

How do you measure Financial Performance of your business ?

The study observed that 51.3 p.c. (p.c.) of the small business units under study, measure their performances on the basis of 'Sales' i.e. total amount of sales during a particular period of time. Only 43 p.c. of the respondent use profit and sales (both) to evaluate their business performances.

What is the frequency of preparing financial Accounting records ?

The survey result revealed that, only 15 p.c. of the small business units of North-Eastern region of India kept their Accounting information upto date on a daily basis; 36 p.c. on a monthly basis and 49 p.c. i.e. majority of them upto date their accounting records on yearly basis.

**Table - II**

#### **Perceived level of performance and frequency of record keeping by the Small Business**

| Frequency of preparing /<br>Financial Records | Level of Achievement |                        |
|---|----------------------|------------------------|
|   | Doing well (N – 109) | No doing well (N – 82) |
| Daily   | 17%                  | 12%                    |
| Weekly  | NIL                  | NIL                    |
| Monthly                                       | 29%                  | 44%                    |
| Yearly  | 53%                  | 43%                    |

N.B. : One unit of above 8 years of age did not prepare accounts.

The result of chi-square test revealed that, the perceived level of achievement and frequency of record keeping has no relationship, i.e. these two attributes were independent. But the study observed that small business firms doing well were more likely to be comfortable with

accounting to maintain financial records and were much more likely to keep their books upto date at least on a yearly basis (53 p.c.).

**Table – III**  
**Age of the Small Business and frequency of record keeping**

| Frequency | Age of the Business                   |                                       |
|-----------|---------------------------------------|---------------------------------------|
|           | Less than 5 (five) years old (N – 67) | More than 5(five) years old (N – 124) |
| Daily     | 4.5%                                  | 21%                                   |
| Weekly    | NIL                                   | NIL                                   |
| Monthly   | 28%                                   | 36%                                   |
| Yearly    | 67%                                   | 42%                                   |

Chi-square test were employed to study the relationship between age of the business and frequency of record keeping. The result indicated that these two attributes has some relationship. As the data (Table – III) revealed that nearly 21 p.c. of more than 5 years old small business units wrote up their books of account daily compared to younger (less than 5 years old) business (4.5 p.c.). Similarly, nearly 35 p.c. of older business (more than 5 years of age) maintain their books monthly compared to younger business (28 p.c.). To see what are the different books of account are maintained by the small business units. Question was asked and the survey result is as follows :

**Table – IV**  
**Common accounting tools used by small business**

| Name of the accounting tools | Used in percentage (N=191) |
|------------------------------|----------------------------|
| Sales Book                   | 9.4%                       |
| Purchases Book               | 12.5%                      |
| Cash Book                    | 100%                       |
| Debtors Book                 | 100%                       |
| Creditors Book               | 100%                       |
| Ledger                       | NIL                        |
| Profit and Loss A/c          | 24.6%                      |
| Balance sheet                | 10.5%                      |

The financial data of small business under study were mostly (90.5 p.c.) kept in single entry system or indigeneous (Mahajani) system, and conversion into double entry is very difficult as records are kept haphazardly. In most of the cases, accounting records were written in one general ledger or register, incorporating various kinds of business accounting information in one common place. The survey result observed that, small business record keeping system is tailor made i.e. based on the requirement and the nature of the business. These accounting statements are generally easy to prepare and understand by the owner-manager themself.

The chi-square test revealed that educational qualification of owner-manager of small business and the uses of financial management and accounting tools were independent. There is no significant difference between educated and less educated owner-manager with regard to use of financial management tools.

### Analysis by features of the business :

There was significant difference with regard to basic record keeping techniques between firms which were less than 5 years old (younger) and those more than 5 years old (older). The study also indicates that older business units were more knowledgeable and diligent enough in record keeping about their business than younger business.

The analysis shows interesting features about the different types of business sector. The retailer, who have the least complex decision process, were the most diligent record keepers – compared to other sector.

There was no major difference between firms doing well and not doing well in keeping the books of account for financial management by the small business owner-managers. The most revealing insight from the analysis is that those not doing well were not diligent enough in preparing financial statements like profit and loss account and balance sheet which are most important accounting tools for business appraisal and financial management and future planning.

**Table - V**  
**Basic Record keeping : Analysis by the features of the businesses**

| Basic Accounting Records for proper financial management | Age of the business            |                                   | Business Sector        |                      |                 | Achievement        |                         |
|--|--------------------------------|-----------------------------------|------------------------|----------------------|-----------------|--------------------|-------------------------|
|  | Less than 5(five) years (N-67) | More than 5(five) years (N – 124) | Manuf acturing (N- 22) | Retail Trade (N-134) | Service (N- 35) | Doing well (N-109) | Not doing well (N – 82) |
| Self kept  | 90%                            | 49%                               | 45.5%                  | 68%                  | 57%             | 60.5%              | 67%                     |
| Computer used  | 3%                             | 14.5%                             | 4.5%                   | 11.9%                | 8.5%            | 15.6%              | 3.7%                    |
| Profit and loss a/c                                      | 6%                             | 35%                               | 45%                    | 24%                  | 14%             | 28%                | 19.5%                   |
| Balance sheet  | 3%                             | 14.5%                             | 13.6%                  | 11%                  | 5.7%            | 15.6%              | 3.6%                    |

**Table - VI**  
**Size of the business and financial management practices (according to monthly sale turnover)**

| Financial Management Tools/Techniques | Upto Rs. 10,000/- (N – 99) | Rs. 10,000/- to Rs. 20,000/- (N – 55) | Rs. 20,000/- to Rs. 50,000/- (N – 20) | Rs. 50,000/- to Rs. 1 lakh (N – 3) | Rs. 1 lakh and above (N – 14) |
|---------------------------------------|----------------------------|---------------------------------------|---------------------------------------|------------------------------------|-------------------------------|
| Sales Book                            | -                          | 1.8%                                  | 20%                                   | 100%                               | 71%                           |
| Purchase Book                         | -                          | 5.4%                                  | 35%                                   | 100%                               | 79%                           |
| Profit and loss a/c                   | 5%                         | 27%                                   | 50%                                   | 100%                               | 100%                          |
| Balance Sheet                         | 1%                         | 9%                                    | 20%                                   | 67%                                | 64%                           |
| Accounts audited yearly               | -                          | -                                     | 10%                                   | 33%                                | 57%                           |

N.B. : Cash Book, Debtor Book and Creditors Book were kept by all (100%) of the small business units of North-East Region of India.

The study revealed that, as the sales turn over increases the use of more financial tools were observed. Those small businesses which has monthly sales turnover of more than Rs. 50,000/- were more diligent in maintaining details financial records.

As the awareness level of owner-managers was very poor, therefore, very few financial management and accounting tools and techniques were practiced by the respondent to assess the level of performance of the business unit. The present study observed a different pattern of behaviour in financial record keeping in the field of cost accounting, pricing decision, credit management, inventory management and capital investment decision, which are at total variance with the prescribed standard rules of financial management and accounting. In most of the cases, small business decision process is the result of 'experience', 'intuition', or 'guess work'. All the respondents of the present study said that even if they did not have firm figures or formal accounting records, but they knew (according to their own perception) how their business is doing. They generally follow a multidimensional and non-quantitative decision process which were primarily informal in nature. This was corroborated by Rice and Hamiltan (1979) study.

The findings of the present study and earlier studies could not able to establish a direct link with improved financial management practices and their (small business) level of achievement/performance. Thomas and Evanson (1987) were similarly unable to establish such relationship.

## **SUMMARY AND CONCLUSION**

The changing economic circumstances have pushed our economy from "infant protection strategy" to the stage of economic liberalisation and to meet the challenges of globalisation. Under these circumstances, it is but natural that the government is shifting its focus from small scale industry by curtailing the fiscal concessions and other benefits doled out to this sector in 70's and 80's. This new but non-protective culture for small businesses, a different outlook with a competitive attitude to mobilising and utilising the resources, is needed by the small entrepreneurs in their struggle for existence in the age of 'survival of the fittest'.

Review of the effectiveness and uses of the financial management tools and techniques, in most of the previous analyses is recorded in the context of large corporate sectors. But if we want to unearth the correct perspective, it is observed that only 500, out of 5,00,000 active business enterprises in India, are recognised corporate setups. Ironically, more than 90 per cent of our industrial units, with turnover in the range of a few thousand, continue to function in an apparently, unprofessional way. So any isolated attempt to improve the efficiency of these few giants may be futile, without improving the rest of the business sector. Following the examples of ASEAN tigers, we must concentrate on the medium and small scale business enterprises, for all round development.

The result of the study highlight the wide gap between theory and practice of financial management. Small Business owner-managers may hardly find the existing financial management techniques of use. At the same time, little effort has been made in the field of research on developing tools and techniques for small business (Soral and Jain, 1994). With their peculiar problems and limited resources, this small business sector generally "relies more on

traditional accounting namely financial and taxation matters, rather than financial management.” The theories of financial management as so far developed, has little relevance in catering to the specific needs of the small business. Thus, the theory and the practice of financial management being interdependent may form a vicious circle hindering the growth of this vital sector. In this age of cut-throat competition more sophisticated financial management tools cannot be a luxury for small business units to flourish. However the onus of designing suitable kit for financial management for small business lies on the academics, which in turn calls for the need of a “real life research” (Chowdhury, 1995).

An accounting system which is the basic of financial management as all the financial data is first of all recorded according to the rules of accounting in the business books of accounts. The accounting system is only useful for financial management as it is upto date and accurate. To prevent errors and to provide correct information of the business, the business accounting system must provide for certain internal checks. A standard method for protecting against errors or employee fraud is to have two or more individuals involved in the recording function. An alternative approach for ensuring accuracy is to employ the services of a public accountant or a book-keeper. Assistance will also be provided by a book-keeping service agency in filling out tax returns and in making periodic audits. Still another approach to handling the accounting function is to purchase a simplified book-keeping systems (software) which is available in the market for small business. Such systems are ideal for the business owner who knows little about accounting and has some workable knowledge on computer.

But there is no denying the fact that small business units in India are facing some problems, which makes the application of these tools difficult due to lack of knowledge, and awareness of the tools of financial management as most of the firm are marginal units. Difficulties are there, but they are not insurmountable, given the determination and concerted efforts – problems of implementation can be overcome. There is no alternative to the observance of proper discipline and financial ethics for ensuring the optimal and efficient use of financial resources. Therefore, measures should be taken to familiarise the owner-managers with modern tools, and their benefits to be derived from their use etc., through the provision of training, short term courses, conferences, seminars/workshops etc. by the development agencies.

At the present stage, it is sad to observe that young technical manpower is shifting to white collar and office jobs, instead of being groomed in factory shop floors. As a result, the think tank of our industries are starved of essential tech-force nourishment and the outcome is self restraining. On the other hand, our management curriculum has not really looked into the requirements of these medium and small scale sector of businesses. Trained managers are rarely interested in working for this sector and generally do not understand or contribute, even if capacitated. Largely, the scope of professionalism does not get an entry in the small business sector in India.

As we understand, the present small business definition in India was framed to withstand the competition from the large scale industries within the country, in a protective environment of 60's and 70's. But at present Indian economy has underwent a 'U' turn from protection to a market economy where we need a broad based small business definition to withstand the competition. In the proposed new definition, where limits on investment have to be removed and include all the constituent of small business i.e. Trade, Industry and Commerce to meet the

present challenges. Therefore, government policies have to shift its direction from investment criteria to employment in defining small business. The proposed shift in the policy shall act as a facilitator of economic activities – as small business may be promoted in the light of employment generation and to cultivate the spirit of entrepreneurship in the country's economy. The Government of India is enacting a legislation soon on Small and Medium Enterprises (SME) Development for the first time in 2005.

In conclusion, this study's major findings will hopefully help focus the attention of researchers, business practitioners and policy makers on the needs and challenges facing small businesses in the field of financial management. These small business units/firms can be formidable competitive forces both domestically and internationally, as they often are the sources of technological innovation and employment generation for developing country like India. Such findings should accelerate the search for ways to improve the efficiency of small business units to match their high growth rates in sales with higher achievement level.

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| TITLE OF PAPER          | <p>THE SITUATION ANALYSIS<br/> AS A COMPONENT IN ENTREPRENEURSHIP<br/> EDUCATION</p>   |

**THE SITUATION ANALYSIS  
AS A COMPONENT IN ENTREPRENEURSHIP EDUCATION**

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**ABSTRACT**

A major component of the first semester entrepreneurship course is the development of a situation analysis for one of Inc. magazine's 500 fastest growing companies. Each student researches the industry, company, brand, competitors, consumers, marketing mix, and international ramifications for a specific company.

An Entrepreneur Program faculty member and a Business Communication faculty member jointly handle the situation analysis assignment. By having two faculty members involved in this integrated project, students realize that both aspects of the assignment, research and writing, are very important. Furthermore, each carries an equal amount of weight with respect to grading. The assignment, itself, represents about one-sixth of the total course grade for a *twelve-credit*, semester-long course.

In course evaluations, students continually say the assignment should remain an integral part of the program and that it provides the background needed to write their business plans.

## INTRODUCTION

A situation analysis is a major step in the strategic planning activity of any firm, regardless of its size. While much is written about preparing business plans, and many examples may be found in textbooks and on the Internet, little time is devoted to the situation analysis itself.

### THE SITUATION ANALYSIS ASSIGNMENT

A major component of the first semester entrepreneurship course is the development of a situation analysis for one of Inc. magazine's 500 fastest growing companies. Because the Inc. list is composed of entrepreneurial ventures, the list is a perfect fit for the assignment.

Students are given the complete Inc. list of companies and are told to choose a company from the list that they will analyze. The analysis is very detailed and covers all facets of the business except financial. Privately-held companies rarely are willing to provide the necessary financial data that would make analysis worthwhile.

Each student writes a situation analysis in which he or she researches the industry, company, brand, competitors, consumers, marketing mix, and international ramifications for a specific company. In the final section of the report, the student synthesizes the material and develops recommendations for changes in the marketing mix, target market, and international marketing of the company.

The final report is enhanced with prefatory parts (cover, title page, letter of transmittal, table of contents, list of illustrations, and executive summary) and supplementary parts (works cited and appendices). The assignment represents about one-sixth of the total course grade for a *twelve-credit*, semester-long course. Thus, the situation analysis assignment is a major component of the course with respect to time, effort, and grade impact.

### AN INTEGRATED PROJECT

The integrated communication approach to this project is unique and provides multiple benefits for students and faculty. An Entrepreneur Program faculty member and a Business Communication faculty member jointly handle the situation analysis assignment. The Entrepreneur Program faculty member is responsible for the content of the analysis while the Business Communication faculty member is responsible for the writing and related communications portions. By having two faculty members involved, students realize that both aspects of the assignment--research and writing--are very important. Furthermore, each carries an equal amount of weight with respect to grading.

Students' poor writing skill is a common topic of discussion among faculty members, who generally agree that additional writing assignments are critical in developing students' written communication abilities. However, faculty members rarely have enough time to grade multiple written assignments, so they give fewer overall assignments and more team-based assignments. Another factor that leads to fewer writing assignments is the difficulty in simultaneously grading content and writing skill. Good writing encompasses three major areas: content and

organization; style issues such as paragraph development, transitions, and sentence structure; and correctness such as grammar, punctuation, mechanics, and word usage. When students have multiple errors in style and correctness, it is difficult to focus on the content of the written analysis. The integrated approach to this project allows the Business Communication faculty member to help students with style and correctness issues. The Entrepreneur Program faculty member is then free to focus on content alone.

One exceptional aspect of the project is that students are forced to revise. In most written assignments, students receive the graded copy, quickly scan the faculty comments, and throw the assignment into their backpack, never to be seen again. In this project, the student writes Part 1 of the situation analysis, receives the graded copy, and must revise Part 1 to be included in the final report. When students write Part 2, they incorporate the suggestions and corrections from Part 1. The improvement from Part 1 to Part 2 is often dramatic. After students revise Part 2, they write the third part of the analysis and combine all three sections with the prefatory and supplementary parts. The three separate submittals help students' revision skills; time management is also improved due to the intermediate deadlines. As an added incentive for students to improve their writing, each part is worth more points than the previous part.

The assignment includes several handouts that provide a very specific, required format. Students are informed that many formats are possible for a situation analysis, but they must use a particular outline, develop standardized headings, and follow specific guidelines for visuals; instructors find that the standardization is a significant benefit when grading multiple reports.

## **LEARNING OBJECTIVES**

The situation analysis assignment has several learning objectives:

1. To give students first-hand experience doing research on businesses that are not household names without much information readily available on the Internet and other popular sources. Students find they must contact the companies personally, most effectively by telephone first and by email later. They often contact competitors, local newspaper reporters, and other local sources as well. In effect, the students must practice some of the actions of investigative media reporters, a learning experience to which few business majors are ever exposed. The assignment develops students' oral and interpersonal communication skills in addition to their writing skills.
2. To expose students to the type of information they will need when they prepare their own business plans later in the Entrepreneur Program. A significant component of a comprehensive business plan is an analysis of the industry, competition, market, et cetera. In effect, the situation analysis assignment allows students a practice run before the real thing.
3. To give students experience in preparing a well-written report—not just another research paper. Writing style, correct usage, graphics, and professional presentation are all important considerations in instruction and grading. In today's educational

environment, students too rarely are required to practice writing that combines primary and secondary research sources into a comprehensive report.

## **EVALUATION**

Students complete Part 1 of the report that covers history of the industry, history of the company, introduction to the product, five-year market share, sales history, and competitive analysis. The Business Communication instructor evaluates, edits, and makes suggestions for revision based on organization, style, tone, grammar, punctuation, mechanics, visuals, formatting, and documentation of sources. The Business Communication instructor does not evaluate the content of the report.

The Entrepreneur Program instructor grades the content of Part 1. Students then revise Part 1 for inclusion in the final report. The process is repeated for the evaluation of Part 2 (analysis of environmental variables and consumers' demographic, psychographic, and behavioristic profiles). The final report includes prefatory parts, revised Parts 1 and 2, Part 3 (marketing mix, international ramifications, conclusions, and recommendations), and supplementary parts.

The final report is evaluated by the Entrepreneur Program faculty for content and analysis and by the Business Communication faculty for written communication skills. Each student submits two copies of his/her report, one to the Business Communication faculty member and the other to the Entrepreneur Program faculty member.

In course evaluations, students continually say the assignment should remain an integral part of the program, even though it is not a popular assignment with either students or faculty. Students must work individually—without a group to share the effort—and each assignment requires an exceptional amount of time and effort on the part of faculty. However, students report that the assignment gives them the background needed to write their business plans the following semester.

## **THE SITUATION ANALYSIS ASSIGNMENT**

Shown below is the assignment the students receive. As noted above, the assignment is divided into three parts with Part 1 due about one month into the course, Part 2 one month later, and the complete analysis due about one week before the end of the semester. The completed project must be submitted in time for both the Entrepreneur Program faculty and the Business Communication faculty to have time to complete their grading.

### **Situation Analysis for Management 401**

#### **I. Overview of the Situation Analysis**

The first step in business planning is to conduct a situation analysis that provides the background for analyzing a company's competitive position. A situation analysis is an evaluation of the organization's environment and of the organization itself. After the situation analysis is complete,

the planner specifies goals, strategies, action plans, and budgets to be accomplished over a specific time period.

Place yourself in the role of a consultant for a business research firm. You are to conduct some portions of a traditional situation analysis. What follows below is a general outline of what you are asked to do.

In keeping with the objectives of the Entrepreneur Program, you are asked to analyze an entrepreneurial venture. Each year Inc. magazine compiles a list of the 500 fastest-growing private companies in the U.S. You are to analyze one of this year's 500. Finding information about your company will be a very difficult task: these are private companies; they are not established firms with long track records.

## **II. Writing the Sections in the Situation Analysis**

- A. Brief history of your industry (2 pages maximum).
- B. Brief history of your company (2 pages maximum).
- C. Brief introductory description of the primary product category and specific brand (if there is a brand).
  1. Past five-year sales history of your company.
  2. Past five-year market share history of your company.
- D. Competitive analysis.
  1. Identification of all significant competitor companies.
  2. Brief description of the closest competitor, its product mix, and the competitor's brand (2 pages maximum).
  3. Strengths and weaknesses of the closest competitor compared to your company.
  4. Other environmental variables affecting your industry and your product.
- E. Evaluation of existing customers of your company.
  1. Existing customer demographic profile.
    - a) Factors such as typical occupations, marital status, sex, household head, race, education, age, household income, stage in family life cycle, and social class. (If yours is a business-to-business firm, consider customers in terms of other businesses buying from your firm. Thus, you will need to describe their size, location, products, etc.)
    - b) Graphs to visually reinforce your written description.
  2. Heavy user psychographic profile including user personality, values, and lifestyles.
  3. Buying behavior profile.
    - a) Purchase occasion.
    - b) Benefits sought.
    - c) Usage pattern including when used, where used, how used, frequency of use, average amount used, urban density of consumers (rural, urban, suburban), geographic regions of heaviest usage, etc.
- F. Marketing mix for your company.
  1. Product analysis.

- a) Primary product—Its development; branding strategy used (if any); features and benefits; and strengths and weaknesses.
  - b) Competitive advantage based on unique product features, ingredients, etc. not offered by the competition.
  - c) Seasonal sales fluctuations including factors that boost or restrict the market for your product, such as customs and unfavorable climatic conditions.
  - d) Product quality.
  - e) Life cycle analysis—Stage of your product and how your company is managing this stage.
  - f) Package (if any) analysis—Sizes, assortments, and any special features that are used to more effectively market your company's product.
  - g) Services provided with product (if any).
  - h) Warranty/guarantee (if any).
2. Price analysis.
- a) Actual price charged for product using a table to compare product prices with nearest competitor (on a price per unit basis for various sizes). The relative impact of demand, costs, and competition in the setting of your product's base prices.
  - b) Pricing policies employed by company (e.g. any discount, promotional allowances, flexible pricing, geographic pricing, price lining, skimming, and penetration).
3. Distribution analysis.
- a) Channels of distribution for your company from the manufacturer to the customer/consumer; diagram of channels of distribution; types of intermediaries (wholesalers, retailers) and their functions in each channel; whether distribution is international, national, regional, or local; and whether distribution is intensive, selective, or exclusive.
  - b) Logistical problems with distribution (e.g. lack of acceptance by middlemen, stock shortages, and unreliable deliveries).
  - c) Strengths and weaknesses of the present distribution.
4. Promotional analysis.
- a) Overview of past and current promotions for your company.
  - b) Apparent objectives of current promotions.
  - c) Relative emphasis devoted to the various promotional mix elements.
  - d) Advertising—creative strategy and media selection.
  - e) Direct marketing and how it used for your company.
  - f) Sales promotion—how it is used and its objectives.
  - g) Public relations.
  - h) Personal selling—location in the distribution channel and types/roles of salespersons.
  - i) Integration of promotional mix elements.
  - j) Promotional examples (in appendix).
- G. Summary, Conclusions, and Recommendations.
- 1. Brief summarization and conclusions about the competitiveness of your company.
  - 2. Recommendations that could enhance the competitiveness of your company.

# **PROFILE OF MICRO BUSINESSES IN A RESIDENTIAL AREA IN SOUTH AFRICA**

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## **ABSTRACT**

Micro businesses play an important role in the distribution of goods and services, especially in low income areas that are further away from the Central Business District (CBD). Micro businesses or Spaza shops, as they are also called, provide a way of living to their owners, family members and sometimes employees.

For local government, financial institutions and other development agencies to be able to assist in the development of micro businesses it is important to determine the nature and problems these businesses experience.

This study determined the profile of the owners and their businesses in Tlhabane, a residential area in Rustenburg in the North-West Province of South Africa. A convenience sample was used that included all the micro businesses in the area. By means of a questionnaire the owners of all 61 micro businesses were interviewed personally.

Conclusions include that many of these micro businesses struggle in terms of expansion because their low turnover, and consequently profit, is lower than they expected. One of the most important problems is the training and support to enable survival in the long run. The majority of the owners of these micro businesses have little or no education and limited background about business.

## **INTRODUCTION**

Micro businesses play an important role in many communities, especially in residential areas that are further away from the Central Business District (CBD) or shopping malls, where they fulfill in the most basic needs of the community and provide a livelihood to their owners and some family members. As these micro businesses grow they often employ someone outside the family, sometimes only on a temporary basis, to assist, especially when the owner or family members are not available.

Micro businesses are growing in numbers on a daily basis all over the world and many of them operate as home-based businesses (Longenecker, Moore & Petty, 2003:275). The owners of these micro businesses have competencies and skills that enable them to create and/or sell products and services that provide in an urgent need in the areas where they are located. The result of the operation of these businesses stimulates initiative and in some cases basic innovation. They promote healthy competition and fulfill a much needed socio-economic role in these communities.

It is estimated that there are more than 2 million people engaged in some form of self-employment in micro businesses in South Africa (GEM, 2002:28). These businesses play a significant role in the distribution of goods and services, especially in the under-developed and rural communities of South Africa with a high unemployment rate. However, most of these micro businesses have problems, in terms of support either in the form of financing or training, to survive in the long run.

The importance of encouraging the establishment of small and medium-sized businesses, which could contribute to economic development and job creation, cannot be emphasized enough. To enable the creation of an environment conducive to the development of micro businesses it is important to determine the nature of as well as the problems experienced by these micro businesses. With these results of this study available, recommendations regarding aspects that hamper business development can be made to local government, financial institutions and developmental organizations. If these problems can be alleviated an environment conducive to micro business development can be created.

### **AIM AND METHODOLOGY**

The aim of this paper was to research the profile of the owner and his micro business, the support they receive as well as the problems they experience.

A literature study was done concerning entrepreneurship and micro businesses to link the theory with the characteristics of the entrepreneurs as well as concerns regarding their businesses.

A residential area, Tlhabane, just 3 kilometers from Rustenburg in the North West Province, was chosen as convenience sample. Tlhabane is in the centre of very large mining activities in the Rustenburg region. Most of its residents are workers in the neighboring mines. The population of the residential area is estimated at about 34 000 people and 61 informal micro businesses exist in this residential area.

The purpose of this study was to determine the profile of the owners and their businesses in Tlhabane. The study was conducted by using a convenience sample that included all the businesses in the specific residential area. A questionnaire was developed and tested in another area with the owners of five micro businesses. The final questionnaire was administered by one of the researchers by conducting personal interviews with each respondent. This was done to ensure reliability of data due to fact that Tswana is the native language of most micro business owners and a few of them were unable to read or complete a questionnaire in English. Conducting interviews made it possible to include all 61 micro business owners in this study.

A business is regarded as a micro business if the business employs less than 5 people. It would normally consist of the owner and one or two family members, and/or one or two other persons employed. These businesses are usually informal since they do not pay taxes, keep records or do business on formal premises. They have a limited capital base and their owners have little or no business skills. Some micro businesses do grow to small businesses and their level of income varies considerably (Moolman, 1998:29).

## LITERATURE REVIEW

Entrepreneurial people are defined by Kuratko and Welsch (2001:12) as people who seek and take advantage of opportunities and through doing so they add value. A definite element in this specific area is the value that is added to the community and livelihood of the individuals engaged in entrepreneurship. Some of the most important factors concerning the entrepreneur's background and influencing the business are explored and include the age, level of education, assets and training, as well as support to the entrepreneur.

### Age

The relationship between age and the entrepreneurial career process indicates that in terms of chronological age, the highest percentage of start-ups seems to be in the 25 to 35 year age group and although each situation is unique, there are some concerns that influence the entrepreneur's decision at certain ages (Longenecker *et al.*, 2003:20). Obviously there are exceptions to this generalization, as factors like experience, financial support, energy level and ability to manage a business also play an important role in starting a business (Hisrich & Peters, 1998:72).

As an example, in the age group of approximately between 20 and 25 the main concerns of the potential entrepreneur will include to be educated, gain work experience, as well as acquire financial resources. Later on, at the age of between 35 and 45, the potential entrepreneur might have different concerns, such as the fulfillment of family responsibilities, the attainment of seniority in their current workplace and the risk of losing an investment in a retirement program (Longenecker *et al.*, 2003:20).

### Education

Education is important in the upbringing of entrepreneurs, because it plays a major role in helping them to cope with problems by which they are confronted and correct deficiencies in business training. The ability to deal with people and communicate clearly in written and spoken word is important in any entrepreneurial activity (Hisrich & Peters, 1998:71). Potential entrepreneurs need to be exposed to creative business education in the classroom to make them aware of situations in the creative workplace (Driver, 2001:28). Although education of entrepreneurs is frequently addressed by higher learning institutions there is a greater need to make it more specific so as to apply it to specific situations and to the individual's needs (Maxwell, 2001).

In conclusion it can be said that South Africa's education system, cultural and social norms do not promote an entrepreneurial mindset and it will take some time to change this pattern (Naude, 2001:15).

### Assets

Assets is an important prerequisite for a successful business. Assets can refer to items which have monetary value and which are owned by a business (Dempsey & Pieters, 1996:1). These assets can consist of both fixed and current assets.

To high-growth orientated entrepreneurs the business is perceived as tool to achieve wealth. The growth of assets implies accumulated wealth when the individual is used as the main unit of analysis. In other instances sales growth and growth in employment are also used as measurement facilitating instruments (Sexton & Landström, 2000:38).

An entrepreneur is motivated from an intrinsic perspective and therefore elements such as status, self-achievement, living one's passion and other personal achievements are often viewed as more important factors in the calculation of assets in the business (Van Tonder, 2003:6).

### **Training and support**

Training is one of the most important parts in running a business (Parker, 2004:279). Training begins with young people when they are in primary school. Schools have cross-curricular themes to pursue economic awareness and empowerment, which creates an opportunity to develop a positive culture, attitude and motivation towards business. It is well known that the correct mix of management skills is important for any business, and it is critical if a business is to grow successfully (Bridge & O'Neill, 1998:250).

Business training and support include newly developed, as well as enhanced industry training. Staff and human resources need to be educated and developed on a continuous basis in terms of their specific occupation through effective training and education (Maxwell, 2001). In South Africa it was found that the percentage of entrepreneurs that feel that they are equipped with appropriate skills was not even half the percentage in other countries. The training and skills development of especially underdeveloped entrepreneurs in South Africa is important in the management of existing small and medium-sized businesses (Uekermann, 2004:12).

### **Capital**

Business can barely run without sources of funding. In order to access funding, financing has to be provided either through loan or own capital from the owner. When stepping out on their own, entrepreneurs realize that the personal and financial contributions they must make will come primarily from their own pockets (Timmons & Spinelli, 2004:88). Entrepreneurs must take a careful look at what financial resources they have and how much of those resources they can contribute to the business opportunity.

## **RESULTS**

The responses of all 61 micro business owners in Tlhabane were included in the results. The biographical information provides an overview of the gender, marital status, age, and level of education.

**Table 1: Gender**

| <b>Gender</b> | <b>Frequency</b> | <b>Percentage</b> |
|---------------|------------------|-------------------|
| Male          | 34               | 55,7              |
| Female        | 27               | 44,3              |
| Total         | 61               | 100,0             |

More male micro business owners are operating in the residential area than women.

**Table 2: Marital status**

| <b>Marital Status</b> | <b>Frequency</b> | <b>Percentage</b> |
|-----------------------|------------------|-------------------|
| Married               | 38               | 62,3              |
| Unmarried             | 13               | 21,3              |
| Divorced              | 1                | 1,6               |
| Never Married         | 9                | 14,8              |
| Live together         | 0                | 0                 |
| Total                 | 61               | 100,0             |

The highest percentage of people, 62,3%, while 21,3% of the respondents were unmarried and 14,8% of the respondents indicated that they were never married.

**Table 3: Age**

| <b>Age category</b> | <b>Frequency</b> | <b>Percentage</b> |
|---------------------|------------------|-------------------|
| 18-25               | 3                | 4,9               |
| 26-35               | 23               | 37,7              |
| 36-45               | 15               | 24,6              |
| 46-55               | 13               | 21,3              |
| 55+                 | 7                | 11,5              |
| Total               | 61               | 100,0             |

From Table 3 it is clear that the biggest group of respondents (37,7%) is between 26 and 35 years, followed by 24,6% between 36 and 45 years.

**Table 4: Level of education**

| <b>Level of education</b> | <b>Frequency</b> | <b>Percentage</b> |
|---------------------------|------------------|-------------------|
| Up to Grade 6             | 7                | 11,5              |
| Grade 7-9                 | 12               | 19,7              |
| Grade 10-12               | 42               | 68,8              |
| Total                     | 61               | 100,00            |

The majority of the respondents, 68,8%, have a level of education between Grade 10 and 12, followed by 19,7% with an educational level of between Grade 7 and 9. The educational level of these entrepreneurs is comparable with that of the rest of the population in the area.

**Table 5: Duration of stay in area**

| <b>Duration</b>    | <b>Frequency</b> | <b>Percentage</b> |
|--------------------|------------------|-------------------|
| Less than 1 year   | 1                | 1,6               |
| 2-5 years          | 4                | 6,6               |
| 6-10 years         | 5                | 8,2               |
| More than 10 years | 51               | 83,6              |
| Total              | 61               | 100,0             |

More than 83% of the respondents had lived in the area for more than 10 years.

**Table 6: Nature of business activity**

| <b>Business Activity</b> | <b>Frequency</b> | <b>Percentage</b> |
|--------------------------|------------------|-------------------|
| Retail                   | 53               | 86,9              |
| Services                 | 8                | 13,1              |
| Manufacturing            | 0                | 0                 |
| Total                    | 61               | 100,0             |

It is clear that 86,9% of the micro businesses are retailers, also called Spaza shops, whilst only 13,1% of the respondent's businesses are into rendering services.

**Table 7: Duration of operation**

| <b>Duration</b>    | <b>Frequency</b> | <b>Percentage</b> |
|--------------------|------------------|-------------------|
| Less than 1 year   | 5                | 8,2               |
| 2-5 years          | 29               | 47,6              |
| 6-10 years         | 16               | 26,2              |
| More than 10 years | 11               | 18,0              |
| Total              | 61               | 100,0             |

Most of the respondents' micro businesses (47,6%) have been in operation for between 2 and 5 years whilst 26,2% have been operating for between 6 and 10 years.

**Table 8: Form of business**

| <b>Form of business</b> | <b>Frequency</b> | <b>Percentage</b> |
|-------------------------|------------------|-------------------|
| Sole proprietor         | 59               | 96,7              |
| Partnership             | 2                | 3,3               |
| Close corporation       | 0                | 0                 |
| Cooperative             | 0                | 0                 |
| Company                 | 0                | 0                 |
| Total                   | 61               | 100,0             |

The fact that 96,7% of the respondents were operating their businesses as sole proprietors correspond with their size as micro businesses. Only 3,3% of the respondents were operating in partnerships.

**Table 9: Place of Business**

| <b>Place of business</b>        | <b>Frequency</b> | <b>Percentage</b> |
|---------------------------------|------------------|-------------------|
| Family home                     | 48               | 78,7              |
| Adjacent to family home         | 4                | 6,6               |
| In location outside family home | 9                | 14,7              |
| Total                           | 61               | 100,0             |

Most of the respondents (78,7%) are operating from a family home with only 6,6% operating adjacent to the family home and 14,7% are operating in the location outside of the family home.

**Table 10: Access to services**

| Services    | Frequency | Percentage |
|-------------|-----------|------------|
| Water       | 1         | 1,6        |
| Electricity | 60        | 98,4       |
| Percentage  | 61        | 100,0      |

It is clear that 98,4% of the businesses have access to electricity and only 1,6% use water for their business services.

**Table 11: Capital employed**

| Capital           | Frequency | Percentage |
|-------------------|-----------|------------|
| Up to R1 000      | 20        | 32,8       |
| R1 001- R5 000    | 25        | 41,0       |
| R5 001- R10 000   | 7         | 11,5       |
| More than R10 000 | 9         | 14,7       |
| Total             | 61        | 100,0      |

Most of the businesses (73,8%) started with an amount of less than R5000 and only 26,2% needed more than R5 000 as initial capital.

**Table 12: Source of funds for the business**

| Source of funds              | Frequency | Percentage |
|------------------------------|-----------|------------|
| Own funds/Savings            | 38        | 62,3       |
| Retrenchment package         | 13        | 21,3       |
| Pension                      | 0         | 0          |
| Local money lender           | 1         | 1,6        |
| Loan from family or friends  | 6         | 9,8        |
| Saving Club or Stokvel       | 3         | 5,0        |
| Loan from commercial bank    | 0         | 0          |
| Income from another business | 0         | 0          |
| Total                        | 61        | 100,0      |

The majority (62,3%) of the respondents had their own funds/savings to start the business and 21,3% of the respondents used their retrenchments package while 9,8% were being helped by their family or friends. Five percent used an informal saving club or stokvel as source of funds. Although the stokvels blossomed in black residential areas, they are generally not oriented towards helping micro businesses with start-up capital (Iheduru, 1998:73). Stokvels as a seed capital source for companies in Asia and Indonesia have proved to be the starting point for later larger conglomerates (Parker, 2004:76).

**Table 13: Tried to get a loan**

| Tried to get a loan | Frequency | Percentage |
|---------------------|-----------|------------|
| Yes                 | 11        | 18,0       |
| No                  | 50        | 82,0       |
| Total               | 61        | 100,0      |

Only 9,8% of the respondents tried to get a loan, whilst 82,0% of the respondents never tried because of the belief that they would not be successful.

**Table 14: Were you successful in getting a loan?**

| Successful in getting a loan | Frequency | Percentage |
|------------------------------|-----------|------------|
| Yes                          | 1         | 9,1        |
| No                           | 10        | 90,9       |
| Total                        | 11        | 100,0      |

Only one of the respondents was successful in getting finance. Reasons given for being unsuccessful were the following:

- “Lack of own property.”
- “No property to use for collateral purposes.”
- “The bank wanted some kind of security.”
- “Lack of enough collateral.”
- “No records were kept.”
- “The business not profitable enough to pay back the loan.”

**Table 15: People working in the business (including the owner)**

| Owner and employees | Frequency | Percentage |
|---------------------|-----------|------------|
| 1                   | 31        | 50,8       |
| 2-4                 | 30        | 49,2       |
| 5+                  | 0         | 0          |
| Total               | 61        | 100,0      |

More than fifty percent (50,8%) of the respondents work alone in their businesses. None of the respondents have five or more employees and the businesses can therefore all be regarded as micro businesses.

**Table 16: How many are family members**

| Family members | Frequency | Percentage |
|----------------|-----------|------------|
| 0              | 3         | 5,0        |
| 1              | 43        | 70,5       |
| 2              | 8         | 13,1       |
| 3              | 6         | 9,8        |
| 4              | 1         | 1,6        |
| Total          | 61        | 100,0      |

A total of 70,5% employed only one family member, while 24,5% of the respondents employed between two and four family members. Respondents prefer to employ their family members (95,0%). A primary benefit from working in a family business comes from the strength of family relationships (Longenecker *et al.*, 2000:30). Only 5,0% of the respondents have non-family members working for them.

**Table 17: Assets of the business**

| Assets            | Frequency | Percentage |
|-------------------|-----------|------------|
| R100-R2 000       | 22        | 36,0       |
| R2 001-R5 000     | 18        | 29,5       |
| R5 001-R10 000    | 15        | 24,6       |
| R10 001-R20 000   | 4         | 6,6        |
| More than R20 000 | 2         | 3,3        |
| Total             | 61        | 100,0      |

The highest percentage of businesses (36,0%) have assets of between R100 and R2 000, followed by 29,5% having assets of between R2 001 and R5 000. Only 2 businesses have assets of more than R20 000.

**Table 18: Profitability of business**

| Profitable | Frequency | Percentage |
|------------|-----------|------------|
| Yes        | 35        | 57,4       |
| No         | 26        | 42,6       |
| Total      | 61        | 100,0      |

Only 57,4% of the respondents view their businesses as being profitable. It implies that they think that they are making a reasonable living, while the rest said they are not making any profit because they perceive it as being too little money for a living.

**Table 19: Monthly turnover**

| Turnover (per month) | Frequency | Percentage |
|----------------------|-----------|------------|
| Up to R1 000         | 11        | 18,0       |
| R1 001-R2 000        | 15        | 24,6       |
| R2 001-R3 000        | 20        | 32,8       |
| R3 001-R4 000        | 8         | 13,1       |
| More than R5 000     | 7         | 11,5       |
| Total                | 61        | 100,0      |

Only 32,8% of the respondents' sale figures were between R2 001 and R3 000, followed by 24,6% with between R1 001 and R2 000. It is clear that most of the respondents' turnover is very low. If an average markup of 33,3% is used, a turnover of R2 500 will generate a gross profit of only R625 per month. That is less than the minimum wage.

**Table 20: Income earned from business**

| Income per month | Frequency | Percentage |
|------------------|-----------|------------|
| Up to R1000      | 25        | 41,0       |
| R1001-R2000      | 21        | 34,4       |
| R2001-R3000      | 10        | 16,4       |
| More than R3000  | 5         | 8,2        |
| Total            | 61        | 100,0      |

Most of the respondents (41%) had an income of up to R1 000 whilst 34,4% of the respondents earned between R1 001 and R2 000 a month.

**Table 21: Are business records kept**

| <b>Business records kept</b> | <b>Frequency</b> | <b>Percentage</b> |
|------------------------------|------------------|-------------------|
| Yes                          | 16               | 26,2              |
| No                           | 45               | 73,8              |
| Total                        | 61               | 100,0             |

Table 21 above clearly shows that the majority of the respondents (73,8%) did not keep business records while 26,2% of the respondents did keep business records.

**Table 22: Characteristics of customer base**

| <b>Customers</b> | <b>Frequency</b> | <b>Percentage</b> |
|------------------|------------------|-------------------|
| Males            | 0                | 0                 |
| Females          | 0                | 0                 |
| Young            | 0                | 0                 |
| Middle aged      | 0                | 0                 |
| Older            | 0                | 0                 |
| All              | 61               | 100               |
| Total            | 61               | 100               |

None of the businesses concentrated on a specific market.

**Table 23: Products advertised**

| <b>Products advertised</b> | <b>Frequency</b> | <b>Percentage</b> |
|----------------------------|------------------|-------------------|
| Yes                        | 1                | 1,6               |
| No                         | 60               | 98,4              |
| Total                      | 61               | 100,0             |

In the area where the businesses are located it is not common to advertise, as confirmed by 98,4% of the respondents.

**Table 24: Supplier**

| <b>Suppliers</b> | <b>Frequency</b> | <b>Percentage</b> |
|------------------|------------------|-------------------|
| Wholesalers      | 53               | 86,9              |
| Retailers        | 8                | 13,1              |
| Total            | 61               | 100,0             |

Most businesses (86,9%) are supplied by wholesalers, while only 13,1% of the businesses got their products from retailers.

**Table 25: Credit granted**

| <b>Credit granted</b> | <b>Frequency</b> | <b>Percentage</b> |
|-----------------------|------------------|-------------------|
| Yes                   | 23               | 37,7              |
| No                    | 38               | 62,3              |
| Total                 | 61               | 100,0             |

Only 37,7% of the businesses sell on credit compared to 62,3% that do not sell on credit.

**Table 26: Percentage credit sales**

| <b>Percentage credit sales</b> | <b>Frequency</b> | <b>Percentage</b> |
|--------------------------------|------------------|-------------------|
| 1-25                           | 12               | 52,2              |
| 26-50                          | 11               | 47,8              |
| 51-75                          | 0                | 0                 |
| 76-100                         | 0                | 0                 |
| Total                          | 23               | 100,0             |

Only 12 of the businesses that sell on credit sell between 1 and 25% on credit and 11 of the businesses sell between 26 and 50% on credit.

**Table 27: Misfortune suffered by the business**

| <b>Misfortune</b>         | <b>Frequency</b> | <b>Percentage</b> |
|---------------------------|------------------|-------------------|
| Stolen equipment or goods | 6                | 50,0              |
| Loss due to bad debt      | 4                | 33,4              |
| Violence in the area      | 1                | 8,3               |
| Natural disaster          | 1                | 8,3               |
| Total                     | 12               | 100,0             |

It is evident that 49 of the businesses did not have any misfortunes, with only 6 businesses having encountered stolen equipment or goods, and 4 businesses had misfortune due to bad debt. Only 1 business had misfortune due to violence in the area and 1 had misfortune due to a natural disaster.

In an open-ended question, the respondents were asked in which way they had dealt with misfortunes. Various responses were received, of which the most salient were the following:

- “I had to price some of other goods to recover amount of stolen goods”.
- “I had to operate without using the fridge, but using a freezer until I had enough money for it”.
- “I used my pension funds to restart it again after repairing disaster due to fire”.
- “Although some were recovered, then again I bought some containers to store some other goods to protect form theft i.e. more security was provided”.
- “The saved money was used to replace the equipment sold”.

**Table 28: Use of a bank account**

| <b>Bank account</b> | <b>Frequency</b> | <b>Percentage</b> |
|---------------------|------------------|-------------------|
| Yes                 | 55               | 90,2              |
| No                  | 6                | 9,8               |
| Total               | 61               | 100,0             |

More than 90% of the respondents had a bank account, compared to 9,8% of the respondents who had no bank account.

**Table 29: Type of bank account**

| <b>Type of account</b> | <b>Frequency</b> | <b>Percentage</b> |
|------------------------|------------------|-------------------|
| Personal account       | 51               | 92,7              |
| Business account       | 4                | 7,3               |
| Total                  | 55               | 100,0             |

The majority of the respondents (92,7%) had personal accounts, compared to 7,3% of the respondents who had business accounts.

**Table 30: Support from any organization in various activities**

| <b>Support</b>                | <b>Frequency</b> | <b>Percentage</b> |
|-------------------------------|------------------|-------------------|
| Training                      | 4                | 6,6               |
| Advice                        | 0                | 0                 |
| Mentoring                     | 1                | 1,6               |
| Assistance with business plan | 0                | 0                 |
| No assistance                 | 56               | 91,8              |
| Total                         | 61               | 100,0             |

More than 90% of the respondents had no assistance or training from any organization whilst only 1,6% of the respondents has encountered mentoring and 6,6% of the respondents had training before starting the business.

Open-ended questions were asked in order to determine the usefulness of support and ways in which support could be applied. The most important comments on the usefulness of support were the following:

- “I had worked at OK before, so it was easy starting the business and running it”.
- “Yes, it helped me start the business. Revlon gave me the training”.
- “A three-day business training helped me deal with customers especially pricing of goods and satisfying my customers”.
- “Our service is good now and customer’s numbers are increasing”.

The respondents’ opinion on what organizations should do to support small business, embraced the following:

- “They should help us with a training course”.
- “Financing and location are most, I would ask for”.
- “Assisting in loaning and give some advice and helping with the business plan”.
- “Location site is often a problem”.

- “Give more training to existing businesses”.
- “Financing and assisting with business plan”.
- “Financing of small business”.
- “Advice on how to run the business”.
- “Support financially and help with information and advertising”.

In the last open-ended question respondents were asked to provide the difficulties businesses persons faced. The most important comments were the following:

- “Loaning money”.
- “Customers not paying in time”.
- “Taking responsibility i.e. control which led either to a success or failure”.
- “Managing the business”.
- “Not having a place of my own to operate”.
- “Commitment and dedication to the business”.
- “Long operating hours stress me a lot”.

### **CONCLUSIONS AND RECOMMENDATIONS**

It can be concluded that the businesses in this residential area face a number of problems. Most of these businesses struggle in terms of their financial situation, monthly turnover and thus profit. These businesses are not registered and as such most of them do not keep business records. Only one of the 11 respondents that attempted to get a loan was successful in obtaining it, mainly due to not having collateral, not keeping records or the business not being profitable enough to repay the loan.

The majority of the owners of these businesses had school education of between grade 7 and 12, but only a few had a background about business. Previous experience and training was mentioned by the respondents to be useful in starting and running a business. Training (4 respondents) and mentoring (one respondent) was the only support these respondents had received. Training and support to survive in the long run is thus lacking according to respondents in this residential area.

Nearly none of the businesses advertise their products. Some of these businesses do suffer misfortunes in terms of theft or loss due to bad debt that makes it difficult to cope. Most of the respondents use their personal accounts as personal and business account.

To conclude, it can be said that good management practices and business related aspects are a prerequisite for running a successful business. However, the owners of these micro businesses need to be assisted in several ways.

From the data gathered, the following recommendations can be made:

- Training of the owners and their assistants should be a high priority. The content of training programs should include basic general management (Planning, organizing, leading and controlling, decision-making, coordination, delegation, communication, leadership and motivation), marketing, credit management, customer relations and record keeping.

- Training should be done and afforded in the following ways. Basic training could be done by letting students practice their skills to do basic training of the respondents. A business person from a large business could act as temporary mentor to assist in facilitating meetings of business owners and in improving their awareness and basic knowledge of management. Training institutions and government agencies could also assist in organizing, funding and formally offer training workshops.
- Support, mentoring or advice should be available to the owners of the micro businesses to increase turnover and profitability of their businesses. One way of assistance could be the formation of a type of chamber of business or support committee that could meet monthly and discuss mutual challenges, provide basic management knowledge and suggest action steps.
- Access to financial services should be enhanced. These services could include assistance by banks with managing their accounts, personal and business budgeting and improvement of the chances of funding and the effective and productive use of potential funding. Having a link between small businesses and big businesses could also enhance assistance in terms of financing or loan applications.
- Suppliers to micro businesses should also provide some assistance. Suppliers could also be involved in training the owners of these micro businesses in good credit management, pricing and ways to promote their merchandise. In this way the trust in micro businesses can be built to improve relationships between new and existing small businesses and suppliers.

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# **CHALLENGES FOR SMALL BUSINESS ENTREPRENEURS: A STUDY IN THE WAIKATO REGION OF NEW ZEALAND**

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## **Abstract**

Small Business Entrepreneurs (SBEs) today face many new challenges in their entrepreneurial efforts with in New Zealand as well as internationally. They often possess the experience of some form of craft or trade training. But generally they are very poorly trained to manage a business. SBEs rarely undergo any formal management training and/or business education. It is also true that today they face an increasing number of challenges in their entrepreneurial efforts than their counterparts two decades ago. In the new economic climate in New Zealand and globally, particular attention needs to be focused on SBEs to ensure that they acquire and use appropriate managerial skills that are needed for small business practice. This attention is needed to minimise the risks of failure in their entrepreneurial ventures. This will prevent SBE's from the unwanted traumatic impacts of business failures on their families and the communities in which they exist. This study is an attempt to identify and examine some of the key challenges faced by the entrepreneurs involved in small businesses in the Waikato region of New Zealand. The findings from this study are expected to be used for a further research that will advise policy decisions, assist in the review of innovation and entrepreneurship management training programmes, and assist in the quality of SME advisory and mentoring services provided in the Waikato region and elsewhere in New Zealand.

## **Introduction**

The major economic reforms initiated by the Labour government during the mid 1980's have seen a major liberalisation and transformation of the New Zealand economy during the last two decades. In order to enhance the utilisation of available economic resources, minimise costs and wastage, manage the economy more efficiently and generate a new level of prosperity , besides other initiatives, state owned departments and organisations were restructured, split up and corporatised or privatised , the NZ dollar was allowed to float in the foreign exchange market and tariffs were eliminated or reduced . There is little doubt that New Zealand is currently one of the most open and deregulated economies in the world. It is also true that many of the larger corporations operating in New Zealand are owned and controlled from overseas. Change and transformation has remained as a key feature of the NZ economy ever since the reforms started. In more recent years there has been a growing realisation to transform away from relying a lot on agricultural outputs toward more dependence on new and knowledge-based businesses. The processes involved in bringing about such a large scale transformation of the economy over the last two decades have changed the game significantly for the small firms and the SBEs. Starting

up and conducting business today is a much more complex and competitive undertaking than it was two decades ago. On the other hand, the present policies for the management and development of the economy and transforming it into a knowledge-based economy require a major contribution from the country's small businesses and, in particular, the innovative and entrepreneurial abilities of the SBEs. The present government realises the important role the SBEs have in the economic development process and it is taking new policy initiatives with more resources to encourage innovation and entrepreneurship. In this context a study to identify some of the key challenges for the SBEs is timely and meaningful.

### **Defining an entrepreneur**

There is no globally recognised, single definition of an entrepreneur. Also any attempt to define it is not a clear-cut task. This single definition problem is also true for a small business entrepreneur (SBE). One key reason for this definition problem is the fact that no two entrepreneurs, big or small, are the same. Some are new and some have been in business for quite some time- in this study one SBE has been in business for only six months in contrast to another one who has been an owner manager for last thirty years. Some started from next to nothing while some had sufficient wealth for a start-up. Some entrepreneurs are old and some are young. Some males and some females. Also entrepreneurs belong to a minority group in the general population of any nation.

The word *entrepreneur* is derived from the French word *entreprendre*, meaning "to undertake." French word 'entre' means *between* and 'prendre' is a verb that means *to take*. This suggests that the word *entrepreneur* was just another term used for a merchant who acted as a go-between or a middleman between different agents or groups involved in trade. French economist Richard Cantillon (1680-1734) is known to be one of the first to have used the term *entrepreneur* and related it to those who carried the risk in the economy (Bill Bolton and John Thompson (2004; 14)). It is highly possible that Cantillon used the term to refer to someone who took the risk between the buyer and the supplier. The French verb 'entreprendre' is used in relation to undertaking a venture or even in relation to a new business start up. Thus the word *entreprendre* in French is very closely related to the word *entrepreneur* in English. Today the word *entrepreneur* is commonly used in French, as well as in English in a very wide context to refer to people doing different things in different markets.

A literature search for a suitable definition of *an entrepreneur* indicates that it is somewhat easier to explain the *what* of an entrepreneur. But it is difficult to accurately pinpoint *who* is an entrepreneur. A number of definitions are indicated in the literature. According to Robert Hisrich and Michael Peters (2002; 10) -, "To an economist, an entrepreneur is one who brings resources, labour, materials and other assets into combinations that makes their value greater than before, and also one who introduces changes, innovations, and a new order. To a psychologist, such a person is typically driven by certain forces-the need to obtain or attain something, to experiment, to accomplish, or perhaps to escape the authority of others. To one businessman, an entrepreneur appears as a threat, an aggressive competitor, whereas to another businessman the same entrepreneur may be an ally, a source of supply, a customer, or someone who creates wealth for others, as well as finds better ways to utilise resources, reduce waste, and produce jobs others are glad to get"(Hisrich & Peters, 2002).

Each profession views an entrepreneur from its own perspective. However they do have some common themes such as risk taking, organising, creating or doing something new or a little different and wealth. Also a single definition will be restrictive because entrepreneurs are found in all professions and each profession has its own perception of this human individual who seems to be quite different from most in the society.

The definition of an entrepreneur as - “*A person who habitually creates and innovates to build something of recognised value around perceived opportunities*” – as drawn up by Bill Bolton and John Thompson (2004; 16) is considered useful for the purposes of this study. It is considered appropriate because this definition captures the orientation, motivation and personality of an entrepreneur and provides useful guidance in this study in problem definition, sample selection and interpretation of results. Hence for the purpose of this research, an entrepreneur is a person who recognises a gap or an opportunity in the market in his/her own area of interest and passion; seizes and converts the opportunity into a workable and marketable idea; uses effort, time, money and skills to add value to the idea; takes risks to implement the idea generally in a competitive marketplace; and endeavours to obtain the rewards for taking risk and use of resources.

### **Why Small Business Entrepreneurs (SBEs)?**

Firstly, for the last eighteen years the author’s passion, professional experience and research interest have continually been in the area of small to medium size firms operating in New Zealand and overseas. During this period the author has provided mentoring and advisory services to more than eighty SBEs in New Zealand and overseas. Over the last five years interest has increased substantially in the area of innovation and entrepreneurship management especially in relation to the SBEs.

Anecdotal evidence suggests that many in the society have quite contrasting perceptions of managers in a large public sector organisations and corporation when compared with the perceptions held for the SBEs. The former are generally perceived to be tertiary qualified professionals who spend a significant proportion of their work time in attending meetings, develop and maintain bureaucratic systems and processes, network, promote the organisations image and public relations, delegate most of their work to others, generally remain far removed from the actual customers and are generally concerned with their own areas of work.

In contrast, the small firm owner/managers are generally perceived to be poorly qualified and trained in business management, spend very little or no time in formal boardroom meetings, use minimal bureaucratic structures and processes in their ventures, spend little time in PR and networking, work with their employees as a member of a team to complete clearly specified jobs and orders, and keep close to the customers. Most of the SBEs carry the burden of the business in their heads all the time instead of just a little chunk of it.

There is no doubt that large corporations and organisations will continue to survive and grow in the market as they continue to obtain and use resources to : achieve economies of scale in production, purchasing, distribution and R&D; conduct business internationally ; recruit , train and develop skilled labour force; offer attractive pay packs to their professionally trained

managers ; do long term planning; diversify and minimise risks of failure from economic downturn or other uncontrollable variables such as war, terrorism, tsunami or the spread of a disease such as Sars . However, the business realities of the SBEs are characterised by being - non-bureaucratic, flexible, and dynamic ; sensitive to changes in the demand for their products in the market; close to the customers; highly motivated as owner/managers due to their cash flow, financing and equity positions; more direct and effective in communicating with their staff , customers and other stake holders ; focussed on a single or a related line of products; mindful of the quality of the products and are able to customise products and services with little fuss to suit customer needs . One example of this last feature of a SBE is, in the sample interviewed, a small car dealer who invites customers to choose from the Internet a car to suit ones tastes and budget from a selected car yard in Japan. From the Net he pulls down all crucial details for a range of cars to choose from. After negotiating an acceptable bid price with the customer he places his bid online at the auction yard in Japan. Once a bid is successful he arranges for the shipment of the car from Japan, completes all importing and registration requirements and delivers the vehicle to the customer in less than twenty days. This SBE explained this sales technique as an innovative way of maximising- his revenues and profits, customer satisfaction and cash flows while at the same time minimising- his risks, costs on inventory, advertising, space rentals and the daily cost of keeping vehicles in a presentable form in his open air car yard.

Other motivations for this study come from a consideration of the following:

- (i) The large scale and rapid economic reforms in New Zealand since mid 1980's has created a very competitive and challenging environment for most businesses, and in particular, the SBEs. One characteristic of New Zealand businesses is that about 95 percent of those registered for tax employ less than five people and therefore, by definition, are small. One may argue that during the last two decades the economic initiatives of the successive governments have been to clear the way for the economy to become more open, with the market for goods and services operating more freely. But as far as the small firms are concerned conducting business today is a more complex undertaking than it was a decade ago.
- (ii) Currently, there is an increasing emphasis on globalisation and internationalisation in business regardless of size and type. Therefore this regional study provides a preliminary understanding of some of the impacts of globalisation on SBEs. Some 'new factors' such as -spread of Aids, wars, diseases, terrorism and the occurrence of natural disasters e.g. the recent tsunami, need to be factored into business planning, practices , decisions and training programmes to minimise the risks of failure.
- (iii) The researcher possesses several years of experience working as a small business mentor/advisor and running courses to train SBEs in the management of innovation and entrepreneurship.

Hence any research involving the SBEs falls within the author's area of passion and provides some challenge and excitement .

### **Research purpose and questions**

The main purpose of this research was to identify some of the key challenges and difficulties that small business entrepreneurs face in the Waikato region of New Zealand. A carefully designed and pilot tested questionnaire, used as an instrument , included questions that required SBEs to provide information on - their overall business situation ; cash flow and finances ; marketing and

sales; profits ; staffing and employment ; legislation and compliance ; vision and passion ; doing trade internationally ; and the key challenges and difficulties they faced today .

## **Methodology**

For the purpose of this initial study a four-page written questionnaire was administered electronically to an independently selected sample of SBEs operating in the wider Hamilton city area of the Waikato region. The sample was selected from the small businesses data base developed and managed by the Business Development Centre (BDC) located in Hamilton, the main city for the Waikato region. Data from thirty six fully completed questionnaire responses obtained from the SBEs engaged in a wide range of enterprises and industries in the region were analysed to write this report. A convenient sample of fourteen SBEs from the above sample were further interviewed at their own business locations to get a more clear understanding of the survey responses received . These on-the site interviews with the SBEs were aimed at obtaining a more in-depth understanding of the challenges they faced and to establish what could be done to improve training in innovation and entrepreneurship management.

## **Findings**

This exploratory research was completed by the middle of March 2005. The findings are based on the data collected from a sample of thirty six SBEs most of which come from the wider Hamilton city area. The findings from this study indicate some common themes and concerns- suggesting that whatever the type of business, the strategic and operational challenges faced by the SBEs are often quite similar across various industries. A summarised version of some of the findings is presented below:

- (i) With regard to the size of the business in terms of the number of staff the average number employed was 5.03. One SBE had 40 staff and when he was as excluded from the sample the average number employed dropped to 4.04. Fourteen percent of the SBEs were operating all by themselves. 44 percent of the SBEs operated with only two or fewer staff whereas 75 percent of them had five or fewer staff. This data on employment compares well with the national employment statistics for the SMEs that make up about 97 percent of all the businesses in New Zealand and employ 19 or fewer FTEs and 86 percent employ five or fewer FTEs i.e. full-time equivalent of the total number of employees and proprietors working full-time and part time in a business.<sup>1</sup>
- (ii) Each SBE was asked to give the key reasons why he/she was in that particular business. About 50 percent indicated that they expected to earn good financial returns and have an improved life style. They were in the business to - be own boss, have basic freedom, make as much money as possible, and have an enjoyable life style. Interestingly enough 70 percent of them said that they were in that particular business because they had the expertise and experience in that industry and were quite passionate about what they were doing. Nineteen percent saw a gap in a growing market and figured out that the market was underserved and /or there wasn't much competition in the market for what they

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<sup>1</sup> (*Small Business Advisory Group's Annual Report, August 2004, p8*)

wanted to do. They also show the potential to grow reasonably quickly and trade internationally.

- (iii) SBEs were asked to list the key challenges they faced when trading internationally or in their plans to trade overseas. Although only 33 percent of the SBEs surveyed were involved in trading internationally and operating on an average about 29 percent of the business in foreign markets, majority, in fact, 86 percent indicated that trading internationally posed challenges and difficulties. They listed the key challenges they faced when trading internationally. An analysis of their responses shows that the main challenges come from the following key areas:
- (a) Finding a reliable business partner or a distributor in the country of interest. Some indicated that they could not afford the time and money to be away from their businesses to meet face to face with an overseas distributor or partner to make all business arrangements.
  - (b) Marketing and selling a product in another country is costly, difficult and with more uncertainties than selling locally. Most felt that they had to depend on an overseas agent or partner to promote and sell their products. They perceived difficulty in establishing trust and confidence in their products amongst the customers overseas. Some expressed concern at “getting ripped off” by agents involved in the international trade. Also meeting the demands of overseas customers involved plenty more resources and efforts e.g. “setting up mid-night shift work to support US customers who require response within a few hours” as one SBE pointed out.
  - (c) Risks involved in trading overseas. Some SBEs were concerned that occasionally they get an overseas customer who would place orders but fail to follow it through. Also when overseas customers do not pay the bills promptly they faced cash flow problems that itself created further problems in the daily business.
  - (d) Fluctuating exchange rates make international trading difficult for the SBEs, particularly when revenues and costs involve different currencies. The survey indicated that a very strong NZ dollar is having an adverse effect on the export incomes of the SBEs. In October 2000 the NZ Dollar was trading for around US 39 cents. On 10<sup>th</sup> March 2005 the dollar was exchanging for US 74 cents (The New Zealand Herald, 2005). This represents a 90 percent appreciation of the NZ dollar against the US dollar in the foreign exchange market. The rapidly appreciating NZ dollar is fast eroding the incomes of the SBEs who are exporting.
  - (e) Meeting shipping and customs requirements. Some had difficulties in obtaining customs/MAF clearances and suffered from a shortage of shipping availability. During an interview one SBE responded that in the foreign country “bureaucracy placed impediments and wharf companies showed scant regard and care for property and there were unnecessary delays due to lack of staff”. Hence it is

possible that trading internationally may cause quite a bit of frustration too sometimes.

- (f) Many SBEs were not familiar with the culture, ethics and business practices in a foreign country and this was another source of challenge for them
- (iv) When asked if they were comfortable with their cash flow to meet all the liabilities as they fell due, 47 percent indicated that they were very uncomfortable with their cash-flow situations to meet their liabilities. A common concern for most was that the cash flow was irregular and fluctuated a lot in the amount received or to be paid out. Those in seasonal markets had huge fluctuations in their cash flows. A general lack of working capital, not being able to pay all the bills on time, using up most of the profit to update plant and technology to keep up to speed in the market, clients not paying on time, the ongoing compliance costs and high fees for professionals were given as the key reasons for the challenge in managing the cash flows.
- (v) Sixty four percent of the SBEs were quite unhappy with all the pieces of legislation they had to follow in order to operate their business ventures. About 20% said they were very unhappy with all the rules and regulations they had to abide by in order to operate their businesses. The pieces of legislation with which most SBEs had a varying degree of familiarity were those relating to ACC, Inland Revenue Department, Winz and OSH. It became evident from the interviews that there were just too many pieces of legislation the SBEs needed to follow in the start-up process and in the daily operation and management of their businesses. Some SBEs indicated that the legislation minefield was getting bigger each year and “changing and updating is too regular and unnecessary” and “is accompanied by increased costs”. Consequently for many, the statement “wouldn’t know all the legislation we’re supposed to follow, except it’s a lot...” would hold true.
- (vi) Fifty three percent of the respondents indicated that meeting all the compliance costs was really an issue for them. Twenty eight percent felt very strongly about the compliance costs they had to meet in order to operate their ventures. A common issue for many SBEs was the fact that “it cost them a great deal of money to comply with “- OSH regulations, ACC levies, accreditation and liability insurance, health and safety requirements, and GST and taxes to remain compliant with various rules and regulations.

## **Conclusions**

Within the small business category as given for New Zealand, 75 percent in the sample employed fewer than 5 people and within this category 44 percent of the SBEs operated alone or with only one staff. This indicates that at least 50 percent of the SBEs are, in fact, operating as micro businesses and are faced with challenges from being too small in the market. Most SBEs face challenges and some of which are quite unanticipated. The areas in which they need solutions and support include – financing and management of cash flows, marketing and sales management, legislation and compliance ; maintaining a clear vision for the business; managing the adverse impacts of unexpected events happening locally and else where in the world , coping

with technological changes , especially IT ; the impact of globalisation and the need for a better management of business internationally.

### **Where to?**

The findings from this study are expected to be used for a further research that will advise policy decisions, assist in the review of innovation and entrepreneurship management training programmes, and assist in the quality of SME advisory and mentoring services provided in the Waikato region and elsewhere in New Zealand.

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## **Training Women to Win**

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### **Abstract**

Female Entrepreneurs are responsible for one third of all start-up businesses in the UK. They are vital to the economy and the future growth of the SME sector. Their dynamism and enterprise enriches the sector. Despite the positive contribution and untapped potential of women in business, the UK government has failed to support an increase in women owned businesses.

This paper is based on a project of the same name currently in progress at the University of Surrey. Training Women to Win supports initiatives relating to gender discrimination in employment. The project also fits with, and has been informed by, the DTI/Small Business Service's Strategic Framework for Women's Enterprise.

The aims of the project are to investigate whether past and current interventions available to female entrepreneurs have been effective and to ascertain whether female entrepreneurs are satisfied with the initiatives. It will further examine whether female entrepreneurs believe that these initiatives have contributed to the financial success of their businesses and assess the impact of targeted women's enterprise support programmes. It will also attempt to assess the reasons for longer start-up periods for female-owned businesses and the role of supply and demand factors as constraints in start-up finance. Finally, it aims to identify any existing discrimination and actions to combat the discrimination female entrepreneurs face when accessing enterprise support.

A postal survey will be conducted on one thousand women selected from a target audience. There will be several focus groups as well as face-to-face interviews on a limited number of the women.

The project will provide an audit of existing training and business support provision as well as detailing the impact of past and current initiatives designed to assist female entrepreneurs. It will produce key recommendations for use when supporting future initiatives and produce recommendations highlighting the possible direction of future provision.

## **1.0 Introduction**

The Training Women to Win project has received European Social Fund (ESF) funding for a period of two and a half years from 1 January 2004. Its aim is to assess the impact of targeted women's enterprise support programmes - to examine whether female entrepreneurs are satisfied with these initiatives and to test whether or not they consider that they have contributed to the financial success of their business. The project fits with the DTI/Small Business Service's Strategic Framework for Women's Enterprise (Sharing the vision: a collaborative approach to increasing female entrepreneurship, 2003) and bridges a number of gaps in current research. For example, the reasons for longer start-up periods for female owned businesses and the role of supply and demand factors as constraints in start-up finance. This will help to identify any existing discrimination female entrepreneurs face when accessing enterprise support.

The objective of the project is to identify good practice and to produce and pilot recommendations that will improve current business support and training provision for women.

The project is effectively split into three stages. The first stage used desktop research to look at enterprise initiatives currently in place. 128 UK initiatives have been identified, offering a mix of business support, incubators, mentoring and business tools. The second stage was to send a questionnaire to targeted women. The final stage was to conduct a series of interviews and focus groups in order to elicit more detailed answers and to follow up certain areas of the questionnaire.

106 questionnaires were completed (a 10% response rate) and the main findings were:

- Women tend to start and run businesses mainly in their late 20s and to mid 40s.
- The main challenges faced by the women were a lack of confidence and financial pressures.
- Reasons for starting a business ranged from finance, independence, flexibility, childcare friendly and lifestyle choice. Others started up following redundancy. A

significant number of women were eager to develop an idea they firmly believed in.

- The most important source of start up capital was personal savings, followed by family and then banks and/or financial institutions.
- The most popular sectors women started businesses in were coaching/mentoring, business services, sales/marketing/PR, media & publishing and education/training. A significant number were in IT/computing.
- A significant number of respondents hold a degree or postgraduate qualification.
- A significant proportion of respondents have children of an age where childcare is an important issue.
- The majority of respondents identified themselves as white British, with only 13 from ethnic minorities.

## **2.0 Female Entrepreneurship**

Early studies on female entrepreneurs concentrated on descriptive accounts of the characteristics and motivations of women in business and their experiences of business ownership, particularly at start up. More sophisticated studies include themes on gender differences regarding management of the business, particularly with regard to finance, business networks and performance (Carter et al 2001).

Female Entrepreneurs are responsible for one third of all start-up businesses in the UK. An estimated 130 000 out of 380 919 start-ups were run by women in 2001. Around 26% of women are self employed in the UK (Carter and Anderson 2001).

The study of female entrepreneurship is gaining momentum globally and many reasons are posed as barriers to it such as in the EU, Stephenson (2002) identified several barriers including a lack of sufficient day care places, societal norms which relegate the primary responsibility for child and domestic care to women. Other barriers identified were access to capital, networks, social support. There was also a lack of sex desegregated data (Stephenson 2002) which hindered analysis. However, consistently across countries evidence suggests that amongst other differences women are less likely to be self employed than men, more likely to start smaller businesses, less likely to have growth firms, less likely to have employees, start their businesses with lower capitalization, finance their firms differently and make greater use of personal rather than professional or business networks.

Women are becoming increasingly involved in entrepreneurship across Europe but face specific problems in setting up and running businesses which are different from those faced by male business owners that are either directly or indirectly related to gender (CEEDR 2000). Women are half of the population of Europe, but make up less than one quarter of the businesses assisted by general business support organisations. Only a minority of general business support organisations have some form of special services or policies aimed at women entrepreneurs.

The economic importance of women's business ownership is now internationally recognised and the numbers of women starting businesses in the UK are increasing

relative to their male counterparts. This is undermined by indications that while access to finance continues to be a major problem, of new concern is that women's business development is being hindered by poor engagement with new technology (Carter *et al* 2002). There is further evidence to support this regarding the Irish economy (Henry and Kennedy 2003), where setting up new economy companies in high technology, professional services and construction is virtually untapped. Marlow (1997; 2002) has also noted the challenges facing female entrepreneurs.

## **2.1 Unequal entrepreneurs?**

It appears that, in general, the UK government has failed to support an increase in women owned businesses.

In general studies have shown that women have less access to start up capital; less management experience; are less welcome in the informal business networks that often provide vital support for small firms. (The Industrial Society 2001).

They have difficulties accessing finance because, for example, guarantees required for external financing are often beyond the scope of personal assets and credit track records. In addition, women face sexual stereotyping from banks. There are informal financial networks, which they find difficult to penetrate. Women rely heavily on personal savings, an estimated 80-99% of initial capitalisation compared to that of 30-59% for men (The Industrial Society 2001).

Ethnic Minority Entrepreneurs face the double discrimination of both race and gender. They face cultural and business barriers as well as issues around social marginalisation. Asian women are a growing group within the SME community and yet there is a paucity of qualitative knowledge regarding this heterogeneous group where education, caste, religion, status of husband and so on are important factors. Asian men tended to benefit from exclusiveness where ethnic solidarity created accessible capital, labour and markets and exclusion forced them to seek economic alternatives. This is not so for the women. Mirchandani (1999) demands the integration of issues of race and ethnicity into studies of self-employment by women

### **3.0 Methodology**

#### **First Stage:**

To conduct desktop research looking at all the initiatives in place currently. Desktop investigation identified 128 UK based initiatives offering business support, incubators, mentoring and business tools.

#### **Second Stage:**

To send a questionnaire to targeted women. Questions revolved around personal data in order to build a profile of the women, the nature of the business in terms of sector, location, number of employees and length of business. The other main areas were the business entry decision and whether there was any awareness or support from agencies. The women were also asked to rate their satisfaction if these organisations had been used.

Finance was another important area. It was important to ask the women how they financed the start-up of their businesses, the amounts required and any advice or training received in this area. They were asked if they submitted a business plan and if they received any help with the writing of this document.

The questionnaire was posted on-line, in collaboration with *Everywoman* Ltd., on the project website. Links were established from other sites such as Everywoman, Business Link Surrey and brought to the attention of women on the University's own database. In total about 1000 women were targeted.

#### **Final Stage:**

To conduct interviews and focus groups. A series of interviews and focus groups were conducted with women in business, in order to elicit more detailed answers and to follow up some of the questions presented in the questionnaire.

#### **4.0 Analysis**

The detail of our findings is presented in Section 4 of this report and in the appendices. This section (Section 3) highlights the major points that have come out of the research undertaken and summarises the conclusions we have drawn.

Our research shows that most women tend to start a business between their late twenties and mid forties, with a significant number either starting or continuing their business after the age of 46. Most of these cited independence, flexibility and/or lifestyle as being the main motivators for their career decision. Childcare was less of an issue, although still a factor. Significant also, was the fact that 66% of this group hold a degree, or some kind of postgraduate qualification. A number of conclusions could be drawn from this. The stereotypical assumption is that women pursue self-employment to obviate the need for childcare. In fact, in many ways the opposite can be true. To devote the time necessary for starting and building a new business, childcare provision continues to be a necessity and, indeed, may need to be extended in many instances. This was borne out by the number of respondents who found the number of hours they had to spend on their business activities to be problematic (although, obviously, this may not be solely a childcare issue). In any case, one of the conclusions to be drawn is that childcare is an important issue (59% of respondents have children of dependant age) and one that must be taken into consideration when designing the mode, timing, and organisation of training.

Another obvious conclusion is that women delay starting a business until they have gained higher educational qualifications (or, in some instances, this acts as a trigger for their decision). Women in this position have already demonstrated a willingness to study beyond the statutory level and an acceptance and commitment to the value of education and training. From this point of view, they are more open to the idea of continuing professional development and thus more accessible to training providers.

Starting a business at a later stage of life can also be shown to impact on the way in which the business is established in terms of finance. Our research shows that personal savings account for the vast majority of start-up capital – this has been true for 86% of respondents. Family help is a factor too, but to a far lesser degree. At the other end of the scale, only 4% of respondents opted for government loans. There are

important lessons here for the government agencies. Responses indicated that women were not reluctant to ask for government assistance, but rather that they found the myriad of agencies and apparent support to be confusing, and systems to be bureaucratic. Not all experiences were negative, but many women find that government information presents as an impenetrable mass and agencies are too focused on meeting their own targets to provide appropriate help. Having said that, there were a number of advocates for the basic levels of support provided by agencies. There does, however, seem to be a lack of support for taking businesses forward into the growth and maintenance phases of the business cycle. In other words, although sometimes confusing, start-up support does seem to be available for most women if they have the tenacity to seek it out. However, guidance and support for the next level of development is not apparent.

The top six challenges faced by our respondents were:

- Lack of confidence
- Financial issues
- Hours worked
- Resource availability
- Lack of support
- Bureaucracy and legislation

More stereotypical issues like childcare and discrimination, although cited as issues, were low down on the list. As indicated elsewhere in specific responses, the care of dependants is a significant consideration. Our interpretation of the apparent inconsistency here is that respondents were considering specific challenges in relation to starting and owning a business. Childcare is a generic problem – a factor whether a woman is employed or self-employed and therefore not specific to the issue of self-employment. It is, however, a vital consideration when designing training and support for female entrepreneurs and must inform both the content and the delivery mode of any pilot training programme arising from this research.

It is perhaps surprising that discrimination didn't figure higher in the list. This could be taken as a positive sign and, in some ways, is indeed encouraging. However, there

are two issues here. Firstly, the vast majority of our respondents run businesses in the following sectors:

- Coaching/mentoring
- Business services
- Sales/marketing/PR
- Media & publishing
- Education/training

Far fewer come from "high-tech" and other traditionally "male sectors." It may be expected then that less discrimination would be encountered in these "allowable" female pursuits.

The second issue returns to the question of the generic responses given by respondents. They tended to define challenges that they encountered, on an ongoing basis as a result of being female. This can actually mask some of the specifics. This research and other studies that have been carried out, reveal that women face problems in accessing some of the more traditional forms of support. In particular, women can face a lack of credibility with mainstream lending institutions and can suffer from a lack of access to traditionally male business networks.

Of the top six challenges, there are two – lack of confidence and hours worked – that can perhaps be regarded as symptomatic of the problems faced by female entrepreneurs. Financial issues and lack of support can also be a gender specific to a degree, but are more likely to be faced by male counterparts (albeit, perhaps, for different reasons). Most of these issues were highlighted in some way by our respondents when we asked them what type of training they thought would benefit them on an individual level and that would take their business forward. The training highlighted was:

- Boosting confidence
- Communication & public speaking
- Motivation
- Networking
- Marketing

- Leadership skills
- Financial advice

The pilot training programme arising from this research will cover all of the above areas and will be delivered in a way that is sympathetic to the needs of our target group in terms of mode, timing and organisation.

#### **4.1 Main Emerging Themes.**

##### **Value of Business Support Provision**

On the whole the women felt they had,

*Made useful contacts at network events.*

The services offered proved to be a good source of information and a sensible starting point,

*They helped us to focus on what needed to be done to get started and to make a logical plan.*

*I'd never run a business before and wanted to find out about regulation, make sure that I'm marketing my work properly and benchmarking my business against others.*

Specific training and courses were also praised,

*Training provided by Business Link is very informative.*

*The one to one meetings with Business Link professionals were extremely useful in having an independent third person look at your business.*

*The training has been essential to start networking and find opportunities in the market. The support has been motivating in terms of finding objectives, strategies and action points.*

However, there was some dissatisfaction with the provision. Many of the women felt that their requirements were not met,

*Business link did not meet my requirements and more importantly were bad in following up communications.*

Many were not aware that these services existed,

*I did not know they were available.*

Many women found that these organisations were a good starting point to open up networks and to give advice and support but were not as useful after this stage,

*Support was great at the initial stage, when I was going to set up a business and had very little idea how to do it. Now that the business is mature and successful I can't find much help from the above agencies in developing it further.*

The main criticisms were that the help offered was theoretical rather than practical, information was given, but in many cases these facts were already known to the women so there was no added value.

*Business Link was theoretical not practical.*

*Business Link free workshops were very good giving lots of information, but the networking element never seems to work at all.*

*Business Link only told me in a report what I already knew.*

Some cited specific cases when they were disappointed,

*I joined a Business Mentoring course which was dreadful - not pitched properly and did not provide any information I didn't know myself as it was focused on marketing/sales, which is my business sector anyway.*

*Lack of on going interest or support in my venture.*

*Lack of understanding of my type of business on their part.*

*Not enough networking time, a long presentation not relevant to the size of my company*

#### **4.2 Gender Specific Issues**

Many did not find gender an issue,

*No - I don't particularly see myself as different just because I'm female, and I haven't experienced any gender-related issues in growing my business.*

Some felt it was an advantage,

*Age and sex can have a bearing, but often they are advantages!  
Mine is a woman-orientated business - they are my customers!*

A lack of confidence was mentioned,

*If everyone worked on building their confidence and knowledge about what they want to do - most obstacles simply disappear.*

Women find difficulty in juggling their personal and professional lives and generally feel that they lack support. They also have a harder time convincing others of their ability and have to break down this prejudice.

Many of the women felt,

*There needs to be more women mentors. Most of the Business Link mentors are men who have held senior positions in large companies and can't appreciate that running a small business from home can be equally as rewarding as being employed in a senior position within a blue chip company.*

Others felt it was a two way problem,

*I believe there are issues concerning the perception of businesswomen e.g. feeling out of place in the business world, lack of confidence, feeling intimidated, not wanting to appear aggressive or pushy.*

One of the main concerns was juggling their various roles,

*Sometimes the hint that I cannot really be a good wife or mother spending so much time running the business, meeting clients.*

*Trying to juggle childcare, work & home life.*

*Childcare childcare childcare (it costs too much and there aren't enough places). For self-employed people who don't have a regular income, we still have to commit to costly childcare or lose a place.*

*The males network on the golf course, I hate golf! Having to run my business and my household - all the house issues fall to me, including management of childcare. But apart from that men and women face the same problems I believe. Many perceived 'female problems' are more likely to be confidence related in my opinion.*

*I find the support of other women invaluable. Business link seemed to be primarily men, would like to see more women available to support women in business.*

#### **4.3 Business Support - Helpful?**

*They do not offer expertise in all areas and are normally run by people who have never been self-employed.*

*I don't seem to fit into their criteria.*

*Not easy to find out about.*

*I received comprehensive help (grants, training, business advice, networking opportunities, references) with starting up my business from Business Link and Enterprise Agency without even knowing what help was available. Very important for new businesses.*

*The information provided is useful and sound, but a more interactive learning environment would be more helpful and more practical.*

*Too much red tape as to how and where they are able to help me.*

*Either not targeted at my needs, not communicated to me or inaccessible.*

*Contacted business link and felt that they were not clear about what they could/could not offer.*

*Not easy to see how support agencies can help - lack of trained staff, too focused on meeting own targets rather than supporting those outside the agency.*

*Sometimes too woolly and non-specific to be of real practical benefit.*

*What most people don't realise is the amount of support that is there if people are prepared to find out about it.*

*They are very helpful in giving grants and helps to start your business. But there's a jump between starting and maintaining in the market and that's when continuity and stability of the business is a problem.*

*There is a lot out there but it is all very confusing/bewildering and feels as if it will take too much time to access.*

*I would like to feel there was ongoing support - one off meetings or training's are fine, but lack continuity.*

*Information available is often in long-winded brochures and sometimes confusing. Often get passed around organisations trying to find the right individual to speak to.*

*Give basic assistance. The best support I've had is from people doing it successfully.*

*It's a question of narrowing down what is helpful for your own situation.*

*They are too prescriptive and too short... business advice and support is a long term process*

*Don't offer much help to anyone who isn't 'disadvantaged'.*

*Lots of advice from all difference sources - but each business is individual and encounters different problems/issues. Forming a relationship with the advice source is hard as you are just another number walking through their door.*

There were many comments about the “one size fits all” aspect of business support provision, in particular with regard to the Government agencies.

*Often a one size fits all. Does not recognise individuality of needs/ability/motivation/knowledge and experience. Often advisors not qualified or capable. They do not inspire confidence and offer very limited ideas. Often very risk averse and discouraging.*

*Most of the advice is generic - overall good but not necessarily when you actually need it!*

Through both our research and the questionnaire, it was found that training offered by these organisations tends to be at times that are not convenient for our respondents, especially for those women with dependents.

*I would prefer to see more daytime events. It's near impossible to attend breakfast and evening events.*

## **5.0 Recommendations**

Childcare and flexible working arrangements are significant issues when planning training. Training providers should, therefore, consider mode, delivery and training when designing a training programme. Our research indicates that relatively short (circa 2 hours) and informative sessions in the middle of the day are the most suitable for this target audience.

Much of the business support currently available is not as effective as it could be. Our research shows that many respondents, although largely aware that agencies exist, are often unaware of the services that they provide and/or how to access appropriate support. It seems that the profile of agencies needs to be raised, there needs to be better signposting or available services and better accessibility for those services offered.

Business support is acknowledged by some to be very good at the initial stages. However, further into the business cycle, this support seems to tail off or, if it does not, then there is less awareness of the help available. The specific recommendation here is that agencies should consider second and subsequent stage provision and ensure awareness and accessibility for this target market.

A major criticism of the government agencies is that the help offered is theoretical rather than practical and that it simply reiterates what was already known. There is a perception, therefore, of very little added value. The recommendation here is that there should be more female entrepreneurial representation amongst business mentors and advisors, as well as more practical examples of female experiences in starting and running a business.

Leading on from this, there is a view that current advice reflected mainstream values and appears conservative and risk adverse. Having more representation from female entrepreneurs would also address this issue.

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## **R&D ALLIANCE FORMATION: THE RELATIONSHIP BETWEEN NATIONAL R&D INTENSITY AND SME SIZE**

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Presented at the ICSB 50<sup>th</sup> World Conference  
Washington, DC

June 15, 2005

### **ABSTRACT**

The resource based view of the firm would seem to suggest that for SMEs the greater their internal resource capacity and the greater the level of external resources available in the environment the less likely the SME will be to form strategic alliances. In this research we explore these relationships and suggest that it is a complex interaction between SME resources, resource needs and environmental munificence that determines the likelihood that an SME will form an alliance. In specific we view the interaction between firm size and the level of national R&D intensity in determining the likelihood that an SME will form an R&D alliance. The study hypotheses are tested utilizing over 2000 completed surveys from SMEs in eight countries.

### **INTRODUCTION**

Resource Based Theory (RBT) and Transaction Cost Theory (TCE) both specify that firms with resource deficits reach into the external environment to obtain needed resources (Barringer and Harrison, 2000). The tenets of both theories suggest that firms will only seek to obtain needed resources through alliances with other firms when the resources are not available in the markets. The underlying assumption is that the more

munificent the environment the less need there is for alliance relationships that carry an inherent potential for opportunistic behavior. Unfortunately, despite the intuitive appeal of this assumption regarding the motivation for alliance formation, there is a great deal of inconsistency in the empirical results of studies seeking to confirm the relationship between environmental munificence and the rate of alliance formation (Park, Mezas, and Song, 2004).

In this research, utilizing a survey of 2,054 SMEs from eight countries, we explore the relationship between national R&D intensity and R&D alliance formation by SMEs. We hypothesize, consistent with RBT and TCE assumptions, that in general the greater the level of R&D intensity, considered as a form of environmental munificence, in a given market the less likely firms will be to form R&D alliances. We suggest that this relationship does not hold true for all SMEs. We hypothesize that SME size moderates the relationship between environmental munificence and R&D alliance formation such that larger SMEs are more likely to form R&D alliances the greater the level of R&D intensity. In exploring these results we suggest that a careful consideration of the types of resources needed by SMEs based on their size as well as the level of resources held by an SME explain the seeming contradictions in RBT prescriptions regarding alliance formation.

To the best of our knowledge no one has previously tested the interaction between SME size, as reflective of resource types and levels, and R&D intensity, reflective of environmental munificence. Park, Chen and Gallagher (2002) suggest that there is in fact a surprising lack of research on how firm resources interact with environmental conditions to determine strategic choices. The findings of the present research have implications for both theory and practice. The findings strongly support the tenets of RBT and suggest possible explanations for the inconsistency in the findings of past empirical research. Specifically, the results indicate that researchers, seeking to understand why SMEs form alliances, should go beyond considering firm and environmental resources separately to consider the complex interaction between both the levels and types of resources needed by SMEs and those available in the environment. Study findings also have implications for managers and policy makers. Given the existing structure of national R&D investments it is important for policy makers to understand the interaction between SME resource needs and those that are available in the environment and the implications that this has for when, where and how to support the formation of collaborative relationships between firms.

## THEORETICAL FOUNDATIONS

Although past research has suggested strong links between firm size and organizational behavior, studies into the relationship between firm size and the rate of R&D alliance formation has produced mixed results (Pisano, 1990; Sakakibara, 2002). The RBT view of the firm suggests two reasons that the rate of R&D alliance formation may be greater for larger SMEs than for smaller SMEs. First, larger SMEs are assumed to in general have greater levels of internal resources making them more attractive as potential alliance partners than smaller SMEs (Park, Mezas and Song, 2004). Smaller

SMEs are typically younger in age with less to offer potential partners (Stuart, 2000). Second, larger firms while typically having greater capacities and relationships that need exploitation also need to focus on developing and discovering new products and markets (Park, Mezas and Song, 2004; Singh, 1995). This dual need results in a greater rate of alliance formation by larger SMEs. RBT rational as well as past research findings suggest the following hypothesis:

H1: The likelihood of R&D alliance formation will be higher for larger SMEs than for smaller SMEs.

Research into the role of the institutional environment in organizational behavior indicates that institutional factors have an important role in determining the strategies that firms pursue (Barney, Wright and Ketchen, 2001). Park, Chen and Gallagher (2002) argue that the more benevolent a market is, in terms of key resources, the less likely it will be that firms will seek to form alliances. RBT reasoning suggests that in general if resources are available in the markets firms will not seek out resources through alliances due to the inherent risk of opportunism in such relationships. Although this reasoning makes intuitive sense research findings suggest that the relationship between environmental munificence and alliance formation may in fact be the reverse when technology-intensive environments are considered. In technologically munificent environments, while there may be greater resources available to the SME, there are also greater demands on continued innovation (Harrison, Hitt, Hoskisson and Ireland, 2001). Kelly and Rice (2002) argue that rapid technological obsolescence and the need for greater breadth of technologies make it difficult for a single firm to stay competitive. These findings suggest two opposing hypotheses regarding R&D alliance formation and environmental resource munificence—in specific the level of R&D intensity in the institutional environment of the SME.

H2a: The likelihood of R&D alliance formation will be higher the higher the level of national R&D intensity.

H2b: The likelihood of R&D alliance formation will be lower the higher the level of national R&D intensity.

Taken collectively the two resource-based views of alliance formation presented in support of the first two hypotheses would seem to indicate a possible moderating effect between SME size and environmental munificence—and specifically in this research R&D intensity. As previously noted RBT reasoning and past research suggest competing hypothesis regarding the relationship between alliance formation and environmental munificence. Taking into consideration the role of SME size, as reflective of resource capabilities and needs, would seem to provide a solution to these contradictory assumptions. The likelihood of R&D alliance formation by larger SMEs, typically with a greater need for involvement in both exploratory and exploitative alliances (Park, Chen and Gallagher, 2002), would tend to be greater the higher the level of R&D intensity (as reflective of more technologically-intensive environments). The likelihood of R&D alliance formation by smaller SMEs who are typically focused primarily on exploitative alliances rather than exploratory alliances (Park, Chen and Gallagher, 2002) would tend

not to be impacted by the level of R&D intensity. This reasoning leads to the following hypothesis:

H3: SME size will moderate the relationship between the level of national R&D intensity and R&D alliance formation. The rate of R&D alliance formation will be higher for larger SMEs the higher the level of national R&D intensity. The rate of R&D alliance formation for smaller SMEs will not be impacted by the level of national R&D intensity.

## METHODOLOGY

The study hypotheses were tested utilizing a survey of 2,054 SMEs, both those with R&D alliances and those that have never formed R&D alliances, in Australia, Sweden, Mexico, Norway, Finland, Indonesia, Greece and the Netherlands. Additionally, a wide range of macro economic data was collected in order to test our assumptions and to control for a wide range of factors that might potentially impact R&D alliance formation. The survey process was rigorously designed and the resulting data unique in both breadth and depth. Hierarchical logistic regression analysis was utilized.

We defined an SME based on size with firms selected at random for the survey ranging in size from 6 to 500 employees. Only independently owned SMEs manufacturing firms that were managed by either the original founder or a general manager with an equity position in the company were included in the final analysis. A key informant designed was used and while every attempt was made to make the survey process equivalent in each country, the methodologies did vary somewhat based on differing constraints. Survey items that were originally developed in English were back translated with care and the surveys either delivered to the randomly selected firms by mail or hand delivery. Both empirical tests and random surveys of non respondents suggested no significant differences between the responding and non-responding SMEs.

### Study Measures

All of the measures utilized, both objective and perceptual, were drawn from existing research. Firm size was assessed based on the total number of employees as reported by the respondent with the natural log of size utilized in the analysis. National R&D intensity was measured by the ratio of R&D expenditures to the real GDP of the country (in 1990 U.S. dollars) and based on a five-year average ending with the year of data collection in each specific country in the study. Data for this measure was drawn from the United Nations Department of Economic and Social Affairs (UNESCO) Statistical Yearbook (2002). The dependent measure for the study, R&D alliance formation, was based on a direct response by the SME as to whether or not the SME currently held or previously held an R&D alliance (either process or product based).

In order to as best possible isolate the impact of SME size and R&D intensity on the likelihood of R&D alliance formation a wide range of control variables was included in the study. These control variables included the age and gender of the respondent, perceptions regarding the attractiveness and uncertainty of the SMEs market, beliefs in

the necessity for alliances, the financial strength and risk propensity of the SME, the industry—characterized by the level of technology—of the SME and the legal system of the SMEs home country. Each of these variables has been either shown or hypothesized in prior research to have a potential impact on strategic choice to form alliances.

The statistical model was tested using hierarchical logistic regression. In the base model all control variables were entered. The contrast group for the industry group was “low technology” and the contrast group for the legal system was “French Civil Law” countries.

## RESULTS

Table 1 provides the study demographics. A total of 2,054 SMEs were utilized in the study out of 7,078 SMEs surveyed (29% overall response rate). Of the SMEs responding 583 held an R&D alliance.

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Place Table 1 about Here

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The results of the logistic regression analysis are provided in Table 2. Hypothesis H1 predicted, supported by RBT reasoning, that the likelihood of R&D alliance formation would be greater for larger SMEs than for smaller SMEs. The results of the analysis support this assumption with firm size positively related to the likelihood of R&D alliance formation. Hypotheses H2a and H2b provided competing predictions regarding the relationship between R&D intensity and alliance formation. The results tend to support H2a suggesting that the greater R&D intensity the greater the likelihood of R&D alliance formation, but consistent with the predictions of H3 this does not hold true across all SMEs. There is a significant interaction between SME size and R&D intensity in determining the strategic choice to form R&D alliances.

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Place Table 2 about Here

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In order to understand the moderating role of firm size on the relationship between R&D intensity and R&D alliance formation a graph of the relationship was prepared and is presented in Figure 1. The graphic analysis suggests, consisted with the predictions of H3 that the likelihood of alliance formation would increase for larger SMEs as the level of R&D intensity increases. Also as predicted it can be seen that increases in R&D intensity of little impact on alliance formation for smaller SMEs.

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Place Figure 1 about Here

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The control variables provide some interesting results as well. The findings suggest that the greater the perceived growth in the market the lower the likelihood of alliance formation while perceived uncertainty is associated with a greater likelihood of alliance formation. Both a belief in the necessity for alliances as well as higher levels of exporting provides a greater likelihood of alliance formation. There are also differences seen across both industries, as categorized by the level of technological development, and legal systems in the likelihood of R&D alliance formation.

## DISCUSSION AND CONCLUSIONS

RBT reasoning seems to suggest that in general the greater the level of resources available to an SME internally the less likely the firm is to seek to form alliances but that this tendency is often offset by the attractiveness of larger SMEs as alliance partners due to their greater resource capacity. The fact that larger SMEs often seek out alliance relationships is also in part explained by the need of larger SMEs both to exploit existing resources and to focus on discovering and developing new products and markets (Park, Chen and Gallagher, 2002). In a similar fashion RBT reasoning suggests that the greater the level of resources available in the SME's environment (environmental munificence) the less likely the SME will be to form alliances. It is suggested in this research that this may not be the case across all sizes of SMEs. In specific, one type of environmental munificence, R&D intensity, is suggested as being reflective of an environment in which technological innovation and the need for technological breadth is essential. In this type of environment, even though technological resources are in greater supply, larger SMEs will be more likely to form R&D alliances in order to acquire increased innovation capabilities. Smaller SMEs, due to their lower resource capacities, are typically more focused on exploiting existing capabilities and in this research are found not to be more likely to form alliances when R&D intensity is high.

The results of this analysis extend our understandings of the resource based view of the firm by suggesting that it may not be either the internal capacity of the SME or the environmental resource base that determines the likelihood for R&D alliance formation but rather an interaction of the two. The results of this study have important implications for policy makers as well. It would appear that the need to form R&D alliances by SMEs is dictated not only by the availability or lack of availability of technological resources in the environment but also the by the resource capacity of the SME and types of resources needed by the SME. Given the existing structure of national R&D investments it is important for policy makers to understand the interaction between SME resource needs and those that are available in the environment and the implications that this has for when, where and how to support the formation of collaborative relationships between firms.

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Table 1  
Study Demographics

| Country     | Total Responding | Percent Responding <sup>1</sup> | R&D Tech Alliances | High Tech Industry | Medium High Tech Industry | Medium Low Tech Industry | Low Tech Industry | Legal System |
|-------------|------------------|---------------------------------|--------------------|--------------------|---------------------------|--------------------------|-------------------|--------------|
| Australia   | 313              | 22.8                            | 39                 | 41                 | 61                        | 143                      | 64                | English      |
| Sweden      | 180              | 30.0                            | 90                 | 29                 | 34                        | 50                       | 67                | Scandinavian |
| Mexico      | 363              | 56.0                            | 77                 | 28                 | 62                        | 59                       | 196               | French       |
| Norway      | 433              | 17.6                            | 154                | 159                | 87                        | 102                      | 85                | Scandinavian |
| Finland     | 121              | 30.3                            | 42                 | 17                 | 30                        | 55                       | 17                | Scandinavian |
| Indonesia   | 285              | 32.0                            | 71                 | 15                 | 70                        | 155                      | 85                | French       |
| Netherlands | 131              | 43.7                            | 38                 | 14                 | 22                        | 59                       | 36                | French       |
| Greece      | 228              | 57.0                            | 72                 | 11                 | 17                        | 152                      | 48                | French       |
| Totals      | 2054             | 29.0                            | 583                | 314                | 383                       | 735                      | 598               |              |

<sup>1</sup>The total number of firms surveyed was 7,078

Study correlation matrix available upon request from the authors.

**Table 2**  
**Logistic Regression for Likelihood of Forming R&D Alliance**

|                               | Step 1     | Step 2            | Step 3            |
|-------------------------------|------------|-------------------|-------------------|
| Constant                      | -3.783***  | -4.642***         | -3.849***         |
| Controls:                     |            |                   |                   |
| Age                           | .003       | -.002             | -.002             |
| Gender <sup>1</sup>           | -.079      | .043              | .027              |
| Industry Attractiveness       | .114       | .121 <sup>†</sup> | .137 <sup>†</sup> |
| General Market Conditions     | -.164*     | -.191*            | -.185*            |
| Technological Uncertainty     | .365***    | .375***           | .378***           |
| Necessity for Alliances       | .251***    | .273***           | .260***           |
| Export Intensity              | .013***    | .009***           | .009***           |
| Firm Financial Strength       | -.017      | -.021             | -.020             |
| Entrepreneurial Orientation   | .177*      | .092              | .084              |
| Industry Group <sup>2</sup> : |            |                   |                   |
| High Technology               | .180       | .308 <sup>†</sup> | .342 <sup>†</sup> |
| Medium High Technology        | .167       | .273 <sup>†</sup> | .278 <sup>†</sup> |
| Medium Low Technology         | .135       | .197              | .195              |
| Legal System <sup>3</sup> :   |            |                   |                   |
| English Common Law            | -.448***   | -.411*            | -.447*            |
| Scandinavian Civil Law        | .759***    | .379*             | .340 <sup>†</sup> |
| Study Variables:              |            |                   |                   |
| Firm Size                     |            | .336***           | .121 <sup>†</sup> |
| R&D Intensity                 |            | .299**            | -.314*            |
| Interaction Variable:         |            |                   |                   |
| R&D Intensity x Firm Size     |            |                   | .162***           |
| X <sup>2</sup>                | 228.696*** | 287.331***        | 303.029***        |
| $\Delta\chi^2$                | 228.696*** | 58.636***         | 15.698***         |
| -2 log likelihood             | 2177.455   | 2118.819          | 2103.121          |
| Cox & Snell R <sup>2</sup>    | .108       | .133              | .140              |
| Nagelkerke R <sup>2</sup>     | .154       | .191              | .201              |

<sup>†</sup>p <.10, \*p <.05, \*\*p<.01, \*\*\*p <.001

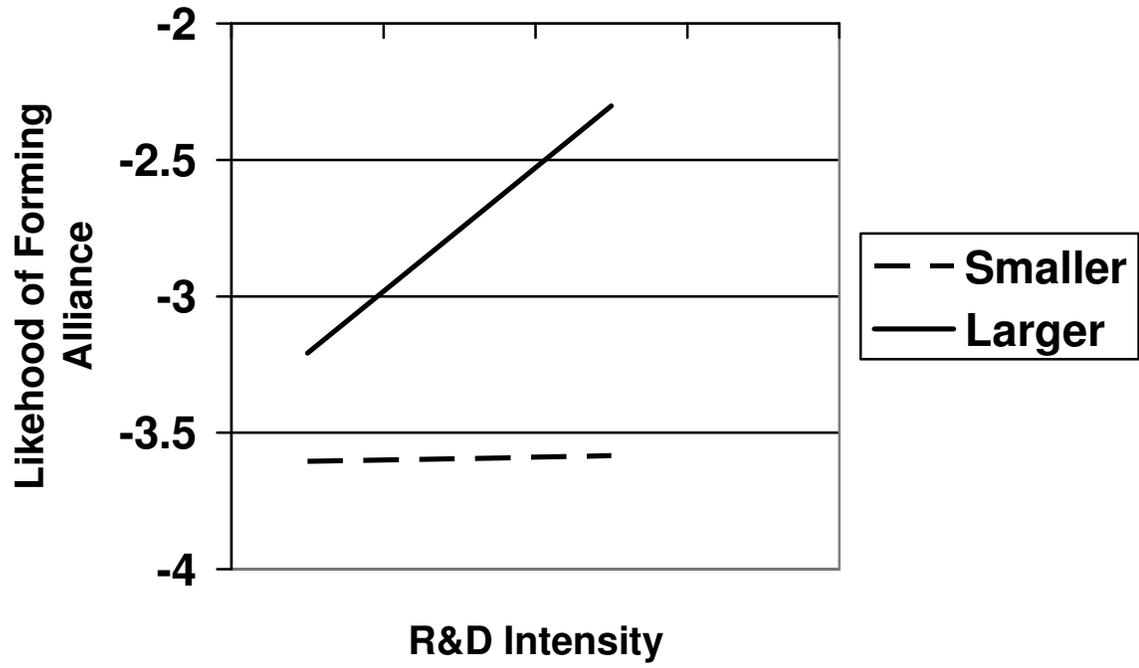
N = 2007; 47 surveys with incomplete data were excluded from the regression analysis

<sup>1</sup>Contrast group was “female”

<sup>2</sup>Contrast group was “low technology”

<sup>3</sup>Contrast group was “French Civil Law Countries”

Figure 1  
Size x R&D Intensity Interaction



# Teaching Scientists Entrepreneurship: A Dialectical Approach

Hung-bin Ding<sup>1</sup>

Harsha Desai

Donald O. Fedder

## ABSTRACT

Today, we know relatively well about what should be taught in the entrepreneurship program for non-business majors. However, our understanding of *how* should the non-business students be taught is still limited. To address this issue, we study the entrepreneurship curriculum developed for the Nontraditional Doctor of Pharmacy (NTPD) students in the University of Maryland Baltimore. In principle, the core of this entrepreneurship curriculum resembles a typical business school entrepreneurship course with an emphasis on developing a business or a project plan at the end of a two-semester long, six-credit course sequence. This entrepreneurship curriculum for PharmD has a successful track record. From 1995 to 2003; 35% to 40 % of the business plans developed by the NTPD students have been successfully funded. Although the program is structured in a similar manner as many other short-term entrepreneurship curriculum in non-business programs, its implementation and dialectic approach create a dynamic learning environment that has effectively assisted non-business major graduate students to engage in business venturing activities. The infusion of dialectical inquiry at the NTPD program enables students of pharmaceutical science to exploit their professional expertise while developing competence in business planning. In this research, we reported the design of NTPD entrepreneurship curriculum and the training of business planning. Given the lack of foundation business knowledge and course time limitation in NTPD (and other hybrid programs), we posit that the effective implementation of dialectical inquiry will help students improve the quality of new venture planning.

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## INTRODUCTION

The growing interest and media attention on private enterprise and the ownership society have created a new demand for entrepreneurship training for non-business majors. Since 1990s, many American universities have developed entrepreneurship curriculums for students and researchers from non-business disciplinary backgrounds (Katz, 2003).

The increasing demand for such curriculums from the broader university community often shows up in the form of short courses or modules (Gartner and Vesper, 1994). The hybrid programs developed for scientists and engineers present a new challenge because of the embedded differences between academic science and entrepreneurship education. The academic training of scientists and engineers emphasizes the importance of identifying and explaining the “variances” of nature (Mohr, 1982). Although variance-theorizing play an important role in the theory development of management and entrepreneurship research (Chiles, 2003), the training of entrepreneurial management focuses on the process of new organization creation, which requires understanding of potential customer groups and skills to manage a business start-up. In addition, the non-business major students lack the fundamental knowledge of business management. While this gap of knowledge needs to be addressed within a reasonably short period, sufficient time needs to be allowed for students to apply the knowledge gained to carry out business planning. Although there is general consensus of what should be taught in the non-business majors, there is limited understanding of *how* these student should be taught.

To address this issue, we study a successful entrepreneurship curriculum developed for the Non-Traditional Doctor of Pharmacy (NTPD) Program at the University of Maryland School of Pharmacy in Baltimore. NTPD students acquire the fundamental knowledge of the four key functional areas in running a business, marketing, operations, finance, and organizational behavior in the first half of the two-semester sequence. Building upon the functional knowledge, students are required to write a plan to develop a pharmaceutical care service program in the second half of the two-semester sequence. The functional courses were taught by business faculty while the business planning courses were co-taught by a business professor and a pharmacy professor.

In conclusion, this study identified two implications for administrators and educators of entrepreneurship curriculums for non-business majors. First, dialectical inquiry challenges students to validate the underlining assumptions of their business plans and improve the quality of business planning. Second, the NTPD students are mostly interested in creating businesses in the pharmaceutical care industry. The highly homogeneous professional background and a well-defined market segment may have allowed the students to thoroughly understand the dynamics of market.

## TEACHING ENTREPRENEURSHIP

The focus of entrepreneurship education is to help students recognize business opportunities and act on these opportunities (Jones and English, 2004). Although small

business management or self-employment management have long been important research subjects in the social science research (Davis, 1968), entrepreneurship as an academic area of training was not widely adopted by American business schools until late 1980s. As successful new ventures are effective integration of an entrepreneur's internal environment (e.g. knowledge or psychological traits) and external environment (e.g. life-cycle of industry, technological trajectory) (Sarasvathy, 2004), it is not surprising that many academic instructors design entrepreneurship courses or curriculums to facilitate the effectiveness of internal-external environment integration. A survey by Hills (1988) reports four objectives of these entrepreneurship curriculums in U.S. business schools:

1. increase awareness and understanding of new venture process,
2. introduce entrepreneurship as an option of career,
3. understand functional business relationships, and
4. recognize or understand traits and characteristics of entrepreneurs.

To accomplish these objectives, a prevailing practice is to design the entrepreneurship course as a discovery process in which students are encouraged to identify a viable business opportunity and to pursue this opportunity through coached business plan writing (Fiet, 2001).

As entrepreneurship becomes a mature discipline in the business schools (Katz, 2003), the rest of the academes start to systematically explore the potential impacts of entrepreneurship on non-business areas. Many entrepreneurship programs were established in the 1980s to encourage scientists and engineers to exploit laboratory discoveries for business potential or to create new platforms of research. However, university scientists and engineers do not see commercialization of business opportunities as the only reason to engage in entrepreneurship. For example, a survey of academic life scientists shows five types of entrepreneurial activities in universities: 1. creating large scale scientific projects, 2. earning supplementary income, 3. gaining industry support for university research, 4. obtaining patents, 5. commercialization of new discoveries (Louis, Blumenthal, Gluck, and Stoto, 1989). The differences of interests between business and non-business academics illustrate the inter-disciplinary distinctions embedded in the social institutional environments. While business school academics and students have interested primarily in exploring entrepreneurial opportunities in the market place, academic scientists and engineers pursue entrepreneurship in both market and institutional settings.

Academic entrepreneurship traditions based in science and engineering, create obstacles for commercialization of its technology. First, university-based scientists and engineers appear to be more comfortable exchanging ideas and concepts with colleagues rather than venturing forth into the private sector. Although there have been administrative measures to encourage university-industry technology transfer in the last decade, the results have been disappointing (Markman, Gianiodis, Phan, and Balkin, 2004). Second, even for those interested in pursuing commercialization, their lack of knowledge in business operations and interaction between market and for-profit organizations has proved to be a behemoth challenge (Markman, Phan, Balkin, and Gianiodis, 2005).

As the number of universities interested in commercialization of research grows, hybrid entrepreneurship programs are created and housed in school of engineering or school of science. Such organizational arrangement aims to mitigate students' uncertainty about new venture initiation in the market place. These programs also bring entrepreneurship skills and knowledge to academic scientists and engineers who are inspired to pursue opportunities in the market place.

### **ENTREPRENEURSHIP TRAINING IN NTPD**

The objective of the Non-Traditional PharmD program is to provide licensed pharmacists, who have a Bachelor of Science in Pharmacy degree, the opportunity to earn the Doctor of Pharmacy degree. The objective of the entrepreneurship module in the doctoral program is to give knowledge and appropriate skills to the students that are both useful and "actionable" (Argyris, 1993). In principle, the core of this entrepreneurship curriculum resembles a typical business school entrepreneurship course with an emphasis on developing a business or a project plan at the end of a two-semester long, six-credit course sequence. This entrepreneurship curriculum for PharmD has a successful track record. From 1995 to 2003; 30% to 40 % of the business plans developed by the NTPD students have been successfully funded.

#### **The structure of the curriculum**

Although the program is structured in a similar manner as many other short-term entrepreneurship curriculum in business and non-business programs (See Meyer, 2001 for a brief review of current state of entrepreneurship education), its implementation and dialectic approach create a dynamic learning environment that has effectively assisted non-business major graduate students to engage in business venturing activities.

The dialectic approach, or dialectical inquiry, has long been an important element in strategic planning (Mason, 1969). In the early stage of strategic planning, managers exchange opinions and raise constructive challenging perspectives to reach consensus.

The Non-Traditional Pharm.D. program recognized early the need and importance of a management track in an otherwise technical doctorate. Argyris (1993) promotes actionable knowledge; knowledge that individuals can use in which a commitment to personal responsibility and a dedication to effective action and learning are paramount. The intent in the program was to give knowledge to the students that were both useful and "actionable". The management pathway included four key functional areas of business: marketing, operations, finance, and organizational behavior.

#### *The Two Course Sequence*

The management pathway was designed as a two-course sequence with an objective of providing students with the business language and tools. Both courses were 16 weeks in duration.

### First Course

This course, labeled PHNT 511, provided a business foundation which includes marketing, finance, operations, and organizational behavior with each of the four subject areas lasting for a total of 12 hours taught over a three-hour session over 4 weeks.

The teaching challenge was obvious - in a typical business school, undergraduate students spend up to four years learning about each of these subjects; we were providing the basics in 12 hours, systematically examining key issues in the four functional management areas.

Each module was taught by an instructor who was usually not a pharmacist but had a health care background – consulting service, professional service provider, operations professor in a business school. One of the key qualifications for the instructor was their considerable experience in business or academia. The second qualification, perhaps even more important than the experience, was instructors' ability to convey concisely and succinctly the most important ideas and concepts in each functional area; precision and brevity were critical.

In each of the four modules, students had opportunities to test ideas about a pharmaceutical care project such as: health care service feasibility, new service / product development and implementation related business plan, chronic disease education service, and medications compounding service for children and elderly.

For example, in the marketing module the students could create a brief marketing plan and get feedback from the instructor; in the operations module, many students designed a "business-process" related to their pharmacy practice site suggesting ideas for improvement.

The module grades ranged from "A" to "C". The required written work was typically submitted by the students at the end of each module; and instructor's comments along with an appropriate grade were returned to the students within a week. Feedback was exhaustive, rapid and frequent. Students were also asked to report on an occasional Fast Feedback in the middle of the modules; this feedback was used by instructors to make mid-module corrections. At the end of each module students were also asked for their "lessons learned."

### Second Course

The second course was designed to give the Non-Traditional Pharm.D. students a hands-on experience in the development of a business plan with an eye toward its implementation possibilities. These submissions were comprehensive and included all relevant sections of a typical business plan. In contrast, submissions in the First Course were focused primarily on each functional area.

The students were required to develop business plans that were "practical" with lots of real data and hard evidence supporting their plans – we continually asked, "how do you

know' question that had to be satisfied with both primary and secondary data and literature search.

Thus the planning process afforded students opportunity to develop a well documented paper mimicking a business plan or a feasibility study that explored relationships between the business aspects of the plan and the pharmaceutical care outcomes for the target patients.

### **Dialectical inquiry**

In NTPD, the dialectic approach is used to assist students in their Second Course that helps the students develop new ventures. The dialectical inquiries help students apply the functional business knowledge to the pharmaceutical care context; well implemented dialectical interactions help students see the potential results of each event and each intended action.

This second 16-week long course created a forum for "structured debate" in which students are forced to consider alternative interpretation of their assumptions. The course meets five times during the semester. The course meets weekly during the first two weeks. The third session of the course takes place four to five weeks after the second session and six to seven weeks into the semester. The fourth session is generally scheduled for the 10th or the 11th week. The final session takes place during the 16th week when students submit their final plans. The spacing of the meeting classes is intended to allow students prepare and submit work-in-progress to the instructors.

The students are required to submit completed sections of their plans as the semester progresses. Each submission is returned promptly to the students with extensive comments for rewriting and regrouping the information submitted in the reports. Most of the exchanges take place face-to-face during the five scheduled sessions or via fax or e-mail.

In this milieu, these not-so-frequent sessions serve two purposes: first, the ample time between sessions allows students to gather material, rewrite sections and allow time to revise and resubmit sections. And second, the face-to-face sessions allow the students to discuss challenges facing them – the questions comprise a simple “how do I prepare a budget” to a much more nuanced question about identifying a subtle opportunity targeted toward a particular ethnic segment of the population.

Students were repeatedly asked to revise and resubmit their draft plans. The most important question that drove the discussion was: How do you know?

For example, in developing a marketing module we asked the students how did they know there was a ‘market’! The question got to the heart of two critical data: first it forced the students to remove all unnecessary clutter surrounding their research (they had to focus on the task at hand); and two, it forced them to link business assumptions (how do you know you have a market? How do you know somebody will pay for the service? How do you know how much demand there is?). Furthermore, in marketing sections, the

students, first, had to demonstrate, using appropriate published literature, that there was a need. Having established the need they had to collect data – either directly via meetings and surveys in the target community with their target market segments or from precisely collected secondary data published in public records and private papers.

This relentless questioning comprises the principal activity during face-to-face and email communications. The business school professor provided the framework that included questions about projects' business models as well as necessary detail establishing a market, development and writing of management experience to carry-out the project, details including site selection and business processes governing the operations of the plan and needed financial analysis and pro forma statements. The pharmacy school professor provided the necessary pharmaceutical care knowledge - it didn't hurt at all that the pharmacy school professor had operated a pharmacy himself when young and continues to run, as the founder-executive director a very successful service organization providing direct pharmaceutical care.

Often there are students who have already passed this 'stage' of their research and writing and quite willing to help their peers - the class as a whole acts as a large "consulting" practice; the conversations are quite animated, providing tidbits of advice and suggestions for improving each other's paper. It's a delight to see 'ahas' emerging from these conversations as the give-and-take during the class builds confidence in those students who may be having a problem getting started with their plans or those who may be encountering writer's block.

This practice of continual sharing of experiences and question-driven participation produces uniformly superior written reports. They are well written and reality-based having ample justification for the markets being pursued along with appropriate financial and managerial information. Since the reports are developed by practicing pharmacists there is a lot of realism and plain language that avoids jargon. These reports invariably show that they have the necessary management experience and the expertise to carry out the proposed project. Finally, these reports are written with a passion suggesting superb confidence in one's expected results if the plans were to be implemented. Time and again we hear that these plans have been accepted by their "superiors" or that the request for money has been granted by the funding agencies.

## **DISCUSSION**

The recent boom of hybrid entrepreneurship programs in American universities reflects a strong drive to encourage scientists and engineers to take an active role in identifying and pursuing potential business opportunities. While the functional knowledge such as accounting, marketing, and operations management remains an essential foundation of knowledge for future entrepreneurs, our observation finds that training of business planning may play a significant role in improving the quality of opportunity identification and resource mobilization.

Dialectical inquiry planning approach improves the quality of business planning (Mason, 1969) and increase the satisfaction of planning process (Schweiger, Sandberg, and Ragan, 1986). The dialectical inquiry process provides a forum of structured debates (Mason, 1969). The implementation of dialectical inquiry in NTPD indicates that such structured debate facilitate the students' understanding and appreciation of new venture planning through three mechanisms.

First, the dialogue between the instructor and the students enables students to validate the assumptions. The instructors of the entrepreneurship course may not be the experts of the specific venturing contexts proposed by the students. However, as non-experts in pharmaceutical science, the business instructors are able to provide alternative interpretation of any assumptions adopted in the business plan. To address these questions, students may have to either validate the existing interpretation of assumptions or to re-evaluate the validity of the alternative perspectives. Although not all business plans demonstrate apparent improvement of quality, students reported to have gained better understanding of assumption validation and new venture planning.

Second, entrepreneurship courses only accounts for a small percentage of overall curriculum requirement in non-business programs. For example, the NTPD entrepreneurship curriculum consists of two courses in a 16 course degree program. Although it is feasible to cram functional knowledge and the training of planning in one semester or shorter, such course design does not allow students sufficient time to reflect to engage in productive debate with the instructors. We found that the one year course sequence seems to be sufficient to NTPD students. However, more analyses will be necessary to determine the impact of lag time and the learning effectiveness.

Finally, hybrid entrepreneurship programs tend to be restricted to specific contexts (Katz, 2003). The narrowly defined context of business venturing is designed to fit the professional specialty of students. In addition to the NTPD program, notable examples include the Entrepreneurship for Artists in Maryland Institute College of Arts; Entrepreneurship for Physicists at Case Western Reserve University. We found such curriculum design effectively engages students to the dialectical debates. Since the students have expert knowledge in the technology and delivery of products/services, the debates tend to be more focused on the creation of business organization and the validity of underlying assumptions.

## **CONCLUSION**

As public interests in entrepreneurship increases, the number of hybrid entrepreneurship program in American universities has been on the rise. The spill-over of entrepreneurship education from business schools to other academic disciplines presents a new challenge to educators. The infusion of dialectical inquiry at the NTPD program enables students of pharmaceutical science to exploit their professional expertise while developing competence in business planning. In this research, we reported the design of NTPD entrepreneurship curriculum and the training of business planning. Given the lack of foundation business knowledge and course time limitation in NTPD (and other hybrid

programs), we posit that the effective implementation of dialectical inquiry will help students improve the quality of new venture planning.

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# EVALUATION OF POLICY IMPLEMENTATION IN WOMEN ENTREPRENEURSHIP DEVELOPMENT

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## ABSTRACT

Women entrepreneurship in economic development of any nation has been documented for its significant contribution. This means that the neglect of women in the development process constitutes a human waste. The increased role of women in economic development had spurred the government in developing policies on women development. However, several studies have discovered that women performance was still low specifically in the small and micro scale industries. Problems like low productivity, high rates of business failures, and no access to credit among others had hindered their growth. In light of this, the study examined the policy implementation of the two programs created to mobilize women on entrepreneurship development. It attempted to determine if the programs have succeeded in empowering women economically and socially. It also aimed to uncover the possible implementation gap problems and determine the extent of which these gaps have affected the effectiveness of the policy implementation.

The study was carried out in Osun State, Nigeria. The subjects of the study who were members of the programs were selected by random sampling method. A total of one hundred fifty respondents were interviewed with the aid of predetermined question. The questionnaire was designed to ferret information using the Women Equality Empowerment Framework. This was to determine the level of development impacted by the programs. Statements were developed to operationalize development into welfare, access, conscientization, participation, and control. These were measured by a 5-point scale method. The variables were described and highlighted using descriptive analysis.

The results showed that despite some constraints in the implementation due to implementation gap, there was an average impact of the programs on women development. Welfare like housing, clothing and food were average. Access to land was also average, but access to credit, services were low. However, the respondents had high access to their own labor. It was further revealed that the programs had impacted highly on the ability of the respondents to relate themselves with the society and that their participations to group activities had increased. Although a high result was revealed in conscientization level, their low level of control over the resources might affect their involvement because of a gap that exists between efforts and rewards. It is therefore imperative that overcoming gender inequality must be a high priority in policy development concerning women.

## INTRODUCTION

One of the key factors in determining the success of development is the status and position of women in the society. This means that the neglect of women in the development process of any country constitutes a human resource waste. In this premise, it will be a disservice for any country to ignore its women population in its development efforts. The task before any government, therefore, should be that of moving steadily and firmly in the direction of economic development by involving women. Faleye (1999) stressed that women's development is not nearly about reducing poverty by increasing productivity, but also about women's liberation and empowerment.

True development means the development in the three categories of a woman. These are individual, social, and economic development (Rodney, 1972). Individual development means increased skills and capability, greater freedom, creativity, self-discipline, responsibility and material well being. Increasing capacity connotes social development, while economic development is determined by the increased capacity of the members of a society in dealing with their environment. This emphasis means that development at the individual stage subsumes both the social and economic categories of development. Development is dynamic and therefore assumes a continuous transformation process and a movement towards better and improved conditions, locally and internationally.

In Africa, women constitute about 50 percent of the population and account for about 60 to 80 percent of the agricultural production. Therefore, for a meaningful development to take place, women development must not be overlooked. In Nigeria, women actively played a meaningful role in the industrialization process of the country. The role of women in social and economic development specifically in the small and micro enterprises was found to be primal in

the economic development of their communities. Their potentials have spurred the government in devising policies to stimulate the industrial sector specifically in the development of indigenous technology. Accordingly, the government has developed trade and industrial policies that will foster industrial development and increase production of manufactured goods in the country. Majority of these policies were created for the informal sector. For instance, the government has formulated policies introducing the Better Life Program (BLP) to improve the conditions of the rural women and the Family Support Program (FSP) to improve the fortune of the family and the condition of women in general.

### **PROBLEM STATEMENT**

The Better Life Program came into existence in 1987 and later launched in all states and local areas of the nation aimed at mobilizing women for resource productivity. The primal objective of this program was to sensitize the government and indeed private organizations to the useful role that women could play in national development. The declaration of International Year of the Family by the United Nation in 1994, as a result of global economic and social upheaval, gave insight into the conception of the Family Support Program, which was predominantly in favor of women whether they are in the rural or in the urban area. This program aimed to improve and sustain family cohesion through promotion of social and economic well being of the Nigerian family. These programs were introduced with the purpose of stimulating and motivating women towards achieving a better life and higher standard of life and good family life of women specifically the entrepreneurs in the small and micro scale industries. In line with these programs, the policy is supported with other fiscal and monetary policies geared to making efficient use of resources, mobilizing domestic savings for investment, and utilization of raw materials among others.

However, observation showed that the fortune of women in Nigeria has not been considerably improved in spite of these programs. According to Aina (1993), there have been complaints about the implementation of the two projects. Ogolo (1997) in her study concluded that the BLP and FSP programs had not really accomplished much. She referred to the program as merely publicity –grabbing gimmick, which is better known for its manner than for its matter. Faleye (1999) predicated that the implementation of these programs was found to have not accomplished much in his study. Faleye pointed out the weaknesses in the programs. He revealed that the rural women and the family unit did not feel the impact of the programs despite the propaganda through mass media. This is not to say that nothing positive came out of the program. Aina (1993) reported an increase in the number of women cooperatives from 413 at the inception of BLP to 9, 422 by 1991. Ogolo (1997) also highlighted the social awareness among rural women through intensive public enlightenment campaigns organized by the programs.

Several studies discovered further that women engaged in the small and micro scale of the industrial sector were still striving to grow and were still bombarded with problems. These problems include high rates of business failures, low productivity; and no access to capital, credit, and labor among others. It was also noted that the policies introducing economic enhancement programs were gender-blind. It was also observed that women were not explicitly included in the programs. Although it was evident that women were found to have been engaged in small scale business, a lot of constraints have hindered their economic participation. In light of this, the study investigated and evaluated the implementation of the programs to determine their impact on women entrepreneurship development, that is, how far the programs have succeeded in achieving their primal objectives of empowering the women involved in the programs, both economically and socially. It attempted to uncover the possible implementation gap problems

and determine the extent of which these gaps have affected the effectiveness of the policy implementation.

### **FRAMEWORK FOR ANALYSIS**

Policy implementation is mainly the activities that are carried out in the light of established policies. Egonmwan (1991) was of the view that implementation refers to the process of converting inputs such as financial, material, technical, human into outputs – goods and services. He further described it as the stage where the earlier preparation and designs, plans and analyses are tested in the harsh light of reality. Policy implementation has been described as one major problem confronting developing countries such as Nigeria. The implementation problem in developing countries is the problem of a widening gap between intentions and results. A manifestation of implementation gap is the phenomenon of the rich getting richer while the poor are getting poorer in spite of avowed stated policy goal of elimination of poverty and equality of access to the basic needs of life. Implementation gap also manifests in the widening of the distance between stated policy goal and the realization of such planned goals. (Egonmwan 1991).

Boserup (1970) opined that development programs in developing countries tended not to be effectual or productive because planners had failed to understand gender inequalities. Development can be viewed as empowerment, the liberation of women. Development is not complete without the reduction of poverty through increasing productivity. However, to achieve a high level of empowerment, structural inequality in the society should be addressed. Therefore, for the empowerment of women, there must be women's collective mobilization to overcome particular instances of institutionalized gender discrimination.

Empowerment is a process aimed at consolidating, maintaining or changing the nature and distribution of power in a particular cultural context. The process is rarely linear because it

takes twists and turns. It includes both resistance and consent, and ebbs and flows as groups with different relations to the structures and sources of power come into conflict (Morgen and Bookman, 1988). Smith (1996) considers empowerment to be a process that can only begin in a climate in which there are high expectations and where everyone feels respected and valued and where people will offer their best at all times. The concept of empowerment ranges from encouraging people to play a more active role in their work through involving them in taking responsibility to enabling them to make more and bigger decisions without having to refer to someone higher in position. Similarly, empowerment is seen as an expansion of freedom of choice and actions which means an increase in one's authority and control over the resources and decisions that affect one's life (World Bank, 2003). In other words, focusing on how women have to be empowered economically and socially, policy implementation must stem from the framework on the Women's Equality and Empowerment Framework (WEEF), which looks at all levels of equality from the perspectives of welfare, access, conscientization, participation, and control (Ostrom, 1974).

Women's Equality and Empowerment are ladders of equality identifying the five levels of empowerment for women to advance towards equal status with men. The higher the levels of equality automatically mean high levels of development and empowerment. The lowest level is the welfare level, while the highest is the control level. Welfare is the level of material resources that females have relative to males in such areas like nutritional status, food supply, and income. Women are seen here more as passive recipients of welfare benefits. The gender gap can be identified through the disparity between males and females on indicators of nutritional status, mortality rates among others. Women's empowerment cannot highly take place at this level because an attempt to improve welfare level will entail access to resources. Access is the

restricted access to the resources of production available in the society results in women's lower level of productivity. These include land, credit, labor, and services. Empowerment means that women are made aware of the differential situation and encouraged to take actions for gaining access to their fair and equal share of the various resources made available within the household and within the wider system of state provision. When there is an attempt by women to overcome the obstacles to access, it means that they have confronted the systematic discrimination, which can be addressed only through the empowerment process to conscientization.

Conscientization refers to the gender gap as a belief gap. The belief that women's lower socio-economic position, and the traditional gender division of labor is a part of natural order. So empowering women, therefore, implies the sensitization to such beliefs and practices and their rejection. It also means that women's subordination is not part of the natural order of things but is imposed by a system of discrimination, which is socially constructed and which can be altered. The realization by women that their problems do not derive so much from their own personal inadequacies, but rather by institutionalized discrimination against women and girls helps to bridge the gender gap caused by inequality.

Participation refers to the participation of women in various positions. However, women participation in the developing countries is very marginal. In terms of gender gap, women's participation is the visible and obvious phenomenon. Participation means that women equally with men, are actively involved in the development process. This includes equal participation in the decision making process as well as in development projects; particularly the projects that affected their direct community. This could mean that women would be adequately represented in a development project in the area of needs assessment, project planning, management, implementation, and evaluation. Equality of participation means involving women from the

community affected by the project and involving them in the same proportion in decision making as their proportion in the community at large. the need to effectively involve the target beneficiaries in the direct projects can be likened to the belief of the public choice theorists which give room for polycentric structure of administration by which people will be able to contribute to decisions that affect their lives.

Control means a balance of power between men and women, so that neither is in a position to dominate. It means that women have power alongside man to influence their destiny and that of the society. Women's increased participation at the decision making level can only be said to lead to their increased development and empowerment if such participation enables them to achieve increased control over factors of production, access to resources and the distribution of benefits. In a situation where the wife makes the effort but the husband collects the benefits, there is a serious gender gap between effort and reward.

Following the above premise, at what level can one say then that a woman is empowered. Using the analytic framework for evaluation, the issue of women empowerment from the perspective of the process overcoming gender inequality through the 5 levels (ladders) of equality would show that the lowest level of women empowerment is attained when equality gap between man and woman is bridged at the level of welfare. Access, which is the next level, implies access to land, loan facilities, labor services, opportunities, and to use own labor. In this case, there is no doubt that empowerment will improve or better still, guarantee better and steady income. In conscientization, the woman is being conscious of her environment, which cannot be done without the individual socializing with the people in the environment. In the participation level, women equally with men, are actively involved in the development process and when there is increased control over the factors of production and when there is a balance of power between

women and men, so that neither a position of dominance. This level of empowerment enables women to actualize themselves. Self-actualization produces such satisfaction as power, prestige, status, and self-confidence. It is at this level at which women feel fulfilled.

## **METHODOLOGY**

The study was carried out in Osun-State, Nigeria. The state comprised three Senatorial Districts, namely Osum East, Osun West, and Osun Central. The subjects of the study were selected from each of the senatorial districts using the random sampling technique. The selected communities were Ile-Ogbo Iperindo, and Ilobu. One hundred and fifty women respondents that participated in the programs were identified in the three communities with the assistance of officials from the Ministry of Information and Women Affairs in the state that were stationed in the various local government as project officers.

The study used both primary and secondary sources of data. Structured interview with the aid of predetermined set of questions (questionnaires) were used to collect the pertinent primary information. The interview schedule was supported by focus group discussion among the selected fifty women groups that participated in the two programs using the double sampling technique. There were three focus group discussions held in each of the three communities. Selection of groups was based on age and education level. The focus group discussion was carried out before the interview schedule as an interactive measure apart from eliciting deeper issues relevant to the variables of the study.

The dependent variable development of women entrepreneurs was operationalized using women's equality and empowerment framework from the perspectives of welfare, access, conscientization, participation and control. Statements were developed in each category addressing the objectives of the programs to measure success of implementation employing the

5-point scaling method. The independent variables, which were the two programs were measured using the objectives set for the policies by Liker scale method. Data collected were analyzed using descriptive statistics to describe and highlight the variables of the study.

## **RESULTS AND DISCUSSION**

### **Demographic Characteristics of the Respondents**

The results in Table 1 show that majority (42%) of the respondents were between 30 and 39 years of age. About 23 percent were above 50 years of age and about 17 percent were between 40 and 49 years. The results also show that majority (89%) of the respondents were married and about 51 percent of them had more than four children, while 26 percent had 3 children. The data can be inferred that the respondents are still at the working age and the married status of the respondents connotes high level of responsibility. Having more than 4 children indicates the necessity of having additional income. This explains the need in participating in the program. The data also revealed that 37 percent had attained higher than secondary level of education, while primary was the lowest level attained by the respondents, which shows that the programs were not left to the illiterates along, neither left in the hands of those with only certificates.

### **Assessment of Programs on Welfare**

The programs aim was to enhance the economic standards of women entrepreneurs in the small and micro scale industries and empower them economically. The results in Table 2 revealed that the programs had averagely impacted their welfare with a grand mean score of 3.329. Furthermore, the programs had made positive impact on the women health care with an average mean score of 3.840. The data also showed that nutritional status, clothing, and housing were affected averagely with mean scores of 3.380, 3.480, and 3.013 respectively. It was further

revealed that income had low mean score (2.933). In fact, it was revealed that 19 percent of the respondents indicated that they did not feel the impact of the programs on their income at all. Also, about 13 percent indicated the same in housing that the programs did not have impact at all.

### **Assessment of Programs on Access**

Facilities refer to land, credit, labor, services and utilization of own labor. The results in Table 3 showed that the respondents had an average access to facilities with a grand mean score of 3.136. The results further showed that the respondents had high access to own labor (4.020), and average access on service (3.140). The access to land (2.78), credit (2.860), and labor (2.880) were revealed to have quite a bit impacted by the programs. These are important resources in the process of production and the absence of these resources has a significant effect on the capacity of the women to contribute economically. It was revealed that 19 percent of the respondents had the opinion that credit facility did not affect their capacity to contribute economically. The results can also be inferred that if these facilities are available to them, they could positively contribute socially and economically, hence they have the access to their own labor. However, the lack of access by some of the respondents was due to the low level in some of the variables in the welfare level of development like the housing and the income.

### **Assessment of Programs on Conscientization**

The data in Table 4 revealed that there was high awareness of the respondents about their environment. This was indicated by the grand mean score of 4.038. This result indicated that the programs had high (4.267) influence on the improvement of their attitude toward self. The respondents were also conscious on the beliefs and practices injurious to their development as well as the understanding on the negative beliefs and practices women indicated by almost high

mean scores of 3.297 and 3.920 respectively. It can be inferred from these results that the programs had sensitized and improved their level of awareness about their selves and that of the environment, which are significant to the development of personality. Once women have the realization of their problems especially the discrimination against women, this will help the bridge the gender gap caused by inequality. The results can be inferred that there would be a high level of development among women once the programs are modified specifically on variables that concern overcoming gender inequality, hence development starts from the personality of an individual.

### **Assessment of Programs on Participation**

The data revealed the participation of women was enhanced indicated by the grand mean score of 4.028, which is high. The participation of women means involving themselves into any development process in the community. It could be in decision making or in development projects. Their involvement has to do with the extent of encouragement by their male counterparts like the husband or the father. The support of the male figure in the family influences their participation. This was shown in Table 5, indicating a high (4.000) encouragement by the husband. Hence the evaluation scale used indicates that once conscientization level is high, the understanding of environment is also high. If this happens, there is gender equality at home. This means that the women would be able to gain the understanding of the husbands, which indicates that men are not impediment to their participation. This would likely build self-confidence among women to face the challenges of the environment.

### **Assessment of Programs on Control**

Development will not take place, neither empowerment through policies and programs if one has no control over resources. An empowerment that is devoid of control cannot be tagged real empowerment. The study revealed that control over possession was averagely (3.396) influenced as shown in Table 6. The control over their labor recorded an average mean score of 3.407. Certainly, even if respondents have high access over their own labor but do not have control over it, development will not take place. Equality of control means a balance of power between man and a woman, so that neither is in a position to dominate. It means women have power alongside man to influence their destiny and that of the society. There is increased in development and empowerment if such participation enables them to achieved increased control over the factors of production, access to resources and the distribution of benefits.

#### **Constrains of Policy Implementation.**

In the focus group discussion held, it was revealed that sound policies were formulated but failed at the level of implementation. Problems like inadequate definition of goals, over-ambitious policy goals, choice of inappropriate organizational structure in implementation of policies, lack of continuity in commitment to policy, lack of monitoring process, inadequate manpower planning, and non-inclusion of the target groups in the determination of policy were revealed to have contributed to failure of the policy implementation. Corruption was also revealed to be one of these problems.

Inadequate definition of goals makes a policy to lack clarity, internal consistency and compatibility with other policy goals. The successful implementation of a poly bedeviled with inadequacies becomes problematic. Over ambitious policy goals in policy formulation are muddled in ideological context that may confuse the actual problems involved in implementing them. Due to scope and comprehensiveness such policies may experience implementation

bottlenecks arising from any or combination of the lack of appropriate technology for implementation; inadequate human and material resources; over-stretching of available resources for maximum visibility and impact at the end of which nothing concrete may be achieved. The lack of continuity in commitment to policy, usually when there is instability in government, it results in unstable priorities particularly in Nigeria; where change of executive power always resulted to change of priorities and objectives. A serious problem is that of bribery and corruption which has contributed greatly to the failure of policy implementation. When huge amounts of money will get stolen by officers in charge of implementation, the problem is bound to arise.

### **CONCLUSION AND RECOMMENDATION**

Although the programs had some constraints in the implementation due to implementation gap arising from problems like in adequate monitoring process, inadequate manpower planning, corruption and non inclusion of target groups in the determination of projects to be established for them, the two programs have succeeded averagely in empowering women in all the five areas under the equality/empowerment framework. The women that participated in the programs were empowered economically because they were able to control their financial resources thus strengthening their income standing.

. The programs have impacted more on their involvement in many activities and had exposed them to the environment, which have great magnitude of changing their abilities to understand their selves as well as their relations to the society. The programs had improved women to develop positive attitude forwards themselves. They had been sensitized to the injurious beliefs and practices against the development of women. In spite of the inadequacies the programs have succeeded in achieving their objective primarily to sensitize women

economically. However, despite the high conscientization level of the women, their average control level over the resources could significantly retard their motivation in engaging themselves to group and societal issues around them because of a gap that exists between efforts and rewards. It is therefore imperative that any aim of developing policy addressing women, there exist a need to significantly consider overcoming gender inequality so that women will have power alongside men to influence their society.

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**Table 1: Distribution of respondents on demographic characteristics**

| Variables           |                | Frequency | Percentage |
|---------------------|----------------|-----------|------------|
| Age:                | Below 30       | 22        | 14.7       |
|                     | 30 – 39        | 64        | 42.7       |
|                     | 40 – 49        | 32        | 21.3       |
|                     | Above 50       | 32        | 21.3       |
| Total               |                | 150       | 100.0      |
| Marital Status:     | Single         | 4         | 2.6        |
|                     | Married        | 133       | 88.7       |
|                     | Divorced       | 6         | 4.0        |
|                     | Widow          | 7         | 4.7        |
| Total               |                | 150       | 100.0      |
| Number of children: | One            | 3         | 2.0        |
|                     | Two            | 25        | 16.6       |
|                     | Three          | 46        | 30.7       |
|                     | More than four | 76        | 50.7       |
| Total               |                | 150       | 100.0      |
| Educational level:  | Primary        | 35        | 23.3       |
|                     | Modern         | 31        | 20.7       |
|                     | Secondary      | 28        | 18.7       |
|                     | Others         | 56        | 37.3       |
| Total               |                | 150       | 100.0      |

Source: Survey 2004

**Table 2: Distribution of respondents on the perceived impact of the programs on welfare**

| Variables        | 5         |      | 4    |      | 3       |      | 2           |      | 1          |      | Mean Score |
|------------------|-----------|------|------|------|---------|------|-------------|------|------------|------|------------|
|                  | Very High |      | High |      | Average |      | Quite a Bit |      | Not at All |      |            |
|                  | F         | %    | F    | %    | F       | %    | F           | %    | F          | %    |            |
| Food intake      | 12        | 8.0  | 79   | 52.7 | 21      | 14.0 | 30          | 20.0 | 8          | 5.3  | 3.380      |
| Clothing         | 20        | 13.3 | 67   | 44.7 | 31      | 20.7 | 29          | 19.3 | 3          | 2.0  | 3.480      |
| Housing          | 15        | 6.0  | 45   | 30.0 | 36      | 24.0 | 35          | 23.3 | 19         | 12.7 | 3.013      |
| Income           | 9         | 6.0  | 51   | 34.0 | 40      | 26.7 | 21          | 14.0 | 29         | 19.3 | 2.993      |
| Health           | 43        | 28.7 | 54   | 36.0 | 42      | 28.0 | 8           | 5.3  | 3          | 2.0  | 3.840      |
| Grand mean score |           |      |      |      |         |      |             |      |            |      | 3.341      |

Source = Field 2004

**Table 2: Distribution of respondents on the perceived impact of the programs on access**

| Score  | 5         |      | 4    |      | 3       |      | 2           |      | 1          |      | Mean Score |
|--|-----------|------|------|------|---------|------|-------------|------|------------|------|------------|
| Variables  | Very High |      | High |      | Average |      | Quite a Bit |      | Not at All |      |            |
|  | F         | %    | F    | %    | F       | %    | F           | %    | F          | %    |            |
| Improved Access to land                                      | 19        | 12.6 | 25   | 16.7 | 26      | 17.3 | 64          | 42.7 | 16         | 10.7 | 2.780      |
| Improved Access to credit facilities                         | 1         | 0.7  | 56   | 44.0 | 22      | 14.6 | 33          | 22.0 | 28         | 18.7 | 2.860      |
| Improved Access to labor                                     | 7         | 4.7  | 45   | 34.0 | 27      | 18.0 | 43          | 31.3 | 18         | 12.0 | 2.880      |
| Improved Access to services                                  | 21        | 14.0 | 48   | 32.0 | 28      | 18.7 | 37          | 24.6 | 16         | 10.7 | 3.140      |
| Improved opportunities to utilize own labor for own benefit. | 49        | 32.7 | 39   | 26.0 | 28      | 18.7 | 24          | 16.0 | 10         | 6.6  | 4.020      |
| Grand Mean Score   |           |      |      |      |         |      |             |      |            |      | 3.136      |

Source: Survey 2005

**Table 4: Distribution of respondents on the perceived impact of the programs on conscientization**

| Score  | 5         |      | 4    |      | 3       |      | 2           |     | 1          |     | Mean Score |
|--|-----------|------|------|------|---------|------|-------------|-----|------------|-----|------------|
| Variables  | Very high |      | High |      | Average |      | Quite a Bit |     | Not at All |     |            |
|  | F         | %    | F    | %    | F       | %    | F           | %   | F          | %   |            |
| Being conscious of the beliefs and practices injurious to development. | 50        | 33.3 | 54   | 36.0 | 34      | 22.7 | 9           | 6.0 | 3          | 2.0 | 3.927      |
| Rejection of the negative beliefs and practices against women.         | 55        | 36.7 | 42   | 28.0 | 43      | 28.7 | 6           | 4.0 | 4          | 2.6 | 3.920      |
| Improvement of attitude to self.                                       | 78        | 52.0 | 45   | 30.0 | 19      | 12.7 | 5           | 3.3 | 3          | 2.0 | 4.267      |
| Grand mean score   |           |      |      |      |         |      |             |     |            |     | 4.038      |

Source: Survey 2005

**Table 5: Distribution of respondents on the perceived impact of the programs on participation**

| Score   | 5         |      | 4    |      | 3       |      | 2           |     | 1          |     | Mean Score |
|---|-----------|------|------|------|---------|------|-------------|-----|------------|-----|------------|
| Variables   | Very High | F %  | High | F %  | Average | F %  | Quite a Bit | F % | Not at All | F % |            |
| To what extent have the programmes encouraged your economic participation.  | 70        | 46.6 | 40   | 26.7 | 33      | 22.1 | 4           | 2.6 | 3          | 2.0 | 4.133      |
| To what extent did you enjoy the support of your husband as regards to economic participation                     | 60        | 40.0 | 44   | 29.3 | 34      | 22.7 | 10          | 6.7 | 2          | 1.3 | 4.000      |
| To what extent did you enjoy your father's support as regards to economic participation.                          | 43        | 28.7 | 42   | 28.0 | 52      | 34.6 | 7           | 7.4 | 6          | 4.0 | 3.272      |
| Since your participation in the BLP and FSP projects, to what extent have you taken part in community activities. | 70        | 46.6 | 51   | 34.0 | 27      | 18.0 | 1           | 0.7 | 1          | 0.7 | 4.253      |
| Grand Mean Score  |           |      |      |      |         |      |             |     |            |     | 3.914      |

Source: Survey 2004

**Table 6: Distribution of respondents on the perceived impact of the programs on control**

| Score   | 5  |      | 4  |      | 3  |      | 2  |      | 1  |     | Mean Score     |
|---|----|------|----|------|----|------|----|------|----|-----|----------------|
|   | F  | %    | F  | %    | F  | %    | F  | %    | F  | %   |                |
| Statements  |    |      |    |      |    |      |    |      |    |     |                |
| To what extent does your husband not control your labor.  | 22 | 14.7 | 55 | 36.7 | 45 | 30.0 | 18 | 12.0 | 10 | 6.6 | 3.407          |
| To what extent has your cash income increased lately as a result of BLP & FSP projects.                             | 19 | 12.7 | 60 | 40.0 | 35 | 23.3 | 27 | 18.0 | 9  | 6.0 | 3.353          |
| To what extent does your husband not control your increased finance.  | 17 | 11.4 | 54 | 36.0 | 36 | 24.0 | 32 | 21.3 | 11 | 7.3 | 3.227          |
| To what extent has your standard of living and that of your children improved as a result of increased cash income. | 21 | 14.0 | 78 | 52.0 | 30 | 20.0 | 14 | 9.3  | 7  | 4.7 | 3.613          |
| To what extent do you feel not dominated by your husband  | 22 | 14.7 | 42 | 28.0 | 64 | 42.7 | 11 | 7.3  | 11 | 7.3 | 3.400<br>3.380 |
|   |    |      |    |      |    |      |    |      |    |     | 3.396          |

Source: Field 2004

# SHARIA AND SMALL BUSINESS PRACTICES IN RELATION WITH CONSUMERS: A FRAMEWORK FOR ENTREPRENEURIAL VIRTUES

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## ABSTRACT

The vulnerability of the entrepreneurs to unethical or sharp practices erodes the trust and loyalty of consumers affecting the success of the venture. In light of this, the study examined the influence of Sharia, which is viewed as a way of life, a legal system enshrined by religion Islam on the small business practices in relations with consumer satisfaction. It attempted at determining the relationship between Sharia variables and consumer satisfaction in terms of consumer motives, participation, perception, and buying decisions. The study aimed also at eliciting the social and moral virtues essential to sustaining entrepreneurship success. The study was conducted in an Islamic community of Zamfara State in Nigeria. Questionnaires were administered in the enumeration areas to collect data from 387 selected head of families. Information on operationalized Sharia into perceived economic, socio-cultural, and political characteristics was measured by Likert scale, while consumer satisfaction variables were measured using 5-point scale. A focus group discussion was done to elicit entrepreneurial virtues inferred to ensue as influenced by Sharia.

The results revealed an influence of Sharia on the practices of small business in relation to consumer satisfaction. These were shown by a linear dependence of motives ( $R=0.237$ ), participation ( $R=0.336$ ), perception ( $R=0.485$ ), and buying decision ( $R=0.562$ ) on Sharia. The t-test also revealed a significant difference before and during Sharia in consumer satisfaction variables, such as motives ( $t=12.82$ ), participation ( $t=26.96$ ), perception ( $t=15.12$ ), and buying decision ( $t=42.83$ ). Social and moral virtues were revealed in the disposition to justice and humanity as important entrepreneurial virtues demonstrated by integrity, dignity, honesty, temperance, and humility among others. Social and individual responsibilities were among other issues considered as significant. In other words, for small business to sustain success, entrepreneurs must seek to reconcile all objectives and claims within the framework that recognizes the rights and needs of individual and the society. In this respect, entrepreneurial virtues must not be overlooked.

## INTRODUCTION

Globalization has indeed invited competition from all nations, which resulted to increasing smaller segmented markets. This progressing heterogeneous demand makes innovation more significant and a challenge to entrepreneurs. For a venture to succeed in this competitive environment, consumer satisfaction should be the ultimate goal of an enterprise. Consumer satisfaction is an emotional and cognitive responses focusing to a particular product or service at a particular period of time. These responses are influenced by factors such as the price of the product, the quality, performance and features of the product, the information about the product as to product's image and value, health and safety among others. In fact, efficient delivery of the enterprise' offers and the management of the factors associated to the offer is the crux of the business. This entails that the entrepreneurs are obliged to run the enterprise as efficiently as possible in such a way that all legitimate goals are obtained. This also stresses that the goal of efficient production of goods and services designed to satisfy human needs is a social goal. A social goal demands efficient management involving careful use of physical resource, worker morale, employee development, research, consumer welfare, consumer protection, and good relation with the community and the society at large.

The entrepreneur is at the center of a network of relationships with people, groups and publics serving as the fulcrum aiming at meeting the objectives of the enterprise. The success of the enterprise in meeting its goal objectives rests on his ability to interact with his environment. In this premise, the entrepreneur must consider the impact of his action on all to which he is related in the industry. He must seek to reconcile all other objectives and claims within the framework that recognizes the rights and needs of both individuals and groups. In this respect, human relations in the business practice must not be overlooked.

Generally, there are certain traits of character that are essentially needed to make the most of what life has to offer. Hence people are not born with a fixed character, character traits are therefore acquired. It is imperative and more meaningful to acquire and keep those character traits that make the most of ones life called virtues. Moral and social virtues are essential in the conduct of business, without them, success is bleak and with them, entrepreneurs prosper so as external circumstances permit. Even when opportunities are abound for an entrepreneur to perceive economic opportunities and to put these to advantage depend on his character. Virtues play a crucial role in the choices or decisions, on what alternatives have to consider, what is regarded as best desirable choice, and to enable for a judgment to be efficacious. The virtues enable entrepreneurs to see aright and choose aright.

A good business practice contributes to the development of men and to the growth of the society as a fit place for men to exist. There exist therefore a need for a framework of entrepreneurial virtues that an entrepreneur may end up successful in his endeavor, otherwise he ends up as mediocre if not morally crippled individual.

### **RESEARCH PROBLEM**

In today's world of business, many values have eroded. In the pursuit of competition and the changed concept on what an ideal enterprise' goal should be, entrepreneurs are pressured to act unethically as they are challenged with competition. It has been observed that temptation for entrepreneurs to compromise ethical standards as they strive to grow is evident (Palich, et al, 2004).A special temptation exists for entrepreneurs who are strongly driven to make profit or on issues that directly affect profits. For instance, entrepreneurs may be tempted to rationalize bribery as a way of offsetting what seems to be a competitive advantage. This vulnerability of

the entrepreneurs to unethical and sharp practices erodes the trust and loyalty of consumers, suppliers, workers, community and other publics affecting the success of the enterprise.

In Islamic community, like other religious communities, religion has an important role in shaping the behavior of people., Religion is a form of belief that binds the spiritual nature of man to a supernatural being, as evolving a feeling of dependence and responsibility, together with the feelings and practices which naturally associated with it (Bassiounno,1988). Religion is a subset of culture that contributes to the cultural belief and values of men living within that particular society. Thus, these acquired values are reflected in the actions and decisions of men in dealing with his environment. According to Grief (1994), religion is described as a club and a mold of behavior. This was demonstrated in the work of Weber in (Hofstede, 2001). It was revealed that the Protestant reluctance to break contracts contributed to greater trust and willingness to honor contracts with strangers and thereby contributed to the spread of more extensive information that promoted growth and rise of individual capitalism. In this premise, Sharia as a way of life among Muslims, which is covering every aspect of their daily individual and collective living could have been guiding the business practices of entrepreneurs. In light of this, the paper investigated the practices of small business entrepreneurs in relation with consumers with the view of discovering the entrepreneurial virtues. It aimed at determining the attitude of consumers towards the business practices of entrepreneurs. It also attempted to examine the relationship between the business practices and consumer satisfaction in terms of motives, participation, perception, and buying decision in a Sharia system

### **FRAMEWORK FOR ANALYSIS**

Abundant evidence affirms that religious belief affects a wide range of behavioral outcomes, and religious activity can affect economic performance. The modernization theorists

such as Hoselitz (1960), McClelland (1961), and Hagen (1962) offered an understanding that traditional societies resist change, and innovative groups can be important in the process of modernization. They stressed that religious affiliation could serve as the base for group cohesion necessary to successfully challenge established practices. This understanding was established by Weber in (Hofstede, 2001) in his popular work “The Protestant Ethic and the spirit of Capitalism”. The Protestant reformation was critical to the rise of capitalism through its impact on belief systems.

Religion is that sublime and profound conviction within the soul, which compellingly admonishes man that it would be wrong for him not to believe in those morontial realities which constitutes his highest ethical and moral concepts, his highest interpretation of life’s greatest values and the universe’s deepest realities. Religion is simply the experience of yielding intellectual loyalty to the highest dictates of spiritual consciousness or super conscious part of human mind. The moral consciousness of man is the human recognition and awareness of those ethical values which duty demands that man shall abide by the control and guidance of conduct. It is the spiritual urge of religion that tends to cause man to project his estimation of moral values directly outward into the affairs of his fellow. Religion creates for the human mind a spiritualized consciousness by faith, derived from antecedent concepts of moral values. Faith becomes the connection between moral consciousness and spiritual consciousness.

Islam is the religion of the Muslims. Qur’an is a devine revelation or messages to reach humankind. Qur’an is the principal source of Islamic Law, the Sharia (Bassiouni, 1988). Sharia as a legal system was also considered as a way of life of the people living in the Islamic society and was viewed as a religion. As Bassiouini (1988) puts, ethics, morality, and religion are inseparable; while law enshrines ethical judgment of a society (Garrett, 1980). Sharia forms the

basis for relations between man and God, between individuals, whether Muslim or non-Muslim as well as between man and things which are part of creation. (Bassiouni, 1988). In Sharia, the preservation of a social order depends on each and every member freely adhering to the same moral principles and practices. It is founded on individual and collective morality and responsibility. Collective morality is expressed in such terms as equality, justice, fairness, brotherhood, mercy, compassion, solidarity, and freedom of choice. Social justice and individual justice are preserved in Sharia. It inculcates the search of justice and applies it to self as well as others. It stresses individual responsibility, which means an individual is accountable to his Creator for what he himself does or fails to do.

The economic aspect of Sharia contains prescription, proscription, recommendations, suggestions, general principles, and guidelines of all aspects of human endeavor and interaction. Because Sharia is described as a way of life, as a form of government, a social structure as well as regulatory norms for interpersonal relationships, business is not something different and apart from all those other aspects of social life. Thus, Islamic society preserves the notions of free enterprise and social solidarity, social responsibility and humanistic concern of all. Profit is recognized and legitimated provided they are lawfully obtained. However, profits cannot overshadow the duties of brotherhood, solidarity, and charity (Bassiouni, 1988). In the fulfillment of an individual in his society, respect for individuals is applied. Higher values are appealed to all in human relations and the most cherished attribute is dignity. Loyalty and fidelity are among the most highly regarded qualities. Rectitude likewise is expected. Rectitude in business dealings and human relations is as important as any other tenet of faith. Fairness in Sharia is both a means and an end, irrespective of the practical realities. Honesty is not a virtue but expected trait.

Additionally, there exist the prohibition against flaunting of one's achievement in the face of others particularly the less fortunate. This reflects the value of equality and humility. Social responsibility is highly encouraged. It requires that property as not for personal advantage but also for the benefit of the community. In contracts and obligations, contracts are essentially predicated on the free will of parties and must manifest the true expression of their intent. It is emphasized that individual contracts, and contracts of adhesion are to be regulated in such a way as to enhance fairness, produce equity, protect the weak and the unwary, and promote social interests. The logical extension of these principles is that no one can enrich himself to the detriment of others.

For entrepreneurship to sustain success, religious influence in the practice of business should not be overlooked. Its influence must be recognized in the business practice in relations with consumers as shown in Figure 1.

## **METHODOLOGY**

The study was conducted at Zamfara State, Nigeria. Muslims are about half of the country's population, forty percent are Christians, and the other ten percent practice traditional indigenous Nigerian religions or no religion at all (Herman, 2001). Muslims are the majority in the northern part of the country. In Zamfara, Sharia was re-introduced in the year 2000, although it has existed since 19<sup>th</sup> century. From Zamfara, Sharia was then observed to have spread over the northern states.

The study used the multi-stage sampling technique in selecting the three Local Government Areas (LGAs) out of the 14 LGAs of Zamfara State and 129 respondents were selected from each LGA. Using enumeration areas, 387 respondents were identified. Structured interview was used in collecting the data aided by a pre-determined set of questions, the

questionnaires. The head of the family either male or female was qualified for the interview as respondent of the study.

The independent variable, Sharia was operationalized into political, economic, and socio-cultural characteristics on business practices. Statements were developed addressing the various practices of the enterprises in conducting business in relations with consumers. The information generated was based on the perceptions of the consumers with the aim of eliciting the characters or traits associated with the concepts being sought. The statements were measured using Likert scale. These concepts of Sharia were presented to a group of respondents to elicit characters and traits essential for entrepreneurship virtues. The dependent variable, consumer satisfaction was operationalized into cognitive, that is the knowledge or perception of consumers on the enterprises' offers, and the motivation, that is the motives, the involvement, and the buying decision of the respondents on the business practices of the entrepreneurs. These variables were measured by 5-point scaling method.

The data were analyzed using descriptive and inferential statistical tools. The variables were described by frequency distribution, percentages, means, and weighted average. Regression analysis was used to test the linear dependence of consumer satisfaction in terms of consumer motives, perception, participation and buying decisions on Sharia, while t-test was used to determine whether a significant difference existed in the relationship between consumer satisfaction and Sharia before and after the introduction of the later.

## **RESULTS AND DISCUSSION**

The results in Table 1 show that majority of the respondents were between 20 and 39 years of age (68%), males (73%), married (97%), tertiary level of education (74%), Muslims

(100%), and were civil servants (84%). The socio-economic characteristics of the majority of the respondents indicate the ability of the respondents for making decisions.

### **Perceived Business Practices in Sharia System**

The results in Tables 2, 3, and 4 show high mean scores in economic (4.7130), socio-economic (4.7790), and political (4.6663) variables used to measure the perceived business practices in relations with consumers in the Sharia system. These variables addressed many business practices. Among others are fair price, standard quality products, educative information, product availability, truthfulness in business transactions, no involvement in uncertainty trading, hoarding practice is unlawful, friendliness and honesty in all dealings, control of human greed, sales of prohibited products, selling and buying by lawful intention, individual responsibility, social responsibility, goodwill, health and safety, conspicuous consumption, consumer protection, contract regulation, social order, and fairness in all matters. The operationalization of Sharia into economic, socio-cultural, and political characteristics had the advantage of eliciting the characters and traits significant in influencing consumer satisfaction.

### **Intervening Characters and Traits in Sharia System**

The entrepreneurial experience is far more fulfilling when entrepreneurs understood the genuine purpose of business, which is the real reason of going into business. It has been observed that the creation of products and services for human satisfaction has been the core reason of business existence. In line with this perspective, relationships with the society are critical and characters are essential to success. It was observed in the group discussion that financial is important but it is only the yardstick to measure success. In fact, excessive focus on financial gain can quickly lead to distortions in business practices. It was further revealed that financial motive it is the root cause of many business failures.

Figure 2 shows the various characters and traits essential to entrepreneurial business practice, which were postulated, inferred, and identified to be associated with most of the characters and traits that could emerge as culture, moral and religion influence the entrepreneurial practices. Integrity was foremost revealed to be the most important in all of the virtues. Integrity is the key to man's character. It means a man that can be trusted. It means a man who is honest in all his dealings. In integrity, there is purity and moral soundness about the entrepreneur as a person. Another major character revealed was the sense of social responsibility and individual responsibility. This humanistic concern is very significant in entrepreneurship. The "early businessmen" has been described as the "slave traders". To them, value must substitute directly to money. The bottom line was profit maximization nearly at all cost. To them, preservation of the environment, welfare for workers, respect for nature, human right, consumer's right are considered wasteful and unwarranted expenditures. Humanistic concern includes friendliness, assertiveness, truthfulness, fairness, among others.

Assertiveness in negotiation is important to avoid sharp practices. Assertiveness refers to social intelligence and tact. It means expressing oneself clearly, directly and appropriately, and demonstrating fairness, dignity and honor. Assertiveness is not achieved by force but rather by behavior that clearly establishes honest thinking and feeling. Assertiveness, therefore, means self-respect. This is character of putting others at their ease, and never saying or doing anything to wound their sensibilities.

### **Sharia Influence on Consumer Satisfaction**

The results of regression analysis in Tables 5, 6, 7, and 8 on Sharia variables and consumer satisfaction variables namely, motives, participation, perception and buying decision respectively indicated the Sharia's influence on consumer satisfaction. In Table 5, a linear

dependence of consumer motives on Sharia variables indicated by  $R=0.237$  with an F value of 2.450 at 0.05 significance. Only 6 percent of the variation was explained by Sharia variables. In Table 6, a linear dependence of consumer perception on Sharia variables was revealed by  $R=0.425$  with an F value of 9.089 at 0.05 level of significance. Sharia variables contributed 18 percent of the variation in consumer perception.

The results in Table 7 show that consumer participation had linear dependence indicated by  $R=0.336$  on Sharia variables with an F value of 10.195 at 0.05 level of significance and contributing 12 percent to the variation, while perception had linear dependence on Sharia indicated by  $R=0.485$  with an F value of 9.089 at 0.05 level of significance as shown in Table 8. Buying decision had linear dependence of  $R=0.562$  with an F value of 15.267 at 0.05 significance level as shown in Table 9. It was also revealed that 31 percent of the variation in consumer buying decision was explained by Sharia variables. The t-test in Table 10 also revealed a significant difference before and during Sharia in consumer satisfaction variables, such as motives ( $t=12.82$ ), participation ( $t=26.96$ ), perception ( $t=15.12$ ), and buying decision ( $t=42.83$ ).

## **CONCLUSION**

A position that a business success premised on consumer satisfaction in this competitive environment, necessitates to refocus its development on human relations and its environment most especially in dealing with consumers. A need of character and traits that demonstrate a behavior of worthwhile business practices or the general concept of worthwhile living is imperative. Worthwhile living is affected by cultural influences but is not wholly determined by them (Hofstede, 2001), morality and religion are among others. A guide to good business practice may need to be rewritten, modified and updated in the light of cultural changes, but the core of morality, which is the cardinal virtues, is expected to remain constant as the basic

necessities of life. As Bassiouni (1998) pointed out that ethics, morality and religion are inseparable, thus the transformative potential of religion is accountable for the alterations in values, behaviors, and outcomes (Bowie, 1982). Thus, as religion operates to influence the business practices in relations with consumers, many of the characters and traits significant to satisfying consumers surfaced to influence the behavior of the entrepreneurs.

The insolvency causing stress, among the myriad of business problems suffered by those who act unethically is a strong ground why anyone in business has a reason to acquire virtues in life. Moral virtue is a disposition to blend emotion and judgment. Moral virtues are enabling. They enable entrepreneurs to feel as they should, to react emotionally to circumstances in an appropriate way. While moral virtues enable someone to act rationally and accordingly, to make choices on what should be regarded as desirable and permissible, social virtues promote peace in the community.

The moral virtues that seem most crucial in entrepreneurship are the dispositions to justice and humanity. Justice includes respect for people's rights and fair-mindedness. To understand people, one needs to have humanity. Associated with these virtues are temperance, courage, good temperedness, fairness, friendliness, and honesty. Temperance is not simply a matter of exercising self-control but possessing and showing sound judgment in the degree of importance. Obviously, those who are honest will demonstrate their attachment to honesty.

In sum, Sharia has influenced the conduct of business in satisfying consumers, which is the ultimate goal of an enterprise to remain competitive in the industry. It has molded the characters and traits of entrepreneurs essential to the disposition to justice and humanity, which is the key to entrepreneurial success. It is therefore imperative that the framework for entrepreneurial virtues be recommended.

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**Table 1: Distribution of respondents on socio-economic characteristics**

| Variables      |               | Frequency | Percentage |
|----------------|---------------|-----------|------------|
| Age            | Below 20      | 3         | 0.8        |
|                | 20 - 39       | 261       | 67.5       |
|                | 40 – 59       | 122       | 31.4       |
|                | 90 above      | 1         | 0.3        |
|                | Total         | 387       | 100        |
| Sex            | Male          | 282       | 73.0       |
|                | Female        | 105       | 27.0       |
|                | Total         | 387       | 100        |
| Marital status | Married       | 378       | 97.6       |
|                | Widowed       | 7         | 1.8        |
|                | Divorced      | 2         | 0.5        |
|                | Total         | 387       | 100        |
| Education      | Primary       | 2         | 0.5        |
|                | Post Primary  | 44        | 11.5       |
|                | Tertiary      | 284       | 73.6       |
|                | Others        | 57        | 14.4       |
|                | Total         | 387       | 100        |
| Religion       | Islam         | 387       | 100        |
| Occupation     | Civil Servant | 324       | 84.0       |
|                | Business      | 25        | 6.5        |
|                | Farmers       | 37        | 9.2        |
|                | Others        | 1         | 0.3        |
|                | Total         | 387       | 100        |

Source: Field 2004

**Table2: Distribution of respondents on perceived Sharia economic characteristics**

| Score   | 5         | 4        | 3        | 2        | 1         |               |
|---|-----------|----------|----------|----------|-----------|---------------|
| Variables   | SA<br>F/% | A<br>F/% | N<br>F/% | D<br>F/% | SD<br>F/% | Mean<br>Score |
| Use of approved weight and standards                                | 363/93    | 18/5     | 6/2      | -        | -         | 4.9224        |
| Sellers are obliged to give fair price                              | 378/98    | 9/2      | -        | -        | -         | 4.9767        |
| Wrong to hoard with the view of increasing price                    | 366/95    | 21/5     | -        | -        | -         | 4.9457        |
| Wrong to sell defective and harmful products                        | 304/78    | 81/21    | 2/1      | -        | -         | 4.7803        |
| Buying and selling decisions are judge by moral intent              | 376/97    | 11/3     | -        | -        | -         | 4.9715        |
| Availability of standard and quality products                       | 283/73    | 80/21    | 24/6     | -        | -         | 4.6692        |
| Unlawful to sell item on credit and later repurchase at lower price | 250/65    | 130/30   | 7/2      | -        | -         | 4.6279        |
| Goodwill and friendliness in transactions                           | 302/78    | 80/21    | -        | 5/1      | -         | 4.7545        |
| Prohibit selling that are yet to be possessed                       | 261/68    | 126/32   | -        | -        | -         | 4.6744        |
| Honesty shown in transactions always                                | 290/75    | 89/23    | 8/2      | -        | -         | 4.7286        |
| Grand mean score  |           |          |          |          |           | 4.7130        |

Source: Field 2004

**Table 3: Distribution of respondents on perceived Sharia socio-cultural characteristics**

| Score   | 5         | 4        | 3        | 2        | 1         |               |
|---|-----------|----------|----------|----------|-----------|---------------|
| Variables   | SA<br>F/% | A<br>F/% | N<br>F/% | D<br>F/% | SD<br>F/% | Mean<br>Score |
| Consumption and sale of goods are accorded to social values | 373/97    | 13/3     | -        | -        | -         | 4.9664        |
| Human greed is controlled by price regulation               | 35/93     | 28/7     | -        | -        | -         | 4.8242        |
| Truthfulness in business transactions                       | 384/99    | 3/1      | -        | -        | -         | 4.9922        |
| Profits are lawfully obtained                               | 288/75    | 99/25    | -        | -        | -         | 4.7441        |
| Contracts manifest the true expression of intent            | 260/68    | 102/26   | 25/6     | -        | -         | 4.5813        |
| Social responsibility and humanistic concern are preserved  | 223/58    | 160/41   | 4/1      | -        | -         | 4.5658        |
| Family members are taught on the right of consumers         | 298/77    | 80/21    | 9/2      | -        | -         | 4.7467        |
| All forms of excesses are discouraged                       | 373/96    | 14/4     | -        | -        | -         | 4.9638        |
| Hoarding is against the norms                               | 278/72    | 109/28   | -        | -        | -         | 4.7163        |
| No involvement in uncertainty trading                       | 266/69    | 121/31   | -        | -        | -         | 4.6873        |
|   |           |          |          |          |           | 4.7790        |

Source; Field 2004

**Table 4: Distribution of respondents on perceived Sharia political characteristics**

| Score   | 5         | 4        | 3        | 2        | 1         |               |
|---|-----------|----------|----------|----------|-----------|---------------|
| Variables   | SA<br>F/% | A<br>F/% | N<br>F/% | D<br>F/% | SD<br>F/% | Mean<br>Score |
| Identify products that are lawful for consumption | 263/68    | 124/32   | -        | -        | -         | 4.6795        |
| Education and protection of consumers             | 283/73    | 80/21    | 42/6     | -        | -         | 4.4625        |
| Conspicuous consumption is discouraged            | 265/68    | 120/31   | 2/1      | -        | -         | 4.6795        |
| Product standardization policy                    | 299/77    | 80/21    | -        | -        | -         | 4.7519        |
| Price control                                     | 306/79    | 81/21    | -        | -        | -         | 4.7906        |
| Equitable income distribution                     | 161/41    | 126/32   | 100/26   | -        | -         | 4.1576        |
| Provision of educative information                | 302/78    | 79/20    | 6/2      | -        | -         | 4.7648        |
| Freedom to consume anything the nature offers     | 376/97    | 11/3     | -        | -        | -         | 4.9715        |
| Contract regulation                               | 301/78    | 79/20    | 7/2      | -        | -         | 4.7596        |
| Social order                                      | 250/65    | 137/35   | -        | -        | -         | 4.6459        |
| Grand mean score                                  |           |          |          |          |           | 4.6663        |

Source: Field 2004

**Table 5: Distribution of respondents on consumer satisfaction**

| Score                               | 5         | 4        | 3        | 2        | 1         |               |
|-------------------------------------|-----------|----------|----------|----------|-----------|---------------|
| Variables                           | SA<br>F/% | A<br>F/% | N<br>F/% | D<br>F/% | SD<br>F/% | Mean<br>Score |
| Provide adequate information        | 47/12     | 206/52   | 129/34   | 5/1      | -         | 3.7622        |
| Products conform with social values | 288/75    | 79/20    | 20/5     | -        | -         | 4.6925        |
| Information captures attention      | 79/20     | 22/58    | 83/21    | 3/1      | -         | 3.9741        |
| Information are meaningful          | 90/23     | 128/33   | 162/42   | 7/2      | -         | 3.7777        |
| Products are available              | 292/76    | 90/23    | 5/1      | -        | -         | 4.7416        |
| Products are safe for consumption   | 32/8      | 272/71   | 83/21    | -        | -         | 3.8682        |
| Prices are affordable               | 191/49    | 115/30   | 81/21    | -        | -         | 4.2842        |
| Prices are right                    | 116/30    | 189/49   | 82/21    | -        | -         | 4.0878        |
| Grand mean score                    |           |          |          |          |           | 4.1485        |

Source: Field 2004

**Table 6: Regression analysis of Sharia and consumer motive variables**

|                         |                |     |         |       |
|-------------------------|----------------|-----|---------|-------|
| Multiple R              | .237           |     |         |       |
| R <sup>2</sup>          | .056           |     |         |       |
| Adjusted R <sup>2</sup> | .033           |     |         |       |
| Standard Error          | .514           |     |         |       |
| Analysis of variance    | Sum of Squares | df  | F-value | Sig.  |
| Regression              | 5.837          | 9   | 2.450   | 0.010 |
| Residual                | 98.459         | 378 |         |       |

Source: Field 2004

P

**Table 7: Regression analysis of Sharia and consumer participation variables**

|                         |                |     |         |      |
|-------------------------|----------------|-----|---------|------|
| Multiple R              | .336           |     |         |      |
| R <sup>2</sup>          | .119           |     |         |      |
| Adjusted R <sup>2</sup> | .098           |     |         |      |
| Standard Error          | .997           |     |         |      |
| Analysis of Variance    | Sum of Squares | df  | F-value | Sig. |
| Regression              | 0.801          | 7   | 10.195  | .000 |
| Residual                | 3.898          | 380 |         |      |

Source: Field 2004

**Table 8: Regression analysis of Sharia and perception variables**

|                         |                |     |         |      |
|-------------------------|----------------|-----|---------|------|
| Multiple R              | .485           |     |         |      |
| R <sup>2</sup>          | .180           |     |         |      |
| Adjusted R <sup>2</sup> | .160           |     |         |      |
| Standard Error          | .093           |     |         |      |
| <hr/>                   |                |     |         |      |
| Analysis of Variance    | Sum of Squares | df  | F-value | Sig. |
| Regression              | .713           | 9   | 9.089   | .000 |
| Residual                | 3.245          | 378 |         |      |

Source: Field 2004

**Table 9: Regression analysis of Sharia and consumer buying decision variables**

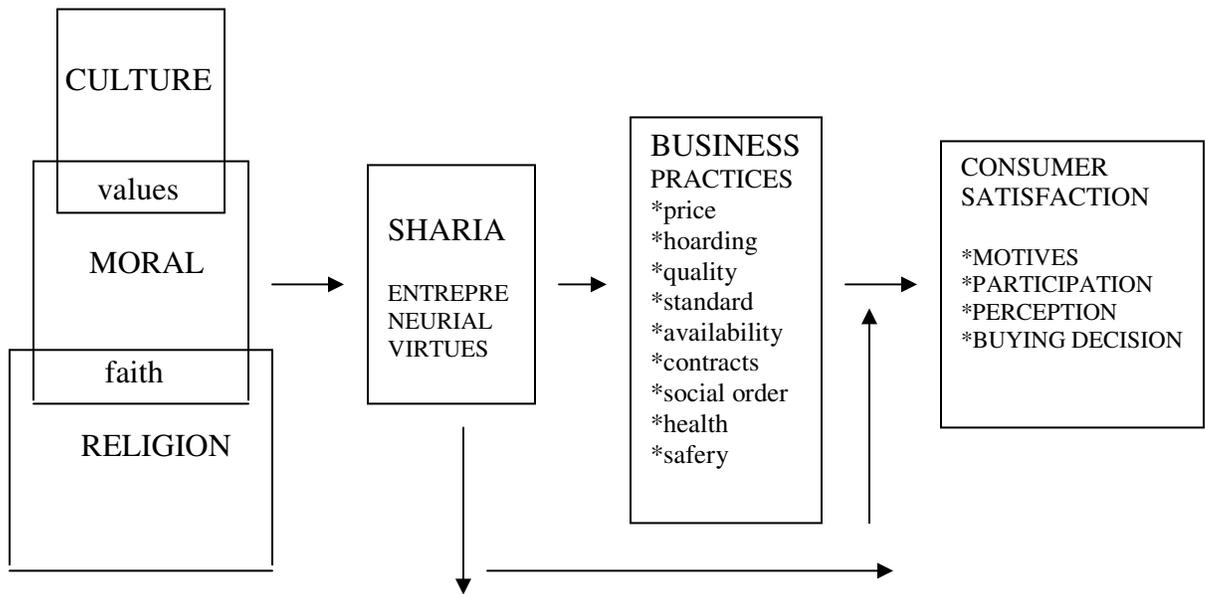
|                         |                |     |         |      |
|-------------------------|----------------|-----|---------|------|
| Multiple R              | .562           |     |         |      |
| R <sup>2</sup>          | .311           |     |         |      |
| Adjusted R <sup>2</sup> | .215           |     |         |      |
| Standard Error          | .102           |     |         |      |
| <hr/>                   |                |     |         |      |
| Analysis of Variance    | Sum of Squares | df  | F-value | Sig. |
| Regression              | .920           | 9   | 15.267  | .000 |
| Residual                | 6.245          | 378 |         |      |

Source: Field 2004

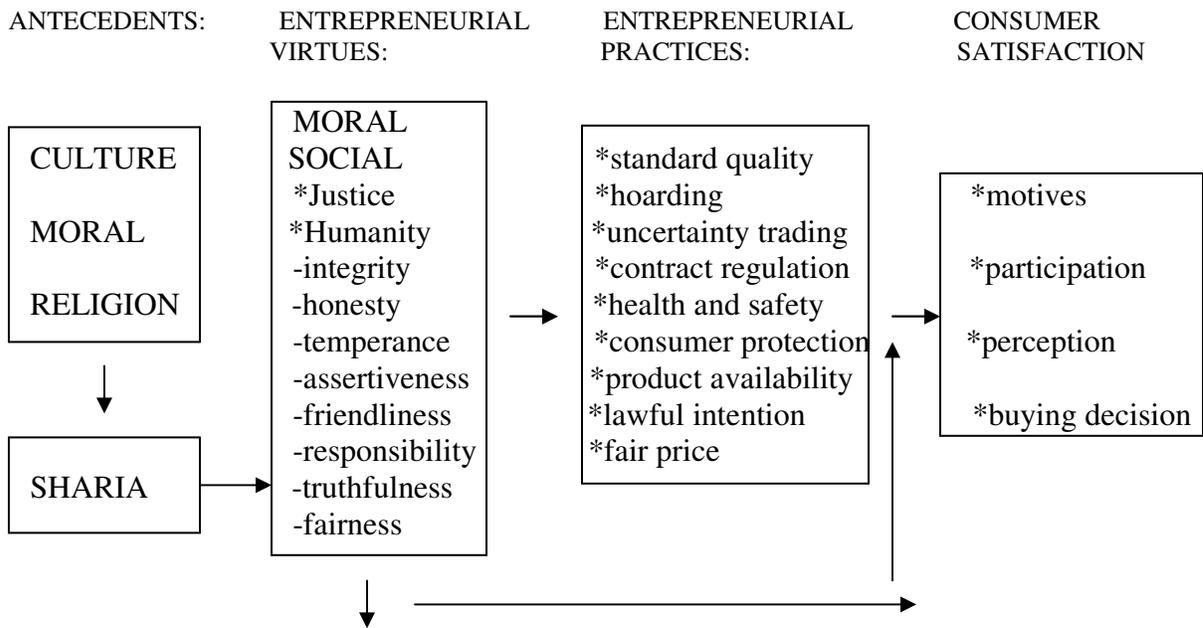
**Table 10: Results of t-test on consumer satisfaction variables before and during Sharia.**

| Variables       | t-value | Sig.  |
|-----------------|---------|-------|
| Motives         | 12.82   | 0.000 |
| Participation   | 26.96   | 0.000 |
| Perception      | 15.12   | 0.000 |
| Buying decision | 42.83   | 0.000 |

Source: Field 2004



**Figure 1: Schematic diagram showing the intervening entrepreneurial characters and traits as business practices operate on consumer satisfaction.**



**Figure 2: A Model framework of entrepreneurial virtues influencing business success.**

# **AN INVESTIGATION INTO THE ROLE OF SERVICE QUALITY WITHIN SMES**

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## **ABSTRACT**

Marketing within SMEs is a contentious issue. SMEs are of course well aware of the importance and impact it can have, as well as the environment they operate within. However, one of the major problems that limits the use of the marketing function within SMEs is the lack of both sufficient financial and physical resources actually at their disposal. These resources will ultimately underpin any organisation's ability to utilise marketing in a professional and effective manner. The most researched area in services marketing to date is service quality and this specific interest in service quality indicates a requirement to improve total quality management and satisfaction throughout the business process.

The aim of this study is to examine whether the levels of service quality offered by a case organisation to its clients, as perceived by their clients, are dependent upon organisational size, geographic location and operating sector. Previous research undertaken with the service quality field through the implementation of the SERVQUAL framework emphasized the importance of recognising clients' combined expectations and perceived level of service in developing a level of service that would retain customers in the long-term.

The results of this research indicate that organisational size, geographical location and operating sector have an impact on some SERVQUAL dimensions. For instance, it was found that clients based in England perceived service levels to be higher with regard to the reliability and employee dimensions.

## **INTRODUCTION**

The contribution of the small and medium sized (SME) firm sector to the UK economy cannot be underestimated with it being both a major source of employment and income. With new and existing markets continuing to grow, the importance of the marketing function is therefore set to grow proportionately and will become a core activity undertaken by many, if not all firms in the SME sector.

In markets where there is a high degree of competition or a large selection of substitutes available to customers or businesses, customer retention is an aspect of the marketing function that can only be realistically controlled through services marketing leading to customer satisfaction (Wilson, 1998). Gaining strategic advantage through the lower price of products alone is not sufficient; quality also has a vital role to play in satisfying customers (Zeithaml & Bitner, 2003). Indeed, in a recent study, Carson (1998) identified that an approximate 5% increase in customer retention could lead to between a 25% and 125% boost in annual profits.

## **AIMS AND OBJECTIVES OF THE RESEARCH**

Delta Publications (a fictitious name) is a specialist publishing organisation producing a unique range of services since 1992. Delta Publications is based in Wales and operates within the leisure, tourism and entertainment markets, predominately producing town guides, maps and event guides, both in-house and in conjunction with local authorities and other commissioning bodies. Delta works with Town Councils and unitary authorities (local government areas) in Wales, in addition to numerous locations throughout England. Delta produces alternative services such as events guides for local theatres, and is currently launching additional new services such as corporate literature and printing. The organisation originally consisted of two employees when it was formed, and has grown gradually over the last decade to the extent where it now employs over ten employees.

The company wanted to discover whether or not its service quality is perceived in the same way depending on three attributes of its clients: their size, their geographical location and the type of their activity. Therefore, this research is exploratory in nature and attempts to find out

the impact of those attributes on service quality perception. In order to achieve this aim, three working hypotheses were formulated:

1. There are differences in SERVQUAL dimensions responses depending on Organisational Size.
2. There are differences in SERVQUAL dimensions responses depending on the Geographic Location of respondents.
3. There are differences in SERVQUAL dimensions responses depending on the sector that respondents are placed within.

## **LITERATURE REVIEW**

Definitions of service quality are generally based on the notion that it is the result of a comparison that customers are likely to make, through identifying their perceptions of how services are performed compared to their expectations (Grönroos, 1984, 2000; Parasuraman et al., 1988). Tenner and DeToro (1992) define service quality as co-productive, intangible and a non-repetitive experience. In addition, the authors believe that these encounters become personal experiences and require expectations and aspirations to be met in order for the relationship to continue.

An alternative view is that of Kotler (1997) who argues that clients are likely to purchase what they believe to be the highest customer delivered value. He identifies this as the difference between total customer value (benefits customers expect) and total customer cost. Kotler believes that customer satisfaction is maximised if customer value is high. This, in a way, concurs with the views of Tenner and DeToro (op. cit) albeit Kotler puts an emphasis on costs as a key element which influences the customer view of the service. As with all services that are provided there is the 'intangibility aspect,' and crucially clients would only wish to pay what they believe the service to be worth.

According to Brassington and Pettitt (2000), the key to developing a service is being able to provide one that is easily accessible. Christopher et al. (1994) however, argue that the challenge is to bring together quality, customer service and marketing to uphold customer satisfaction. Through identifying the attributes of service, Stone and Woodcock (1998) state that customers' views on the level of service typically include variables such as time taken to deliver the service, the extent to which the customer perceives the need to be in control, the effort required to receive the service, the relative importance of the service, the effort of the

supplier and the level of skill or professional expertise expected of the service staff. It could be suggested in reality that this is perhaps a limited selection of criteria, with little scope for determining alternative areas such as the performance level of communication systems or (importantly) reliability of service offered.

One of the most important ways of measuring service quality levels within an organisation is the SERVQUAL model. This model has emerged as one of the most popular methods used to measure service quality of an organisation and despite numerous criticisms, SERVQUAL continues to be utilised in many different industries even though it was initially utilised within the retail sector.

The SERVQUAL model as devised by Parasuraman et al. (1985, 1988, 1991), results from detailed studies based on focus groups that included representatives from four retailing sectors. The original components identified for evaluating service quality have been factored to five dimensions, which can be expressed as:

*Reliability*: defined as the ability to perform the service dependably and accurately.

*Responsiveness*: identified as the willingness of the service supplier's staff to assist customers and provide their service promptly.

*Assurance*: defined in terms of the ability, knowledge and courtesy of employees to inspire trust and confidence in how they deliver the service.

*Empathy*: defined as treating customers as individuals, through providing individualised attention.

*Tangibles*: The final dimension formulated is principally geared towards presenting the service in a physical manor. This includes facilities, equipment, personnel and communication tools.

The scale utilised with the SERVQUAL survey is based entirely on identifying clients' combined expectations and actual levels of service quality provided through determining clients desired level of service. Consequently, it will be impossible to examine clients' expectations individually, although results from the survey are likely to indicate their expectations are lower, the same, or higher than the service they have received. The level defined by the client will only be determined as positive when the service provided meets or exceeds the client's expectations.

One of the major advantages of SERVQUAL is that it can both determine the level of service expected by clients, combined with the perceived level actually being received. Therefore, SERVQUAL allows a direct measure of service quality through quantifying ratings for each attribute.

Even though there has been a significant amount of research conducted using the SERVQUAL, there are still a number of issues that it fails to fully address. Indeed the model fails to develop and recognise the expectations of consumers in an effective and constructive way (Cronin and Taylor, 1992; Carman, 1990). Over the past decade or so, many improvements and refinements have been made to help make the model both more effective and more reliable. One example is a the series of minor adjustments made to re-order the sequence of the items as well as reduce the number of factors and these have assisted in making the model more effective (Caruana, 2000).

## **METHODOLOGY**

A sample of 350 organisations was randomly selected, using a random numbers table, from the Delta Publications client database (approximately 35% of total clients).<sup>1</sup>

The modified version of the SERVQUAL by Gilbert and Wong (2003) was used to measure various aspects of Delta Publications services. The scale contained 24 combined expectation and perception items. These were placed within six service quality dimensions. The questionnaire is based on Likert alike scale ranging from one to nine, with one representing 'lower than my desired service level' and nine indicating 'higher than my desired service level'. Slight modifications were made to the scale such as the wording to suit the advertising industry context where the case company is active (see appendix). The second section to the SERVQUAL survey allows weighted scores to be taken into account, measuring the relative importance and rating the most important of all of the six service dimensions identified by clients.

The Questionnaire utilised within this study was 'piloted' to ensure it was unproblematic to complete, and to determine the willingness of respondents to answer sensitive questions.

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<sup>1</sup> To ensure that the response rate was as high as possible it was decided that follow up telephone calls and e-mails would be made to encourage all respondents to complete the questionnaires after the initial two week deadline passed.

## DATA ANALYSIS & INTERPRETATION

### Response Analysis

The response rate for the questionnaires was initially just 31.1 percent (109 returned responses), which represents an average rate of return for this type of survey in the UK advertising industry. However, the follow-up phone calls and emails increased the response rate to 54.5 percent (191). After initial analysis of the questionnaires four responses were not completed appropriately and were consequently discarded. A total response rate of 53.4 percent (187 responses) was therefore available for more detailed analysis. With regard to non-response, the most common answers on follow-up were that clients stated that they either did not have the time to complete the survey or no specific interest in taking part in the research.

### Descriptive Analysis

The main variables examined here are the SERVQUAL dimensions in addition to those factors postulated to affect the service quality levels as discussed in the introduction. As stated above these are geographical location, organisational size and operating sector.

### Company Location

The analysis indicates that the majority of client responses (77 percent) were forwarded from Wales, while one fifth (20 percent) were based within England. Delta Publications primarily operates within Wales although has been venturing into England over the last few years to secure additional clients. The corresponding results are presented below in figure 1.

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Figure 1 about here

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### Size of Client Organisations

Figure 2 illustrates the mix of firm sizes that make up the client base of Delta Publications. This is a typical picture for the publishing and advertising sector, especially for companies

based in Wales. 51 percent of the client firms were ‘small,’ using the DTI definition: micro [0-9], small [10-99], medium [100-499], and large [500 and more] (Tonge, 2001). A further 38 percent were identified within the ‘micro’ category, with 9 percent identified as ‘medium sized’ and a final 2.1 per cent were large.

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Figure 2 about here

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### **Client Industrial Sectors**

The majority of Delta’s clients were identified within the Hospitality (24 percent) and Retail sectors (20 percent) followed by the manufacturing and construction together at 11 percent. The smallest category evident was the Finance/Insurance and real estate industries with 2.7 percent of responses recorded (Figure 3).

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Figure 3 about here

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### **Service Quality Attributes**

This section outlines descriptive results of the SERVQUAL dimensions for the whole sample of 187 respondents. The results are illustrated in figure 4 and show that reliability comes first with a mean of 6.37 followed by employees, tangibles and responsiveness with means above 5. This suggests some degree of satisfaction with these dimensions. The empathy and assurance means, however, are just 4.96 and 4.24 which is not as convincing. There appears to be a general feeling that staff are adequately responsive in reacting to clients’ needs, although it is evident that there is a lack of confidence in the employees’ abilities to answer client queries in a consistently courteous manor.

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Figure 4 about here

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## INFERENCEAL ANALYSIS

The main aim of the inferential analysis is to test the forwarded hypotheses of this study. In effect, the objective is to determine whether or not there is a difference in SERVQUAL dimensions (levels of service) responses depending on the selected three factors: geographical location, organisational size and operating sector.

### **1. The impact of organisational size on SERVQUAL dimensions:**

In order to test hypothesis number one, an independent samples t-test was undertaken to test whether there are significant differences when controlling for organisational size. To achieve this, micro and small clients were collapsed into one group ( $\leq 99$ ) and medium and large clients ( $\geq 100$ ) were collapsed into a second group. The means for the small and medium grouped are shown in Figure 5. The results of the statistical test, in Table 1, show that there are differences but are only statistically significant in terms of two dimensions: reliability and employees, where the levels of significance are 0.04 and 0.03 respectively. Figure 5 below illustrates the mean differences of SERVQUAL dimensions graphically.

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Figure 5 about here

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Table 1 about here

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Preliminary observation of the results appear to uphold the findings of Kandampully (2000) and Beaumont & Sohal (2002), who identified that combined levels of expectations and desired service are essentially determined by the expectations of the service recipient, which in turn vary depending on the size of the organisation. It can be suggested that organisations that are larger in terms of employees, have overall higher expectations in the level of service for both the reliability and employees dimensions, which are actually being met. The mean

values presented within the group statistics clearly illustrate this. It is perhaps worthwhile here to note the views of Stanley & Wisner (2002) who suggests that there is a requirement on service providers to deliver a consistent level of service to all clients, regardless of their size.

The corresponding results possibly indicate both Delta and its employees aim to provide higher levels of service to larger organisations. This may well be evident as larger organisations are considered important clients that acquire high revenues for Delta. Providing higher levels of reliability to larger organisations that have monitoring processes to judge service quality is deemed essential. Zeithaml & Bitner (2003) confirms that “service providers that are not recognised as reliable fail their customers in the most direct way”. The ability of firms to develop relationships with clients is an objective achieved through the employees of the service provider. With results indicating higher mean values for combined expectation and perceived service levels amongst larger organisations, it is clear that employees aim to satisfy and provide higher service levels to this client grouping.

In examining the other dimensions, responsiveness, assurance, tangibles and empathy were all found to have no statistically significant difference between the two groups of organisations.

It is interesting to discuss why the remaining dimensions did not indicate a significant difference. It is possible that clients in the two separate groups did not identify these dimensions as important and consequently combined expected and desired values were not significant. There is certainly an indication that client expectations could have been influenced by past experiences of Delta’s or other organisations’ service, thus affecting the clients’ current perception of these particular service attributes. In addition, it is quite possible that implicit, explicit or exaggerated promises made by Delta are not being fully delivered to clients. These would take the form of personal and non-personal statements made by the organisation towards clients, in addition to the service cost and the tangibles that are utilised to present the service to clients. If these implicit and explicit promises have been well presented but the service provided does not match the clients’ expectations, lower service levels would be identified by all clients (Robledo, 2001; Zeithaml & Bitner, 2003).

## **2. The impact of geographical location on SERVQUAL dimensions:**

Once again, two independent samples t-tests were conducted to test whether geographical location has an impact on SERVQUAL dimensions. The two regions being tested for difference in terms of the attributes being Wales and England and shown in Figure 6. The results of the test shown in table 2 below indicate that the reliability, employees and responsiveness dimensions are significantly different, with the first two dimensions significant at 0.05, while the last is significant at 0.1.

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Figure 6 about here

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In discussion of these results, it is possible that these are attributable to the performance of the staff working in the England area. Delta Publications have only started recently to operate within new districts within this location and are keen to develop its service so a good perception of the company can be built up. The sales manager has been identified by the Delta management as being able to effectively communicate Delta's services in these locations. In addition, it is believed Delta Publications has prioritised these new locations in terms of distributing the service, in comparison to other areas in order to expand the client base within these regions.

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Table 2 about here

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In examining the remaining dimensions that did not show a significant difference, it can be identified assurance tangibles and empathy demonstrated lower levels of combined expectations and desired service within Wales. These results possibly indicate clients have lower expectations of the service provided in Wales due to previous experience of Delta's service and implicit and explicit promises not satisfying clients' expectations. This can be related to the views of Zeithaml & Bitner (2003) who suggest past experience is a key determinant of influencing client's current expectations and perceived level of service.

These results raise a further series of questions. For example, are Delta Publications attempting to satisfy English clients more because they want to get a foothold in the market? Or are clients in Wales more aware of Delta services, and do not expect and are similarly not satisfied with the service they receive?

Alternatively, it may be that service levels have weakened through Delta not matching client's expectations, through implicit and explicit promises made within Wales (i.e. the service responsiveness delivered has not met their perceived expectations)

### **3. The impact of activity sector on SERVQUAL dimensions:**

In order to test the last hypothesis, one way analysis of variance (ANOVA) was carried out to determine if any differences were apparent between organisation sectors (12 groups) and service quality. Table 3 below show that there is no one result that is significant at all. Further analysis was carried out where some small groups were collapsed but the results were not statistically significant as well. A t-test for the main two groups (retail and hospitality) was carried out and still the results were not significant. Therefore, it was concluded that we do not have enough evidence to conclude that the sector activity affects SERVQUAL dimensions.

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Table 3 about here

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These results are interesting. They appear to suggest that high quality of service is the general expectation of all clients regardless of their sector of activity. Given that significant differences were identified in terms of some aspects of quality for both geographical location and organisational size, this is clearly an area that warrants further investigation. Future work will attempt to identify for Delta Publications any differences that exist when the data is stratified by (a) organisational size and activity sector and (b) geographical location and activity sector.

## **SUMMARY AND CONCLUSIONS**

The main aim of this study was to examine whether certain attributes of clients affected SERVQUAL dimensions. In terms of Service quality, the level currently provided to clients

did vary between each of the SERVQUAL dimensions. Furthermore, the results clearly indicate Delta Publications is perceived by clients as being generally proficient in providing their services reliably through the fine performance of their employees.

The management of relationships is a key issue and one which has not been measured within this study; however it is an integral element in maintaining service quality levels (Zeithaml & Bitner, 2003). Ideally, Delta can achieve this through meeting client expectations and desired service levels, which can be formulated through accurately performing to the implicit and explicit promises previously made.

In discussing the primary areas related to service quality, the study principally focused on whether or not there is a difference in SERVQUAL dimensions (levels of service) responses depending on organisational size, geographic location and operating sector. These findings provided an extended perspective of possible influences of service quality in respect to the case organisation. It was identified through analysis that only the reliability and employees dimensions were dependent upon organisation size; larger organisations provided higher values, clearly suggesting that combined levels of expectations and desired level of service are essentially determined by the expectations of the service recipient, which in turn vary depending on the size of the organisation (Kandampully, 2000 and Beaumont & Sohal, 2000). In this case specifically, it is recognised Delta Publications and their employees aim to provide higher levels of service to larger organisations due to the financial means these firms ultimately provide.

Information collected in examining if there was a difference in service quality levels dependent on geographical location clarifies that only three dimensions were related (reliability, responsiveness and Employees). In general terms, clients based in England perceived service levels to be higher; this provides sufficient evidence to indicate that clients in Wales do not receive a service that is of as high quality. It may be concluded through applying the expectation model (Zeithaml & Bitner, 2003), that previous experience and word of mouth may have resulted in lower expectations being formulated amongst clients in Wales.

The analysis found no specific difference in service quality levels between clients in different operating sectors. It was acknowledged it would have been difficult to establish which sectors

were likely to hold more financially prominent and larger organisations that could undertake monitoring and analysis of the services they receive; consequently having higher expectations. It was also determined that each sector clearly held a mixture of organisations that were of varied sizes, financial stature and held mixed expectations of Delta Publications services.

It can be suggested that service quality problems often require major effort from service suppliers over a long period of time to resolve, since service quality is more dependent on people than systems and procedures. Attitudes and perceptions will take longer to transform than procedures alone, so it is difficult for managers to keep their attention focused on the problem and remove the root causes of quality deficiencies (Zeithaml & Bitner, 2003).

In examination of service level areas, there certainly needs to be a more consistent approach in developing all service levels and constantly achieving higher levels of client satisfaction. More specifically, developing relationships further with clients through being more responsive, empathetic and reassuring in dealing with client problems is a key area for development. Furthermore, employees need to be more consistent in satisfying all clients and not those who are acknowledged as more important to the firm.

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## APPENDIX

### The Modified SERVQUAL

|  | Lower than my<br>Desired service level |   |   | Same as my<br>Desired service level |   |   | Higher than my<br>Desired service level |   |   |
|--|--|---|---|-------------------------------------|---|---|---|---|---|
| 1. Promise to complete work<br>For us by a certain time  | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 2. Delta show a sincere interest<br>In following a problem through                             | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 3. Accuracy in performing service<br>Correctly the first time                                  | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 4. Provide Final service at date<br>Originally promised  | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 5. Informing customers on when<br>Service will be delivered                                    | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 6. Prompt overall service  | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 7. Employees always willing to<br>Help you.  | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 8. Staff are proactive and never too<br>Busy to respond to your needs                          | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 9. Competence of staff to provide<br>The service successfully                                  | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 10. Security in Handling your<br>Transaction   | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 11. Consistency of employees<br>Courtesy shown towards you                                     | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 12. Employees knowledge and<br>Expertise to answer your queries                                | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 13. Individual attention shown<br>Towards you by employees                                     | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 14. Employees understanding your<br>Business needs   | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 15. Ability to communicate with you  | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 16. Placing your business interests<br>First   | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 17. Promotional materials associated<br>With service (such as sales<br>Literature & pamphlets) | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |

|  | Lower than my<br>Desired service level |   |   | Same as my<br>Desired service level |   |   | Higher than my<br>Desired service level |   |   |
|--|--|---|---|-------------------------------------|---|---|---|---|---|
| 18. Convenience of business hours  | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 19. Efficiency of our<br>Communicative<br>Technology to process the<br>Service | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 20. Level of sales representatives<br>Knowledge in advertising                 | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 21. Sales Representatives Attitude<br>Shown towards you                        | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 22. Presentation of sales<br>Representative                                    | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 23. Scope of services made available   | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |
| 24. Development of relationship by<br>Sales representative                     | 1                                      | 2 | 3 | 4                                   | 5 | 6 | 7                                       | 8 | 9 |

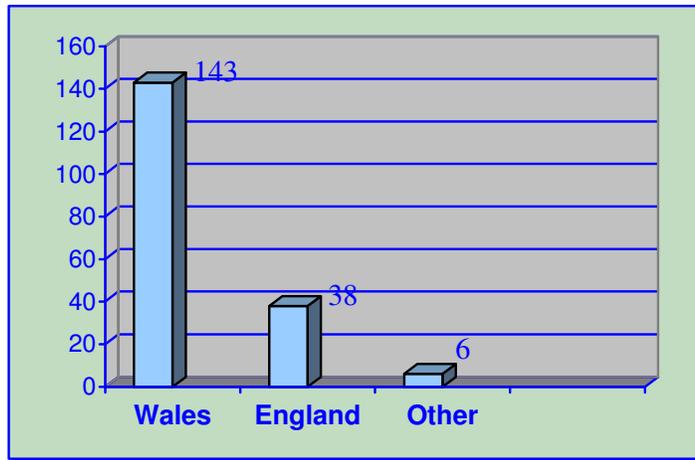


Figure 1: Clients' Primary Operating Location

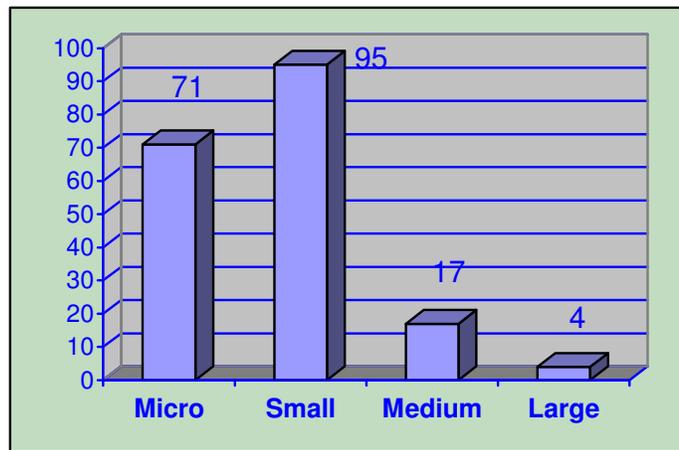


Figure 2: Clients' Organisational Size

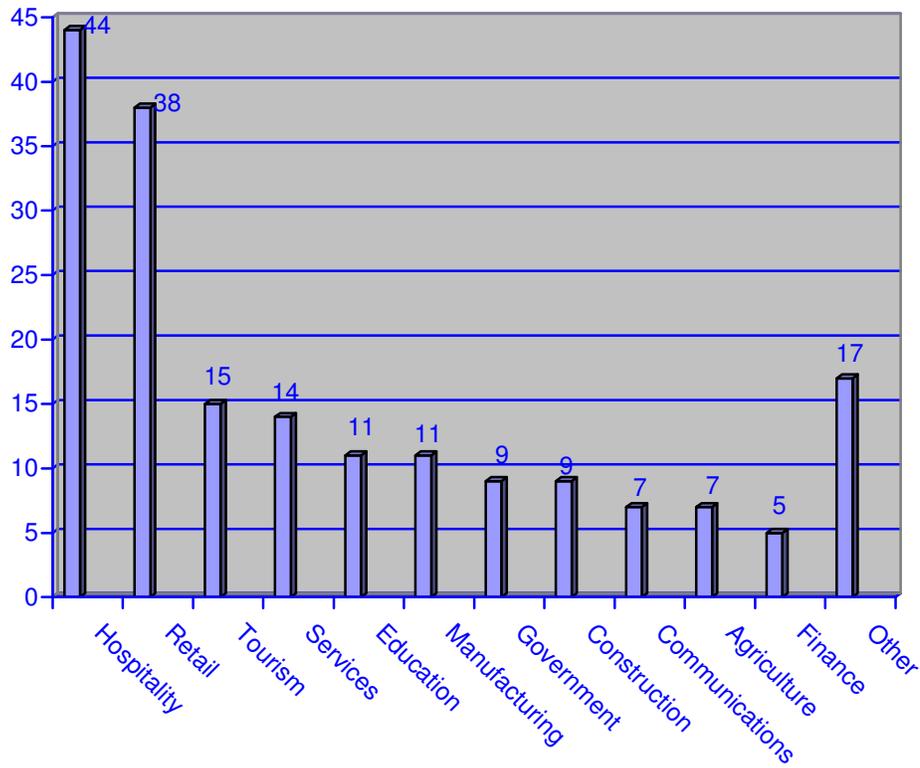


Figure 3: Sector of Activity of Clients

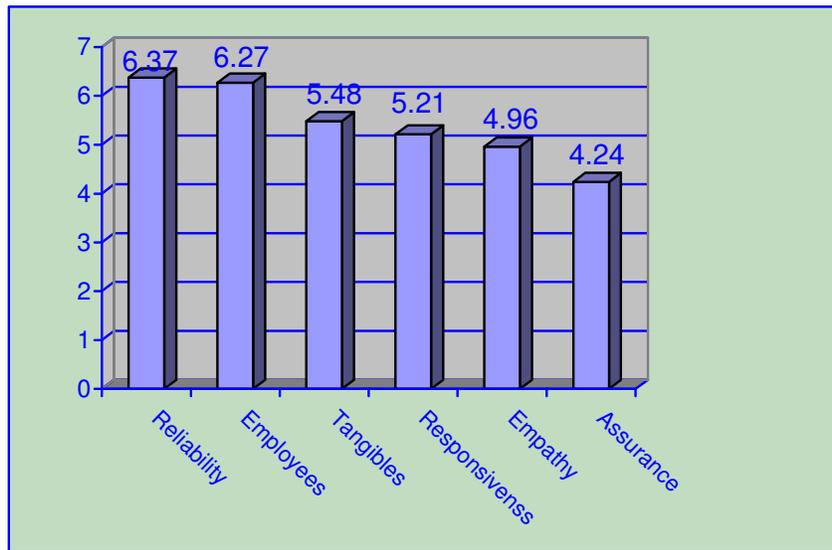


Figure 4: Standardised SERVQUAL Results

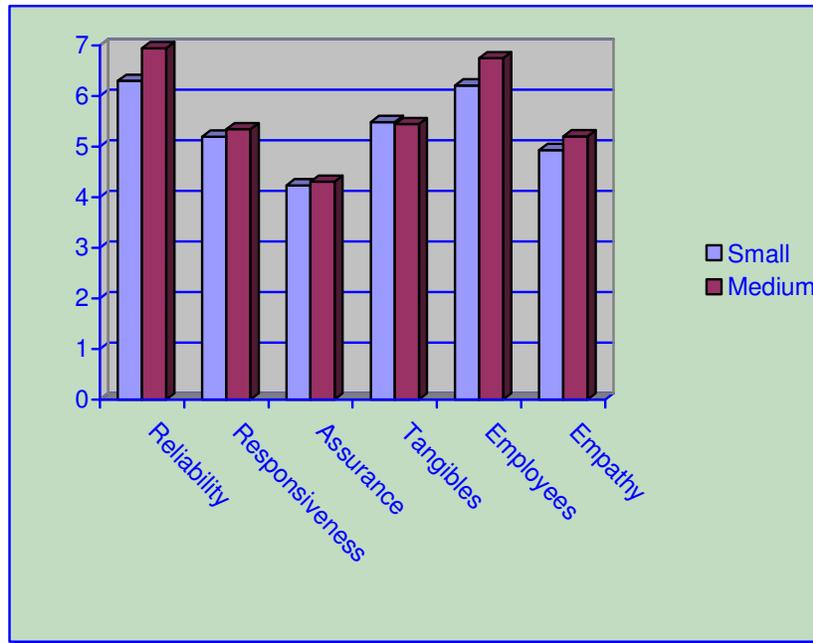


Figure 5: Graphical Comparison of SERVQUAL Dimensions  
Controlling for Clients Organisational Size

|                       | t      | df  | Sig. (2-tailed) | Mean Difference |
|-----------------------|--------|-----|-----------------|-----------------|
| <b>Reliability</b>    | -2.039 | 185 | .043**          | -.6423          |
| <b>Responsiveness</b> | -.601  | 185 | .548            | -.1480          |
| <b>Assurance</b>      | -.254  | 185 | .800            | -.0759          |
| <b>Tangibles</b>      | .203   | 185 | .839            | .0430           |
| <b>Employees</b>      | -2.188 | 185 | .030**          | -.5392          |
| <b>Empathy</b>        | -1.104 | 185 | .271            | -.2727          |

Table 1: Independent Samples t-test Controlling for Organisation Size

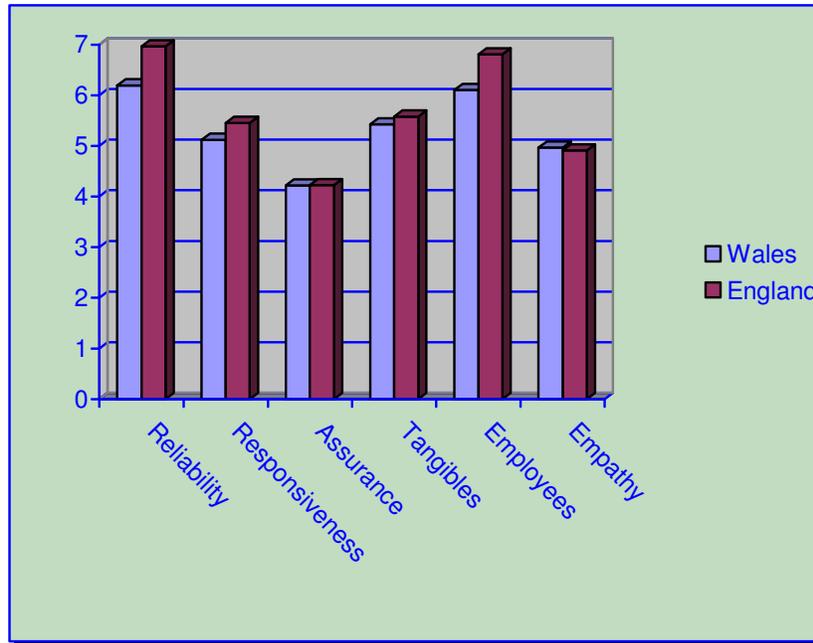


Figure 6: Graphical comparison of SERVQUAL Dimensions  
Controlling for Clients Geographic Location

|                       | t      | df  | Sig. (2-tailed) | Mean Difference |
|-----------------------|--------|-----|-----------------|-----------------|
| <b>Reliability</b>    | -3.130 | 179 | .002**          | -.7731          |
| <b>Responsiveness</b> | -1.734 | 179 | .05*            | -.3351          |
| <b>Assurance</b>      | -.0350 | 179 | .972            | -.0081          |
| <b>Tangibles</b>      | -.9360 | 179 | .351            | -.1559          |
| <b>Employees</b>      | -3.721 | 179 | .000**          | -.7045          |
| <b>Empathy</b>        | .3010  | 179 | .764            | .0589           |

Table 2: Independent Samples t-test for Geographical Location

|                       |                | Sum of Squares | df  | Mean Square | F     | Sig. |
|-----------------------|----------------|----------------|-----|-------------|-------|------|
| <b>Reliability</b>    | Between Groups | 22.955         | 11  | 2.087       | 1.117 | .350 |
|                       | Within Groups  | 326.838        | 175 | 1.868       |       |      |
| <b>Responsiveness</b> | Between Groups | 11.645         | 11  | 1.059       | .938  | .506 |
|                       | Within Groups  | 197.549        | 175 | 1.129       |       |      |
| <b>Assurance</b>      | Between Groups | 20.817         | 11  | 1.892       | 1.156 | .321 |
|                       | Within Groups  | 286.401        | 175 | 1.637       |       |      |
| <b>Tangibles</b>      | Between Groups | 7.269          | 11  | .661        | .789  | .651 |
|                       | Within Groups  | 146.646        | 175 | .838        |       |      |
| <b>Employees</b>      | Between Groups | 10.210         | 11  | .928        | .794  | .646 |
|                       | Within Groups  | 204.643        | 175 | 1.169       |       |      |
| <b>Empathy</b>        | Between Groups | 13.707         | 11  | 1.246       | 1.109 | .357 |
|                       | Within Groups  | 196.575        | 175 | 1.123       |       |      |

Table 3: One-Way ANOVA test for Operating Sector

# **HOW SMALL BUSINESS KEEPS ABREAST OF EMERGING TECHNOLOGY**

by

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## **ABSTRACT**

This research focuses on the practices employed by both small and large firms to keep abreast of rapid change in a high technology industry. The challenge of remaining constantly up to date is especially acute for firms that provide technology services, so we selected the Information Systems Services Providers (ISSP) industry as subject. Since ISSPs face extremely rapid technological change and have high incentive to keep abreast, we feel they may well have developed keeping abreast “best practices” that are being revealed through this research.

Through case studies of fourteen successful ISSPs of both small and large size we determined that keeping abreast is best accomplished via a portfolio of nine approaches, each distinct in character. The portfolio includes traditional methods such as customer and vendor relationships, employed in new ways, and still evolving approaches such as tech labs and communities of interest. The best implementations of the portfolio involve considerable interaction and integration among the individual approaches, resulting in a keeping abreast “system” for the organization. We found that small firms are capable of employing the full nine-method portfolio, but tend to devote uniformly lower levels of resources to these methods. Since small ISSPs operate profitably and grow rapidly, they apparently enjoy efficiency or other advantages in leveraging resources to keep abreast. We offer some possible explanations. We believe that many of our findings can provide small business managers with insights useful in keeping abreast in a variety of industries and markets.

## **INTRODUCTION**

Small business organizations in high-technology industries face a significant challenge in keeping abreast of rapidly changing technologies, as do their larger counterparts. Small businesses must be equally up to date, with comprehensive awareness of how new technology can be exploited in pursuing new opportunity and solving the problems of their customers.

However, small businesses typically cannot afford to devote as many resources to keeping abreast as do their larger competitors. How do small businesses manage to hold their own in meeting the challenge of keeping abreast?

The organic model of organizations posits an active relationship between organizations and their external environments (Burns and Stalker, 1968; Galbraith, 1977; Kanter, 1984; Morgan, 1986). Very rapid change in the external environment causes environmental turbulence and a high level of uncertainty about the future (Daft and Lengel, 1986) that can constrain organizational success (Stinchcombe, 1990; Galbraith, 1977). Getting the right information – “the news” – about these uncertainties becomes a critical goal of organizations facing rapid change (Stinchcombe, 1990). Organizations that fail to interpret the environmental changes adequately cannot respond and often do not survive those changes.

In times of severe environmental turbulence, organizations gather and process more information about the environment and develop more lines of inquiry into it (Daft and Lengel, 1986; Lozada and Calantone, 1996), thus leading to the development of more formal systems to acquire and process that information (Stinchcombe, 1990). We reasoned that the emergence of these types of systems ought to be observable in both small and large organizations that are in a high-tech, rapidly changing environment.

## **RESEARCH DESIGN**

Our research involves case studies of fourteen corporate Information Systems Services Providers (ISSPs), including both small and large firms. For the purpose of the study, an ISSP was defined as a firm that, as its core competency, helps customers manage their business information through the design and implementation of information systems, telecommunications networks, and computer hardware. ISSPs were chosen as the study subject for two reasons: 1) because the information technology environment within which ISSPs deliver their services is a high-tech industry that is currently experiencing increasingly rapid technological growth; and 2) because this industry is central in supporting so many important rapidly growing firms.

The case study population is divided between small and large firms, allowing a useful comparison of the approaches taken to keeping abreast and the success achieved therein by the two groups. The small firms (four) ranged in number of employees from 120 to 570 and averaged 360 employees, while the larger firms (ten) were all larger than 1,000 employees. Seven of these fourteen firms have a customer focus primarily on the government market, while the other seven have either a split focus or favor the commercial sector. Customer focus distributes about evenly between the small and large firms.

Despite differences in size and customer focus, all fourteen ISSPs studied provided a full range of information technology services for their customers. These services included: advising on trends and specific technologies; procuring technologies; integrating technologies into systems; developing new software; and helping to maintain and update systems. The core knowledge required for the ISSPs to provide these services changes rapidly in this industry, requiring vigorous attention to keeping abreast in order to achieve business success.

An interview-based approach was used to explore the keeping-abreast approaches used by the subject ISSPs. An extensive framework of expected behaviors was developed based on the existing literature and this framework was used in constructing the interview guide. Several open-ended questions allowed for the exploration of several new behaviors identified by interviewees and these new behaviors were then added to the framework. Interviewees were the cognizant senior executives involved in technology management – CEO, COO, CIO, etc. – whether small or large firm.

## **RESULTS: THE KEEPING-ABREAST PORTFOLIO**

We have found that new approaches to keeping abreast of rapidly changing technology are emerging as the pace of technological change increases. The ISSPs in our study, whether small or large businesses, do not rely predominantly on a single practice or unit – for instance, an advanced technology group – to keep them up-to-date. Instead, the most effective ISSPs employ a variety of approaches, managing them as a portfolio of keeping-abreast activities that interact and reinforce one another.

We have identified nine distinct types of keeping abreast activity, all potentially available to well-managed ISSPs of any size. These approaches include only those present in the majority of our subjects and for which a spectrum of organizational commitment was evident from the interviews. The nine keeping-abreast approaches that met our tests and are included in the standard keeping-abreast portfolio are:

- Vendor relationship programs
- Technology gatekeepers
- Staff learning programs
- Communities of practice and interest
- Customer relationship programs
- Formal scanning units
- Technical laboratories
- Internal projects
- Research and development.

These methods are listed in the approximate order of their apparent “importance” to the population of fourteen ISSPs studied. Importance was judged on the grounds of the level of organizational commitment to the approach, as discussed below.

Several keeping abreast approaches that were mentioned in a limited number of cases do not meet the tests for inclusion in the standard portfolio. Professional networking is an example. Although mentioned quite often, none of our corporate subjects formalized or structured the use of this approach. Explicit objectives were not stated nor were personnel committed to managing the activities in this area. Other approaches mentioned but not included in the standard keeping abreast portfolio are corporate information centers, competitor intelligence, and participation on external standards committees. In time, or in other industries, some of these practices and others

may be found to be sufficiently wide-spread in their utilization that they would be incorporated in a standard keeping abreast portfolio.

## KEEPING ABREAST APPROACHES

**Vendor Relationships.** The intent of the vendor relationship is to get the news first about changes in the vendor's products in order to anticipate the effects that those changes can have on the implementation of the products. Key elements of organizational commitment include the assignment of a liaison to manage the ISSP's vendor relationship, the development of a contractual relationship (or some kind of shared expectations) with the vendor, vendor training, involvement in vendor user groups and attendance at vendor sponsored conferences, site visits, exchanges of marketing leads, and vendor certification programs.

An important issue for an ISSP is whether to focus on one or two key partners in each important technical category or to develop relationships with as many vendors as possible. Small firms may often prefer the former since it is more economical in terms of time and resources. This approach, however, can make the ISSP dependent on a particular vendor and in turn jeopardize the ISSP's ability to adapt to changes in the long run. The many-vendor approach, which is more easily practiced by a larger firm, allows broader coverage of the technology front.

**Technology Gatekeepers.** The intent of this popular source of keeping-abreast information is to provide trusted, highly-skilled liaisons between internal and external professionals and their technology communities. Key elements of organizational commitment include formal identification of gatekeepers; a budget allocation for gatekeeping activities, such as training and travel to conferences and vendor sites; and development of a career path that encourages senior professionals to serve in that role in preference to moving into a management role (usually horizontally).

For the smaller, more resource-constrained ISSP businesses, it is important to make use first of all resources that are close at hand (Strandholm and Kumar, 2003). Since gatekeepers arise naturally in most organizations (Nochur and Allen, 1992), they are available to have their expertise tapped by the strategic planning group. A number of the larger ISSPs we studied have enhanced the technical career path so that technologists can rise to the same levels of respect and compensation as managers. This may often be less of an issue in small businesses because of the greater tendency for key professionals to "wear many hats."

**Staff Learning.** The intent of staff learning is to develop keeping-abreast ability and responsibility within each professional staff member. Organizational commitment is driven primarily by the understanding that the individual's own ability to keep up with change will eventually determine the organization's ability to keep up. In addition, as the management literature over the last decade indicates, the interplay of individual and organizational learning is a source of innovation and organizational growth. Elements of the staff learning approach include the creation and management of individual development plans, annual quotas for required training for each employee, incentives for advanced levels of training and education.

Small businesses may have difficulty devoting the resources to establishing formal programs for integration of a training plan with career path counseling. Large firms, which can more easily afford to integrate training and career progression, have another kind of problem, though. They often look to training as an early source of cost savings, and tend to make such decisions more remotely and less selectively than can small firms. Thus, in the overall sense it may be easier for a small firm to align training with the firm's strategic direction.

**Communities of Practice/Interest.** The intent of this approach is to provide a way to use natural and field-centric social structures to maintain intimate contact with particular technology sub-sectors. Brown and Duguid (1998) describe communities of practice and interest (COP/I) as groups within the organization that share meaning and sense-making about the "know how" aspect of a particular subject. Particularly important to ISSPs are technology areas core to the ability of the firm to deliver services or those representing a developing trend or emerging technology. Our interviews indicate that COP/I are gaining in importance and formality within ISSPs.

Large firms appear to have some clear advantages in this area. One large firm we studied has structured technology focus groups (TFGs), and had seventeen of them functioning at the time our interviews were conducted. These TFGs coordinate through the firm's technology resources center and are responsible for maintaining the area of the corporate knowledge base that is dedicated to their subject of interest. Small firms today are not far different from large firms in their ability to access scientific and technical information. Topical Internet forums represent a virtual professional COP/I that levels the competitive ground. In addition small firms, or small units of large firms, may be able to exploit the oft-cited small business advantage of greater responsiveness to change in their use of COP/I. For example, one firm we studied described one of their processes as: "Communities of interest spring from the bottom up and are all totally on their own in terms of resources." Moreover, small firms have a potential advantage over large firms in that their strategic planning groups have easier access to knowledgeable technologists who may have unique technology strategy insights. Key professionals are easier to identify and typically much closer to the level of the decision maker in small firms. Large firms can compensate to some degree if their COP/I can play an accumulator role, gathering input from the members of each community, extracting and validating the important elements from the accumulated knowledge, and passing the results on to the planning group.

**Customer Relationships.** Customer relationship management plays an interesting role as part of the keeping-abreast portfolio. The intent in this approach is for key customers to take the lead in important developments. The elements of this approach include identification of "lead users" (Von Hippel, 1986), assignment of a semi-permanent customer representative within the ISSP, mechanisms to gain input from the customer for use in planning, and mechanisms to get feedback from the customer for use in improving service delivery. Resources committed to the customer-relationship approach include the time of the customer representatives, infrastructure support in terms of information systems and communication for managing customer contacts and feedback, expenses for travel to customer sites, and potentially expenses for bringing customers together with the ISSP to work on specific ideas in larger groups.

Small businesses have the potential to leverage their traditionally-motivated customer relationships – those intended to promote customer satisfaction and loyalty – to enhance their success at keeping abreast. In small businesses it is not unusual for technically sophisticated employees or technology managers to be closer to the customer than in large firms. This comes about through purposeful or expedient structuring of units that manage traditional customer relationships so as to also facilitate customer access for their technology developers and applications specialists. In large firms customer relationship management tends to be more protected. Units established to build customer satisfaction, for example, may be organizationally distant from and not particularly friendly to those that exist for the purpose of gaining technology learning from the customer. We found examples in large firms of very mature, highly structured customer-relationship management programs that have little or no relationship to the ISSP's keeping-abreast activities.

**Formal Scanning Unit.** The intent in this case is to establish a unit that has formal responsibility for scanning and evaluating technology trends, for making recommendations for adoption of new technology, and for providing input for longer-term planning. The unit may reside in a stand-alone group dedicated to scanning or it may be attached to some other organizational unit, such as the technology laboratory (see below), the planning organization, or the ISSP's IT architecture group. The unit will have some dedicated staff and in many cases will have a required reporting connection of some sort with the planning process.

Small businesses appear to have a fairly strong disadvantage relative to large firms in this keeping abreast approach, in that the amount of resources devoted to the effort is more limited. On the other hand, a small business may choose to assign responsibility for some of the more sophisticated scanning activities to a working professional on a part-time basis. This can offer a much more insightful quality of scanning compared to a large firm's scanning staff who would typically have lesser technological qualifications.

**Technology Laboratories.** The intent of this approach is to provide a dedicated unit that stages IT products and offers a ground for experimentation, demonstration, and learning. Various roles for the technology lab include a demonstration center for customers, a setting for the installation and testing of new products, and infrastructure and support for experimentation and integration. The elements of the technology laboratory include dedicated space for the laboratory, hardware and software required to run the various applications, staff and budget assigned to the maintenance and operations of the laboratory, and specific metrics and expectations for governing the lab's performance during the year.

Some organizations have entertained the idea of a technology laboratory and rejected it. This decision may be based on economic rationale, as in the case of one of the small business ISSPs we studied ("I can't imagine getting enough value out of it to warrant the expense of creating and staffing it"). Or based on experience, as in the case of one of the large business ISSPs we studied ("We used to have a dozen labs but decided we could get more bang for the buck by distributing the resources to the people who need them most – the projects.") The tech lab is one of only two keeping-abreast approaches that show evidence of having been tried and then rejected. (The other is the research and development approach described below).

**Internal Projects.** The intent of the internal projects approach is to develop superior understanding of the product in real-world applications and then to transfer newly developed skills to other work. The elements of this approach are: 1) projects that are intentionally selected for learning; 2) staff who are assigned for the specific purpose of learning and assisting in transferring new technology; and 3) mechanisms developed for transferring learning from the specific project to other parts of the organization. Internal projects may be undertaken for business reasons that have nothing to do with keeping abreast, per se, but because of the newness of the technology to be implemented, they still offer a keeping-abreast opportunity. Or projects can be selected because the ISSP wants to learn a new technology internally before assuming the risk of external failure by offering it to a customer.

Internal projects have been cited as one of the important sources of new information and innovative ideas for the organization (Leonard-Barton, 1995). Nonetheless, the ISSPs in our sample, whether small or large, gave little evidence of having evolved this approach to a high level of organizational commitment.

**Research and Development.** The research and development approach to keeping abreast makes the exploration and discovery of new knowledge the primary goal of the activity. The intent is to create the future rather than merely keep abreast of it, in the case of exploratory research. The intent is to test new products and ideas before buying in, in the case of applied research. Elements of this approach include support for applied R&D projects, mechanisms for selecting from among competing R&D proposals, methods for incorporating R&D results into project teams, and staff time and materials to support the R&D effort. The majority of the research observed in this study was of the applied type.

Research and development projects are the least frequently observed of the keeping-abreast approaches in this ISSP sample. Only one ISSP, a large business, had a fully integrated research and development capability. Several of the larger firms have centers for research in business innovation and technology advancement. It is growing more common for these centers to enlist customers as partners in the research. The partners help share the cost of the research in exchange for this participation and early access to the research results. Small firms can participate also, by treating proposal development as a chance for some applied research and development. R&D was one of two approaches (along with technology laboratories) that some ISSPs have tried and rejected on the grounds that it does not provide enough return on investment.

## **LEVELS OF ORGANIZATIONAL COMMITMENT**

A key objective of our research was to analyze the ways in organizations manage their keeping-abreast portfolios. We believed this would reveal patterns that could lead to better understanding of keeping-abreast "best practices." To facilitate this analysis we developed a five-level measure of the degree of resource commitment to the keeping abreast approaches, using existing process maturity models as a starting point. The level of commitment was evident through the degree to which organizational supports – specific goals, objectives, expected outcomes, defined processes, capital investments in equipment and software, recognized organizational status for participants,

and assigned personnel – existed for each approach. Though qualitative, this measure gives a reliable indication of level of commitment, we believe, and provides a means for comparing keeping abreast behaviors among firms and groups of firms, such as the small vs large ISSPs in this study.

Individual keeping abreast approaches were assessed as reflecting an organizational commitment of resources at these five levels:

- *None* No occurrences of approach observed.
- *Ad hoc* Approach exists only temporarily, often in reaction to some external event.
- *Basic* Approach has some continuity and definition, but fairly limited in organizational expectations, structure, personnel, and other resources.
- *Structured* Approach has continuity and permanence. Processes, structures, and expectations have been established and personnel are assigned continuing responsibility for the approach.
- *Integrated* Approach is integrated with the other keeping-abreast approaches through some form of linkages.

These levels were assigned point values ranging from 0 to 4, respectively. This aids in the depiction of patterns of commitment to the various approaches in an organization's portfolio, as will be illustrated below. No proportionality of business value is implied by this point scale.

### **MANAGING THE KEEPING ABREAST PORTFOLIO**

We found that both small and large firm ISSPs commit differing amounts of resources to the various keeping-abreast approaches. In some cases the resources committed ranged widely. Some ISSPs were found to allocate quite modest resources in support of a series of largely independent individual approaches. At the other end of the spectrum, some ISSPs made commitments of millions of dollars and dozens of persons to support a clearly articulated keeping abreast *system*. In general, commitment levels were found to be quite consistent across approaches within any one organization. The case study interviews suggested that at the higher levels of resource commitment the various keeping-abreast approaches support and interact with each other, offering some synergy.

Employing the five-level measure of resource commitment described above for each approach in the portfolio reveals a unique keeping abreast “profile” for each organization studied. This profile represents the way a company manages its keeping abreast portfolio. When this analysis is extended to the classes in the full population -- that is, when the commitment levels for each individual keeping abreast approach are averaged for all small firms and then for all large firms – a comparison of the portfolio management practices of the two defined groups can be made. This is depicted in Figure 1, a radar chart in which the nine radial branches represent individual keeping abreast approaches, and the distance from the origin along each branch represents the average commitment level of the members of the group.

Our research demonstrates that small business ISSPs act quite comprehensively in keeping

abreast, including in their portfolio at least minimally-effective levels of activity in most or all nine of the identified keeping abreast approaches. When averaged as a group, all nine approaches are shown to be supported, albeit to varying degrees. With regard to the averaged portfolio profiles, the small firms mimic the large in shape of their profile, both groups showing quite balanced comprehensive utilization of the nine approaches. The large firms, however, show uniformly higher commitment levels in all nine approaches.

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Figure 1 about here  
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A number of reasons might explain the noteworthy overall commitment level differences. The fact that the larger ISSPs have more money to spend is immediately obvious. However, the larger firms also have more staff who need to be kept abreast of current developments. In smaller firms there may be more informal communication underway and that may be sufficient to disseminate important keeping-abreast information to those who need to know it. Thus, small firms may need less formal keeping abreast structure than that required by the larger organizations.

The small vs large firm commitment levels are closest in the approaches relied upon most heavily, vendor relationships and the technology gatekeeper. They are also quite close in another important and useful approach, communities of practice/interest. The small vs large firm commitment levels are most divergent in the approaches that are apparently deemed least useful in this industry, internal projects and R&D. This may suggest that small firms marshal their relatively scarce resources and allocate them where they will count the most. The sizable difference in the formal scanning unit, one of the most visible and resource-intensive of the approaches in the portfolio may be a reflection of corporate financial pressures. This approach requires a steady commitment of funds so the resource demand is much less elastic than in other approaches. This makes the formal scanning unit approach more vulnerable to financial pressures that may arise during the ISSP's budgeting processes.

Interestingly, the relatively balanced comprehensive use of all nine approaches by small firms contrasts with the much less balanced and much less comprehensive practice portfolios we found in a companion study. This study includes private and non-profit organizations that provide their ISSP services to internal customers and governmental ISSP organizations, many of which were quite large (Durney and Donnelly, 2005). This suggests that small businesses are efficient in their use of keeping abreast resources, recognizing that by employing the full portfolio of approaches concomitantly they are able to form a dynamic and integrated organizational response to the keeping-abreast challenge in a rapidly changing technological environment.

## **SUMMARY**

Our research revealed that keeping abreast is a dynamic, interactive organizational activity for ISSPs. We determined that nine key approaches were used in the majority of the organizations interviewed, forming what we have called the keeping-abreast portfolio. When commitment levels were measured for each approach in the portfolio, a unique keeping-abreast "profile" was revealed for each organization studied. Of course, each organization's keeping abreast activity is

subject to organizational pressures such as the financial performance, changes in leadership, disruptive technologies, and so on, as for any other organizational activity. Given this dynamic quality, and the fact that these profiles represent snapshots of the keeping-abreast activity at the time the interview was conducted, it is quite possible that these profiles will change over time and not always toward higher levels of commitment.

We believe the results of our research are of value to small and large business ISSPs and other high-technology managers in both small and large organizations who are seeking to improve their organization's success at keeping abreast of rapid change. Our findings regarding the structure of keeping-abreast portfolios provide a useful framework for assessing one's own keeping-abreast activity. While our study focused on the information technology sector, we believe our findings can be reasonably extended to keeping abreast of change in any high tech industry susceptible to rapid technological change. Finally, the portfolio concept is providing a solid foundation for our ongoing research that may determine whether a higher commitment of resources to keeping-abreast activities correlates with greater long-term success for both small and large organizations.

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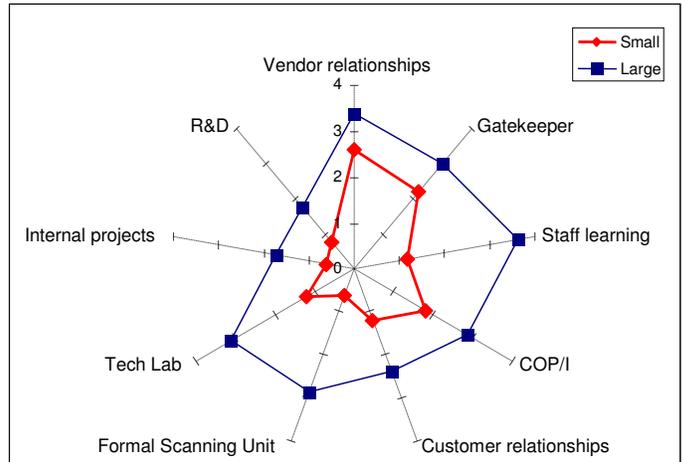


Figure 1. Small vs Large Firms

## **Advising small and medium-sized enterprises (SMEs) on their liquidity issues**

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### **Abstract**

This paper explores the literature on the liquidity of the SME globally. The focus of this paper is mainly on Australian SMEs yet the same issues exist in other parts of the world. The UK studies found that poor credit management practices and being undercapitalised are two of the major concerns for small business as they feel powerless to do anything about their debtors' late payments (Chittenden & Bragg, 1997; Peel, Wilson, & Howorth, 2000).

This empirical study is based upon a one period (1997-98) sample from the Australian Bureau of Statistics (ABS) Business Longitudinal Survey (BLS). Regression analyses were undertaken on demographic, owner-manager and financial characteristics to identify the determinants of SME liquidity for Australian businesses. Analyses of the results indicate that financial variables appear to be more important than demographic and owner-manager characteristics. The results from this research needs to be given to SMEs in order for them to understand what characteristics affect their liquidity and how it may vary from industry to industry in which the business operates needs further research.

Peel & Wilson (1996) found that there was a dearth of both theoretical and empirical small business research relating to liquidity issues. The findings of this paper suggest that there is a lot to the liquidity of the SME and legislation should be introduced to remedy the situation. The results of this study have implications for both future research and policy makers into liquidity of the SME.

Keywords: liquidity, small and medium-size enterprises

### **Introduction**

As from 2005 the international accounting standards have implications for the small and medium-sized enterprises (SMEs) to disclosure requirements. The importance of the SME's financial management especially liquidity issues has for sometime been overlooked in some countries with limited research in others (Coleman & Cohn, 1999; Chittenden & Bragg, 1997; (Drever & Hartcher,

2003). Yet in Australia alone there are over one million SMEs employing almost 50 per cent of the workforce making SMEs vital for the economic development.

The methodology is based a one period (1997-98) sample from the Australian Bureau of Statistics (ABS) Business Longitudinal Survey (BLS) that contained 9,732 cases with 724 variables that cover a variety of characteristics. Regression analyses were undertaken on the characteristics to identify the determinants of SME liquidity.

From these preliminary results it suggests that financial characteristics have more relevance than the demographic and owner-manager characteristics. Further research is needed to give owner-managers of SMEs information as to how they can better understand financial management affecting the liquidity of their business. Then investigate further with more research on how liquidity varies from industry to industry in which the business operates is vital for economic growth of SMEs.

Some of the demographic characteristics of an SME for this study include the size of the enterprise by the number of employees, the legal structure, the growth of the enterprise, the age of the enterprise, along with their innovativeness.

Empirical studies commonly use three measures of enterprise size – sales revenues, total employment and total assets (Agarwal, 1979; Barkham, 1994; Casson, 1999; Greiner, 1998). The employment size of micro businesses has changed over the last three decades in the United Kingdom (UK) as with other countries (Osteryoung, 1992; Storey, 1994). By 1991, 10 workers or fewer constituted 92 per cent of all UK enterprises (Storey, 1994).

There are a number of different legal structures but little is known about each structure context. Penrose (1959, 6) suggest that the legal structure sometimes determines the survival of an SME. Bolton Committee (1971,5) noted that the majority of SMEs were not incorporated but were either partnerships or sole traders. Freedman and Godwin found that 40 per cent of limited companies started as a sole proprietorship or as a partnership then moved into a limited company. Choice of the legal structure has implications for the business ranging from the way, in the way it is taxed, to the legal liability of its owner-manager (McMahon, 1995). In Australia, the legal structure of an SME can take the any of the following (Shailer, 1993) sole trader, partnership or proprietary company

Growth of the enterprise has been measured in the literature by the number of employees or sales (Greiner, 1998; Small Business Research Program, 1997). Some economic theorists believe that motivation of the owner-manager has a crucial role in the growth of the enterprise (Casson, 1982; Penrose, 1959; Casson, 1982 #57). Cressy (1999) reports that older owner-managers will have either

no growth or gradual growth since their need to learn in business is smaller and their decisions will respond less to short run news. SMEs' growth and higher exit rates are higher than larger businesses that are older (Small Business Research Program, 1997).

For a business to survive the owner-manager has to meet a number of different challenges relating to growth due to demands on management and business resources (Holmes et al, 2003). Jarvis et al (1996) suggests that owner-managers may be dependent on cash flows for growth and survival of their business. Bianchi & Bivona (2000) report that more a business grows and the perceived current income and cash flows increase, the higher the number of family members' withdrawal requests. Balancing withdrawals and investments to maintain family satisfaction is compatible with business liquidity which is one of the keys to survival and growth of both business and family (Bianchi & Bivona, 2000).

The age of an enterprise or the length of time an SME has been in business is a commonly used demographic so a debate in the literature and debate exists over whether the age of an SME is an important characteristic (Coleman, 2000; Gibson & Cassar, 2002; Greiner, 1998; D. J. Storey, 1994). Storey (1994) found that in the UK and USA younger SMEs grew more rapidly than older enterprises. Coleman (2000) adds the size and age of an SME remains constant with no significant differences between man and females owner-managers. The ABS reports that 56 per cent of newly formed enterprises are expected to cease trading over the following three years. Enterprise survival for the first 10 years without either changing ownership or ceasing is about 45 per cent from the ABS data (Bickerdyke et al, 2000).

Almost any sector in any country could be the breeding ground for entrepreneurs taking risks and introducing innovation into their business (Marsden, 1986; Neck, 1985). The expansion of the service sector began in 1970s and continued through the 1980s enhancing the opportunities for entrepreneurs because economies of scale were less important in that service sector. During the last decade there has been a revival of smallness, entrepreneurship and individual initiative (Davidsson, et al, 1993).

In understanding more about the owner-manager in regard to liquidity is investigated. The gender, educational level, years of experience, their decision-making and whether the business is a family business may impact on the SME are some of the characteristics studied. Owner-managers can be defined as individuals who both own and manage their businesses. Deeks (1976) classified the manager to three positions in a company: whether or not he was an owner of the firm, either as a

shareholder, a partner, or as sole proprietor, whether his responsibilities were general or specialist in character.

Keasey et al (1993, 10) found there is a need for achievement and desire for independence for owner-managers which are fundamental requirements. Those two character traits together might accurately describe an entrepreneur who is also an owner-manager there is no reason to suppose that: a) On average employees in large firms have any less (or more) need for achievement than small firm owner-managers or b) That the need for achievement is particularly strong amongst small firm owners generally. Timmons (1994) found that entrepreneurship involves building a team of people with complementary skills and talents and making sure that the venture does not run out of money when it needs money most. The owner-manager and entrepreneur come together in complex and interrelated ways (Keasey & Watson, 1993, 83) and a clear overlap is evident between entrepreneurship and the SME environment (McMahon et al, 1993).

Research studies on the gender of the owner-manager has been carried out by a number of different countries (Fay & Williams, 1991; Spilling & Berg, 2000; Watson, 2001). Spilling & Berg (2000) claim Norwegian female business manager's account for about seven per cent of total private sector employment, and about five per cent of total turnover. Fay & Williams (1991) reported on the loan manager's view of female business owners in Canada. Cliff (1998) reports on growth, gender and business size of Canadian SMEs. Coleman (2000) conducted an American study into the comparison between male and female-owned firms and the use of financial leverage. Watson (2001) reported from his Australia SME study that failure rates for female controlled businesses are likely to be higher than for male controlled businesses.

There have been a number of research studies on the educational backgrounds of owner-managers in the UK (Hall, 1995, 2000; Robinson & Sexton, 1994). (Deeks, 1976) measured the education undertaken by managers in small furniture enterprises as being the proportion of managers who had attended university. Robinson & Sexton (1994) reports education has a close relationship to entrepreneurship. Dadak (1995) found that there are relatively high levels of education of entrepreneurs in small towns in Bulgaria. Poutziouris et al (1998) claimed that companies run by owner-directors with a university degree, or higher level qualifications exhibit gearing ratios higher than companies run by less formally educated owners. Hall (2000) found that directors of established SMEs who had degrees generally achieved lower rates of growth than those less well educated.

There were a few conflicting surveys on females is educational levels (Cliff, 1998; De Carlo & Lyons, 1979; Welsch & Young, 1984). A greater proportion of non-minority females than minority females reported that they had graduated from both high school and college (De Carlo & Lyons, 1979). The typical female woman entrepreneur emerged as being younger, better educated, more interested in education and more likely to use written information sources than male entrepreneurs (Welsch & Young, 1984). On the other hand, a Canadian study found that females were significantly less likely to possess a business degree (nine per cent of females and 23 per cent of males) (Cliff, 1998).

The more experience the owner-manager has the greater the opportunity to seek out and access finance. There is substantial and growing evidence that SMEs experienced enormous difficulties in raising early-stage capital in the investment range of \$0.5 to \$2.0 million in Australia (Department of Workplace Relations & Small Business, 1998). Hall (2000) found from the UK study that SME owners with little experience at the start-up phase could have problems remaining solvent with an increase in expenditure in relation to their earnings. Storey (1994) suggests that prior business experience did not seem to be a factor to influence the growth of a business.

Differences in participants' managerial and industry experience have been studied (Cliff, 1998; Robinson & Sexton, 1994; Rosa et al, 1994). Rosa (1994) claimed that gender had a significant impact on experience of ownership and management in SMEs. Rosa et al (1994) claims that focusing on separating the complex interaction of gender and other economic forces the shape of business performance. Another study found the effect of education and experience did increase over the span of one's career as the levels of experience increase (Robinson & Sexton, 1994).

A number of financial characteristics to find associations with liquidity are wages expense, interest cost, bank overdraft, creditors, intangible assets, profitability and provisions. Balls (2003) assumes that tens of thousands of SMEs are barely scraping a living. No attempt has been made to measure how many SME households have an income from another source which raises the question about the liquidity of the business. There must be many SMEs operated by one spouse with another in regular waged employment (Balls, 2003).

Garcia (1994) reports that the interest cost can take the bit out of profits and the ability to obtain financing at the drop of a hat could signify life or death to a company today. With the evident of rising interest rates the SME may find itself unable to pay the loan thus affecting the liquidity of the business.

Tax has been an issue for SME for sometime. Little is documented as to how the owner-manager uses the depreciation as a tax shield for the SME. Depreciation in Australia follows the guidelines issued by the Australian Taxation Office. The amount of depreciation can vary depending of the method used. If the SME has a considerable amount of employing assets the tax shield would be high. The deduction than would be high and reduce the amount of tax to be paid.

Storey et al (1987) states that profitability appears to increase with size. Hall (2000) suggests that there is a positive correlation between size of the workforce and profitability. Cooley & Edwards (1983) reported that twenty-seven of seventy-four respondents (36 per cent) ranked the uncertainty of future profitability as the most influential on how much debt was used. There study also found that arranging the responses by business size reveals no significant differences in the relative rankings of the various debt-influencing factors.

Benton (1997) gives an insight as to why bad debts occur. When a company collapses by creating serious implications for those to which it owes money. He found that the issue of repetitive and large bad debt write-offs was an issue and the credit manager had to enforce strategies on a regular basis to minimise bad debt losses.

Burns & Walker (1991) found that 82 per cent of respondents reported having accounts payable with 4.4 per cent reporting accounts receivable which indicates that SMEs in the manufacturing are typically net suppliers of trade credit. Cosh and Hughes (1994) found that current liabilities had a higher proportion of total liabilities for small companies at 33.3 per cent than large companies at 62.4 per cent especially in non-manufacturing. SMEs stretch their accounts payable in order to give themselves extra cash flow liquidity. Venkatesan (1998, 88) found that effective accounts payable can have major strengths by optimises cash flow, reduces interest costs and bridges working capital deficiencies.

Cosh & Hughes (1994) found that for small companies there was a reliance on short-term bank loans and overdrafts than large companies. Poutziouris et al (1998, 13) reported that bank overdraft has remained the major source of external finance in the UK at 45 per cent. Both females and males commonly financed their businesses through overdrafts, but males were significantly more likely to do so (Rosa et al., 1994).

There is no literature to suggest that many SMEs use these accounts to keep their operations liquid. It would be worthwhile to have some information available on what percentage of SMEs had made provisions (annual leave and sick leave) and how it is associated to liquidity of the business.

Previous research suggest men and females have different experiences when attempting to obtain loans (Breen, Calvert, & Oliver, 1995; Coleman, 2000; Fay & Williams, 1991; Rosa et al., 1994). Fay and Williams (1991) reported loan officers were less likely to recommend a loan to a female applicant than they were to a male applicant. The results indicated that gender discrimination might occur in granting loans. Breen et al (1995) found anecdotal evidence that females were discriminated against in the lending process, and were less successful than males in gaining access to business finance. The conclusion is that the females surveyed had no difficulty in obtaining finance where there was a long-standing banking relationship. Coleman's (2000) study demonstrated females owned SMEs had to produce collateral and were not able to access credit the same as males.

Howard (1971) stated that working capital is the lifeblood of the enterprise. Chittenden et al (1998) found from their study that the responsibility for the management of working capital in small businesses goes to the owner-manager. A change in net working capital is the difference between a change in current assets and current liabilities. For a long-term investment, a change in net working capital may arise when acquisition of new equipment results in an expansion of operations (Black, 1993).

## **Methodology**

The data in the ABS BLS utilised for this study investigated the determinants of liquidity in Australian SMEs. The BLS is comprised of data from the 1994-95, 1995-96, 1996-97 and 1997-98 Business Growth and Performance Surveys and for this paper only the 1997-98 period was used.

The BLS data is by far the largest set of data on SMEs that is available at this point in time in Australia. It is also the most comprehensive set of data about the financial characteristics of SMEs that researchers could possibly hope to access and certainly contains a far greater set of data than an independent researcher could hope to obtain. Use of the BLS data also overcomes the constraints and difficulties associated with gathering financial information on businesses. The difficulties associated with obtaining reliable and consistent financial information from businesses has been acknowledged by many researchers and has long been an impediment in the development of any research involving the financial characteristics of businesses (Cassar & Holmes, 2001; Gibson, 2001; McMahon, 2000).

The value of the data in BLS cannot be understated as it provides key data on a large number of SMEs involved in a broad range of different industry activities. In the past a considerable amount of research has reported on relatively small and narrowly defined samples with results that need to be interpreted cautiously and extrapolation to broader populations can be difficult.

The comprehensiveness of the data in the BLS overcomes the disadvantages of a poor response rate that typifies much of the research examining the financial characteristics of businesses because of the compulsory collection of data by the ABS. The testing and evaluation of the data conducted by the ABS prior to its release reduces the need to test for response and non-response bias. Typically, studies attempting to obtain financial information from respondents have very low response rates, which in turn leads to less than optimum outcomes and analyses that need to be interpreted with caution (S. Holmes & Kelly, 1989).

The use of BLS data for the current study reduces the time and costs associated with normal survey work when investigating financial data. Under the Census and Statistics Act 1905 all information enabling the identification of a particular person or organisation must be removed to protect confidentiality. As well, all users of the BLS (or any ABS data) must adhere to strict usage and confidentiality guidelines that form part of the purchase and license agreements.

### **Limitations of the BLS**

The BLS data are still not a complete file covering all SMEs financial data and sets limitations to the analysis in that area until the next time the survey is organised, which is not until 2006. There are a number of missing variables that may have made a significant impact relate to the BLS data. No separate data is available on accounts receivable (debtors) and cash held, sets up a number of limitations that may have created a major impact to the BLS data. To have available separate information on the accounts receivable (debtors) and cash at hand would have expanded this paper into areas that have not been fully researched previously in Australia.

### **Working with the BLS data**

The BLS data contains 724 variables over a broad range that contains material that is not relevant to the current research. The main aim of the study is to determine characteristics of SMEs that predict liquidity. This meant that variables that were considered as to not assist to measure demographic, owner-manager and financial characteristics for this research were removed from the data set. Only 40 variables were maintained from the dataset and some of them were grouped in sets according to small business demographics, owner-manager characteristics and financial characteristics for transformations into ratios of variables and for variables that needed recoding. For simplicity purposes only the period 1997-98 was to be used for this paper's testing. Cases were removed from the data set for the period to be tested because they contained minimal information relating only to the age of the business and gender of the owner-manager.

The ABS made sure the BLS data only contained business having less than 200 employees. In keeping with SMEs the point is made that a number of variables in the data set refer to subsidiaries of parent companies and Gibson’s (2001) study gives reasoning why those cases should be removed. His current research recommends omitting those cases because SMEs with that sort of information would be deemed not as typical SMEs. The cases that were removed were chosen on the basis of the business indicating they had a source of debt or equity from a parent company. It needs to be recognised that these may have precluded some franchisees which could still be ‘typical’ SMEs.

A number of calculations were needed to be carried out prior to data in the BLS being in a format suitable for the analysis of liquidity and its predictors. The transformations required the calculation of ratios. Thomas & Evanson (1987) state ratio analysis is traditionally used to measure liquidity, performance and profitability of a business and to monitor the effectiveness and efficiency of management. The research aims to investigate the relationships among each of these dimensions of the financial characteristics of SMEs. Ratios have been used by a number of researchers to justify their conclusions about financial data.

The calculations and variables used to compute the two measures of liquidity that are to be used as dependent variables in this study. The two measures of liquidity are standard ratios found in any finance textbook (Ross, Thompson, Christensen, Westerfield, & Jordan, 2001; Wilson & Keers, 2003). Calculations used to compute variables to measure liquidity are:

$$NWC \text{ (Net working capital ratio)} = \text{current assets minus current liabilities} / \text{total assets}$$

The following summary of the calculations used to compute values for the independent financial variables. The calculations used to compute each of these variables derived from the prior studies literature. The calculations used to compute the independent demographic variables for the BLS data are:

- SIZE (Employees)* = total employment
- LEG (Structure)* = structure of the business (incorporated or not incorporated)
- GROS (Growth)* = sales turnover for three years/ last year
- GROE (Growth)* = employee turnover for three years/ last year
- AGE (Age of the SME)* = number of years
- INNS (Innovation)* = innovation by service (dummy variable)
- INNP Innovation)* = innovation by product (dummy variable)

The owner-manager variables used in this study using the BLS data are discussed. The independent variables for the owner-manager variables of an SME required for this study from previous studies are as follows:

$$GEN \text{ (Gender)} = \text{male and female (dummy variable)}$$

|                              |   |
|------------------------------|---|
| <i>EDU (Education level)</i> | = secondary, tertiary and degree          |
| <i>EXP (Experience)</i>      | = number of years                         |
| <i>DEC (Decision-making)</i> | = major decision-maker (dummy variable)   |
| <i>FBUS (Family)</i>         | = family decision-making (dummy variable) |

Next the financial variables used in this study using the BLS data are discussed. The independent variables for the demographic variables of an SME required for this study from previous studies are as follows:

|                                |                                       |
|--------------------------------|---------------------------------------|
| <i>BKO (Bank overdraft)</i>    | = bank overdraft/current liabilities  |
| <i>PROM (Profit margin)</i>    | = derived profit/sales turnover       |
| <i>BAD (Bad debt)</i>          | = bad debt written off/total expenses |
| <i>CRED (Creditors)</i>        | = creditors/current liabilities       |
| <i>PROV (Provisions)</i>       | = provisions/current liabilities      |
| <i>WAG (Wages)</i>             | = wages expense/total expenses        |
| <i>TAXS (Tax shield)</i>       | = depreciation/total expenses         |
| <i>IAS (Intangible assets)</i> | = intangible assets/total assets      |

Regression analysis to test the variables discussed above was undertaken by means of employing various independent variables which are regressed against liquidity measures. Each of the independent variables enters the regression equation eleven times, for each of the industry categories. This study is not just considering the different determinants of liquidity for SMEs in Australia but to evaluate the relationships across industries.

## **Results**

Table 1, 2 and 3 shows a significant association between the liquidity model net working capital ratio and a number of independent variables. The independent variables were a number of demographics, owner-managers and the financial characteristics of the SME.

Two demographic characteristic coefficients were statistically significantly different from zero and they were the coefficients for size (number of employees) and age of the SME. No other independent variables for net working ratio liquidity models show any significance.

With the size and age of the SME having a positive result to liquidity is worth mentioning to the owner-manager to must ensure better financial management is undertaken when employing staff and as the business is growing.

Insert Table 1

| Independent variable |                              | Net working<br>Capital ratio  |
|----------------------|------------------------------|-------------------------------|
| SIZE                 | beta<br>[t-statistic]<br>p = | .382<br>24.090<br><b>.000</b> |
| LEG                  | beta<br>[t-statistic]<br>p = | -.011<br>-.682<br>.495        |
| AGE                  | beta<br>[t-statistic]<br>p = | .059<br>3.534<br><b>.000</b>  |
| INNP                 | beta<br>[t-statistic]<br>p = | .002<br>.132<br>.895          |
| INNS                 | beta<br>[t-statistic]<br>p = | -.003<br>-.199<br>.842        |
| GROE                 | beta<br>[t-statistic]<br>p = | .002<br>.133<br>.895          |
| GROS                 | beta<br>[t-statistic]<br>p = | .019<br>1.131<br>.258         |

Table 2 shows there were three owner-manager coefficients that were statistically significant. Educational level coefficient were statistically significant  $p = < .001$ . The family business coefficient showed a significance level of .013. No other independent variables for net working ratio liquidity models show any significance.

It was surprising to learn that the educational level of the owner-manager can have a positive affect the liquidity of the SME. With the negative result for family business towards the SME liquidity is worth monitoring. Understanding the negative aspects of the years experience of the SME with regard to liquidity issues is worth advising the owner-manager.

Insert Table 2

| Independent variable |                              | Net working<br>Capital ratio   |
|----------------------|------------------------------|--------------------------------|
| GEN                  | beta<br>[t-statistic]<br>p = | .007<br>.132<br>.895           |
| EDU                  | beta<br>[t-statistic]<br>p = | .081<br>3.256<br><b>.001</b>   |
| YRE                  | beta<br>[t-statistic]<br>p = | -.034<br>-1.697<br><b>.090</b> |
| DEC                  | beta<br>[t-statistic]        | -0.30<br>-.564                 |

|      |               |             |
|------|---------------|-------------|
|      | p =           | .573        |
| FBUS | beta          | -.039       |
|      | [t-statistic] | -2.485      |
|      | p =           | <b>.013</b> |

Table 3 shows there were financial characteristics for this liquidity model were interest cost, wages expenses and profit margin for the net working capital ratio model which all had coefficients that were statistically significantly different from zero. No other independent variables for net working ratio liquidity models show any significance.

To advise SME that their wage expense does have a negative effect on liquidity and plays an important role in the operating of the business. So too to having interest costs has a positive effect on the SME liquidity. Profit margin has an positive effect on liquidity and needs to be watched by the owner-manager of the SME.

Insert Table 3

| Independent variable |               | Net working Capital ratio |
|----------------------|---------------|---------------------------|
| WAG                  | beta          | -.121                     |
|                      | [t-statistic] | -7.843                    |
|                      | p =           | <b>.000</b>               |
| INT                  | beta          | .113                      |
|                      | [t-statistic] | 7.152                     |
|                      | p =           | <b>.000</b>               |
| TAXS                 | beta          | -.017                     |
|                      | [t-statistic] | -1.094                    |
|                      | p =           | .274                      |
| BAD                  | beta          | -.020                     |
|                      | [t-statistic] | -1.350                    |
|                      | p =           | .177                      |
| CRED                 | beta          | .010                      |
|                      | [t-statistic] | .597                      |
|                      | p =           | .551                      |
| BKOV                 | beta          | -.020                     |
|                      | [t-statistic] | -1.274                    |
|                      | p =           | .203                      |
| PROV                 | beta          | -.005                     |
|                      | [t-statistic] | -.285                     |
|                      | p =           | .776                      |
| IAS                  | beta          | -.009                     |
|                      | [t-statistic] | -.569                     |
|                      | p =           | .570                      |
| PROM                 | beta          | .072                      |
|                      | [t-statistic] | 4.441                     |
|                      | p =           | <b>.000</b>               |

## Conclusion

Policy makers need to know that there are different sets of independent variables that influence the liquidity of the SME which has not been fully researched. It was disappointing that the liquidity of SME results did not include a number of the financial characteristics such as creditors and bank overdraft. These are two areas requires a considerable amount of research. This research is exploratory but explains some of the issues facing owner-managers.

Further research is needed over a number of industries as there maybe different aspects of liquidity for the owner-manager to be advised on which only is associated to that particular industry.

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**GENDER DIFFERENCES IN ENTREPRENEURIAL ACTIVITY:  
AN ANALYSIS OF INFORMAL INSTITUTIONAL FACTORS**

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**Abstract**

The aim of this paper is to determine and compare the influence of certain informal institutional factors upon the decision to become an entrepreneur among men and women entrepreneurs in Spain. To attain this objective we adopt a socio-cultural institutional approach. We undertake a logit model using a robust Spanish dataset from 2003. The main contribution of this paper lies on the identification of specific factors that influence women entrepreneurship, which differ from those of men's. The results show the importance of entrepreneurial self-confidence, as a common factor for both women and men entrepreneurial activity. The main result indicates that the presence of entrepreneurial role models is an important informal institutional factor explaining the difference between women and men's entrepreneurial activity.

**JEL classification:** M13, B52, J16

**Keywords:** Entrepreneurial activity, women entrepreneurship, informal institutional factors.

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## 1. PROBLEM STATEMENT

Since the *discovery* of women entrepreneurs by entrepreneurship and small business scholars in the mid 70's (Catley and Hamilton, 1998), research on women's entrepreneurship expanded and matured considerably (Carter et al., 2001). However, there are some *silent areas* in the research on women's entrepreneurship, mostly concerned with how the social world is constructed and how it affects entrepreneurship (Ahl, 2002: 168).

In her extensive literature review on women's entrepreneurship, Ahl (2002) points out that the *typical* study is based on a strong individualistic assumption as it focuses on individuals and their businesses. Women and men are compared by their distinctive entrepreneurial characteristics (e.g. motivations, personality traits, experience) or features of their firms (e.g. size, goals and strategy, management, performance). There are also studies that consider structural factors such as financial constraints or other barriers that women face in the start-up process or development of their businesses. The ways for overcoming such barriers are still suggested at an individual level.

Nevertheless, starting and running a business involves other people such as partners, employees, suppliers, customers etc. It also involves structural and institutional arrangements such as legislation, politics, public services, infra-structure, and business cycles. Turning away the attention from such aspects means the loss of a discussion on the importance of the institutional framework relevant to women's entrepreneurship (Ahl, 2002:166).

The objective of the paper is to determine and compare the influence of the informal institutional factors upon the decision to become an entrepreneur among men and women entrepreneurs in Spain<sup>1</sup>. To reach this objective, we focus the analysis on the socio-cultural and institutional approach.

There have been relatively few investigations focusing on the factors that determine the entrepreneurial activity of men and women from a country perspective (macro level). Recent studies as Arenius and Minniti (2004) or Verheul et al (2004) focused on this issue and used large samples of individuals to compare entrepreneurial activity across countries and the differences and similarities between men and women. Nevertheless, we consider that the results of such direct comparisons between countries should be cautiously interpreted due to the different social and economic contexts in each country (Stevenson and Lundström, 2001). Separate macro level analysis in distinct national settings is also needed, as it may contribute to a better understanding of the differences (if any) between women's and men's entrepreneurial activity and the factors that determine it in each case.

The paper adopts the following structure. Section 2 presents the theoretical framework and the construction of hypotheses. Data and research methodology are introduced in section 3. A discussion of the main findings is offered in section 4. Final conclusions and implications are displayed in section 5.

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<sup>1</sup> As indicated by García and Jiménez (2004:2), in Spain 26.57% of the enterprises are managed by women, percentage which varies by size, only 16.4% of them, managing business with more than 10 workers, 25.6% managing micro-enterprises and 46.3% being sole entrepreneurs. The authors also indicate that their participation is higher in retail and service sectors.

## 2. THEORETICAL FRAMEWORK AND LITERATURE REVIEW

As indicated in Verheul et al. (2004:4) research on gender and entrepreneurship mainly consists of studies at micro level, focusing on the distinctive characteristics of female and male entrepreneurs such as their motivations to become entrepreneurs, their personality traits, background and experience (e.g. Masters and Meier, 1988; Sexton and Bowman-Upton, 1990; Mroczkowski, 1997; Catley and Hamilton, 1998; Anna et al, 2000). Comparative studies have also been conducted in terms of the features of the firms created by women, capturing aspects such as the size of the firm, the goals, the management style and the strategies adopted by women, or the performance of businesses controlled by women (e.g. Chaganti, 1986; Brush, 1997; Shabbir and Di Gregorio, 1996; Gundry and Welsch, 2001; Watson, 2001; Watson and Robinson, 2003). Other studies have included environmental characteristics, such as financial constraints or other challenges, faced by women at start-up or development of their businesses (e.g. Fabowale et al, 1995; Shabbir and DiGregorio, 1996; Orhan, 2001).

There are relatively few studies that investigate the influence of macro-level factors on female and male entrepreneurship. Exception of this, are investigations as Kovalainen et al (2002); Reynolds et al. (2002); Arenuis and Minniti (2004) and Verheul et al (2004) that use large samples of individuals compare entrepreneurial activity across countries and the differences and similarities between men and women.

Much of the research developed in this field is not theory based (Brush, 1992; Ahl, 2003) and those that are, start either from psychological, managerial or economic frameworks to analyse and compare individual aspects of women entrepreneurs and their businesses.

An alternative approach that a growing number of studies are demonstrating as being more appropriate for the study of entrepreneurship and SME's, is the use of a theoretical framework based on a socio-cultural and institutional approach (Granovetter, 1985; North, 1990; Gnyawali and Fogel, 1994; Maillat, 1996; Urbano and Veciana, 2001; Aponte, 2002; Uhlaner and Thurik, 2004, etc). The main hard-core common to the theories falling under this approach is the basic belief that the decision to create a new enterprise, and therefore to become an entrepreneur, is conditioned by external or environmental factors. In other words, the institutional framework and its socio-cultural factors are what determine the levels of entrepreneurial activity in a specific time and place (Veciana, 1999).

Examples of theories that adopt a socio-cultural or institutional approach have been compiled and described in Veciana (1999). In the mentioned article, the theories under this and the other main approaches used for the study of entrepreneurship are described in much greater length. We will therefore not venture into this task within this paper.

Of the theories within the socio-cultural or institutional approach, the Institutional Economic Theory, developed mainly by Douglass North (1990), is one of the most general, which encloses most of the specificities of the other theories falling under the same approach. The theoretical amplitude that the institutional economic theory offers us is ideal for the objective laid out for this study, and was therefore used as the theoretical backbone guiding our research.

Institutional economic theory develops a very wide concept of “institution”. North (1990: 3) proposes that “institutions are the rules of the game in a society, or more formally, institutions are the constraints that shape human interaction”. Institutions include any form of constraint that human beings devise to shape human interaction. Institutions can be either formal - such as political rules, economic rules and contracts - or informal - such as codes of conduct, attitudes, values, norms of behaviour, and conventions, or rather the culture of a determined society. North attempts to explain how institutions and institutional framework affect economic and social development. The main function of institutions in a society is to reduce uncertainty by establishing a stable structure for human interaction. An exhaustive literature review on the topic of institutional factors that condition new business formation can be found in Rutherford (2001) and Urbano (2003).

According to North (1995), formal institutions are subordinate to informal ones in the sense that they are the deliberate means used to structure the interactions of a society in line with the norms and cultural guidelines that make up its informal institutions. Policy making that attempts to change the formal institutions of society will therefore have little success if it does not first adjust the informal institutions in a compatible way. The difficulty rises from the fact that, whereas a governing body can influence the evolution of a society’s formal institutions in a rather direct way, informal institutions are much less tangible and usually fall outside the direct influence of public policy. They can be moulded, but tend to resist change and take time to evolve towards new social norms.

In the literature on entrepreneurship many different versions of models describing the entrepreneurial process can be found. Models of the entrepreneurial process that consider informal institutional factors as determinants of business creation can be found in Veciana (1988) and Bygrave (1995). Among the fundamental factors affecting the decision to create a business, Veciana’s (1988) model consider informal institutional factors such as the positive examples that make entrepreneurship a more credible alternative; the social attitudes towards entrepreneurship and the non-pecuniary rewards for entrepreneurs. The importance of informal institutional factors also stands-out in Bygrave’s (1995) model. Here, the presence of the entrepreneurial role models is considered as one of the most consistent influential factors, throughout the different stages of the entrepreneurial process.

Very few empirical studies analyse gender and entrepreneurship adopting specifically the institutional economic theory. A rare exception is Nilsson (1997), who investigates the business counselling services directed towards female entrepreneurs in Sweden. Nevertheless, several studies have included variables that can be considered institutional factors in their analysis.

Some of the work produced on gender and entrepreneurship include in the analysis formal institutional factors as, for example, support received by women initiating businesses (Anna et al, 1999), programmes fostering women’s entrepreneurship (Nilsson, 1997; Weeks and Seiler, 2001), the impact that certain governmental policies have on the entrepreneurial activity (Mroczkowski, 1997; Lituchy and Reavly, 2004; Verheul et al., 2004) or the relationships that women entrepreneurs establish with governmental and non-governmental institutions (Mroczkowski, 1997; Fielden and Dawe, 2004; Lituchy and Reavly, 2004).

Research on women's entrepreneurship has given little attention to the analysis of the impact that informal institutional factors may have on the entrepreneurial activity of men and women entrepreneurs. The literature review of studies produced during the past decade, indicate that the fear of entrepreneurial failure and the impact that an entrepreneurial role-model may have on women's decision to start-up, were most investigated within this stream of research.

The fear of failure (usually operationalized through the individual's risk aversion) is a particularly critical issue for entrepreneurs due to the little separation between business and personal risk in an entrepreneurial venture (Watson and Robinson, 2003). Research comparing women entrepreneurs' risk aversion with that of their male counterparts tend to hypothesize that women are more risk averse than men (Buttner and Rosen, 1988; Sexton, 1989; Sexton and Bowman – Upton, 1990; Powell and Ansic, 1997) but there is no agreement yet on this question. However, the social stigma to entrepreneurial failure has been previously investigated on a micro level, but rarely from a macro perspective where the social stigma of failure is analysed.

In their study on Pakistani women entrepreneurs, Shabbir and DiGregorio (1996:516) point out that women in the sample tended to limit their financial risk to their own funds, mainly because they were afraid of the social consequences of business failure, that is, social embarrassment. Fielden and Dawe (2004) obtain similar results of British female entrepreneurs, the social stigma towards the entrepreneurial failure being found as an important barrier to business creation.

Under the light of these findings we expect Spanish female entrepreneurs to perceive the social stigma towards entrepreneurial failure as a barrier to entrepreneurship in a greater extent than their male counterparts. From this argument comes the first hypothesis:

**H1:** Female entrepreneurs are expected to be more negatively influenced by the belief that there is a social stigma towards business failure than their male counterparts.

The Role Model effect on the entrepreneurial activity of women is the second informal institutional factor considered in our analysis. Indirect experience like previous work experience or the experience of others that own businesses is one way of entrepreneurial learning. The role model effect comes from the observation of behaviour in others and can influence substantially how one thinks about entrepreneurship (Reitan, 1997). Role models are persons that by their attitudes, behaviours and actions establish the desirability and credibility of a choice (in this case becoming an entrepreneur) for an individual.

Examples of research on women's entrepreneurship which analyse the role model effect are Lerner et al (1997), Dhaliwal (2000), Levent et al (2003), Arenius and Minniti (2004) or Lituchy and Reavly (2004). In these studies, the presence of a role model for women entrepreneurs was considered as a factor that facilitated their decision to start their businesses. Nevertheless, it is also considered that women, as they historically have been a minority of the entrepreneurial population, lack of close role models or at least, they have less role models than men do (Delmar and Holmquist, 2004: 42).

Hence, in the case of Spanish entrepreneurs we expect similar results, leading to formulate the second hypothesis:

**H2:** The positive influence of entrepreneurial role models on the decision to start-up a new business is greater for men than for women.

The social acceptance of entrepreneurship and business ownership as a valid career option is an informal institutional factor that can affect the perceived attractiveness of becoming an entrepreneur (Hamilton, 2000). The literature on gender and entrepreneurship suggest that entrepreneurship as a career option is gender-blind, studies as Masters and Meier (1998) and Sexton and Bowman-Upton (1990) finding few differences between men and women on this issue. However, we believe that the social acceptance of entrepreneurship as a valid career choice depends on the gender beliefs system existing in a society (country). As argued by Delmar and Holmquist (2004: 33), gender beliefs are cultural schemas representing what we think *most people* believe or accept as true about the categories of *men* and *women*. Also people in general perceive entrepreneurs as masculine and entrepreneurship to be a male domain (Ahl, 2002, 2003). Hence, in most countries, men may be perceived as more *suited* to entrepreneurship than women are. Consequently, the third hypothesis emerges:

**H3:** The influence of the perception of the social acceptance of entrepreneurship as a valid career option upon entrepreneurial activity is greater for men than for women.

Finally, the social praise for entrepreneurs and the social prestige and status that entrepreneurs receive can act as an important non-pecuniary reward for entrepreneurship and therefore affect the opportunity cost of becoming an entrepreneur (Baumol, 1993; Gifford, 1998). We will test whether the belief that the community praises its entrepreneurs is having a positive effect upon entrepreneurial activity and if this effect is the same for women as for men. As argued above, due to the attitudes formed by the traditional gender roles (Delmar and Holmquist, 2004:46), women may be viewed as less entrepreneurial than men and therefore, they may place less value on the social prestige and status they perceive as a reward for their entrepreneurial activity. This leads to formulate the fourth hypothesis:

**H4:** The perception that there are social rewards for entrepreneurs influence women's entrepreneurial activity less than men's.

### 3. DATA AND METHOD

#### 3.1 Data and variables

The data used to carry out this study come from the Spanish Global Entrepreneurship Monitor (GEM) for the year 2003. The original database contained 7000 observations, including 3508 (50.11%) men, and 3492 (49.89%) women. However, in the interest of following a rigorous methodology, only individuals for whom a complete dataset of the independent variables can be constructed are included. Thus, data availability limits the sample to 4877 observations, 2423 (49.68%) men, and 2454 (50.32%) women.

As regards the dependent variable, entrepreneurial activity covers several fields related to business creation, business growth, and innovation strategy. Nevertheless, the meaning used within this study will be the same as that most commonly convened within recent literature, i.e., entrepreneurship as the act of creating a new business. As a result, the dependent variable used in this study as a measure of entrepreneurial activity is the main index resulting from the GEM project, the Total Entrepreneurial Activity index (TEA). This index assumes a value of one if an individual is either involved in “start-up” activities or has recently launched a business (over the last 42 months).

The rationale for the selection of the independent variable set follows. Firstly, to determine the entrepreneur’s profile we consider variables commonly found in many models trying to explain entrepreneurial activity (Usitalo 2001, Douglas and Shepard 2002). Thus, the variables incorporated are the following: age, expressed in years, and; formal education, using dummy variables distinguishing people who finish secondary and those who did not, as well as people with university studies. Furthermore, we consider the self-confidence in one’s own entrepreneurial skills as a dummy variable, assuming a value of one if the person makes a positive assessment of his/her entrepreneurial skills, and zero otherwise. Several studies have recently used this variable in substitution, or together with, formal business training. These studies have found that entrepreneurial self-confidence explains an important part of the decision to become an entrepreneur (Krueger and Brazeal 1994, Arenius and Minniti 2004, Köllinger et al. 2004, Lee et al. 2004).

In addition, a second set of four dummy variables associated with the informal institutional framework have been added to support that the informal socio-cultural environment is an important stimuli, or obstacle, to business creation. These variables are: 1) the social stigma to entrepreneurial failure as an obstacle to business creation; 2) the presence of an entrepreneurial Role-Model, who has created a new business over the past two years within one’s personal social circle; 3) the perception that the community perceives entrepreneurship and subsequently business ownership as a valid career choice; and finally, 4) the perception that entrepreneurship is socially valued and leads to greater social prestige. Table 1 presents the descriptive statistics for the selected variables of the study.

### **Table 1 about here**

As we can see within table 1, there is a highly statistically significant difference between both samples in what refers to entrepreneurial activity. The results show that, in the women sample, the educational level is concentrated in the lower bounds, i.e., women have lower education levels as compared to the men sample. Also, women’s sample shows a statistically significant higher level of social stigma to entrepreneurial failure, as compared to men’s sample. Finally, we report a significant difference in what refers to self – confidence in entrepreneurial skills as well as for our proxy for the Role-Model effect, which result is statistically significant lower in the case of the women sample.

### 3.2 Method

An individual will become an entrepreneur if the total consideration of push and pull factors considered in the analysis results in a positive decision. It is easy and convenient to consider the decision process for becoming an entrepreneur as a process that generates a binary choice model. Thus, to identify the differentiating characteristics that affect the likelihood of women and men to become an entrepreneur, we perform a logit regression model estimated by maximum likelihood method expressed as follows (Greene 1997),

$$\hat{p}_i = p(\text{become an entrepreneur}) = \frac{e^{\hat{b}_0 + \hat{\mathbf{a}}' \hat{b}_n x_{ni}}}{1 + e^{\hat{b}_0 + \hat{\mathbf{a}}' \hat{b}_n x_{ni}}} = L(b'x) \quad [1]$$

Expression [1] may be expressed as a linear function of the odds to turn into an entrepreneur  $\ln \hat{W}_i = \frac{\hat{p}_i}{1 - \hat{p}_i}$ . Thus, after a logarithmic transformation, the resulting expression is,

$$\ln \hat{W}_i = \hat{b}_0 + \sum_{n=1}^N \hat{b}_n x_{ni} + e_i \quad [2]$$

where,

$\hat{b}_0$  = constant term

$\hat{b}_n$  = vector of parameters to be estimated for the  $n$ th independent variables.

$x_{ni}$  = vector of observed value for the  $n$ th independent variables and the  $i$ th cases.

$e_i$  = logistic distributed error term for the  $i$ th cases.

Parameters estimated from the logit model only indicate the direction of the effect of each explanatory variable on the response probability. To obtain a better understanding of the results, we also calculate the probability changes at the sample mean of the regressors by differentiating equation [2] as follows (Greene, 1997):

$$\frac{\partial \hat{p}_i}{\partial x} = \hat{p}_i \hat{\mathbf{a}}' \hat{b}_n \frac{\partial \hat{b}_n}{\partial x} = L(b'x) \cdot \hat{\mathbf{a}}' \cdot L(b'x) \quad [3]$$

Equation [3] applies in the case of individual independent variables. However, in this paper our hypotheses are determined by the influence of the considered informal institutional factors upon women's decision to become entrepreneur, as compared to that of men. We therefore follow Ai and Norton (2003) to estimate robust interaction effects, where for the case of two dummy variables  $(x_1, x_2)$ , the change in the predicted probability that  $y = 1$  results from the discrete double difference with respect to  $x_1$  and  $x_2$ .

Finally, we also calculate the proportion of correctly classified (predicted) observations. This is done for the full sample as well as for those observations that are entrepreneurially active (adopter) and those that are not (non-adopters).

#### 4. EMPIRICAL FINDINGS

The results of the logit models of the binary decision to become an entrepreneur are presented in this section. To corroborate our hypothesis that the informal institutional framework exerts a different influence upon women entrepreneurs, as compared to their male counterparts, we run several specifications where an interactive term between gender and the informal institutional factors is considered individually.

Rather than report the coefficient estimates, table 2 reports the estimated change in the probability to become an entrepreneur. The full set of logit estimates are presented in appendix 1. Model 1 takes into account all the aforementioned variables linked to entrepreneurship. Specifications 2, 3, 4 and 5 have been ran including the interactive terms between gender and the informal institutional factors individually.

The results emerging from table 2 show that, for every specification, the variable linked to the positive valuation of self-confidence in entrepreneurial skills increases the likelihood to become an entrepreneur. For example, the result of model one implies that individuals with entrepreneurial self-confidence are 7.31% more likely to become entrepreneurs, as compared to those who do not. This finding, consistent for every specification, relating the positive influence of entrepreneurial self-confidence and entrepreneurial activity is consistent with previous studies having use similar variables (Arenius and Minniti 2004, Köllinger et al. 2004, Lee et al. 2004).

#### Table 2 about here

Column 2 in table 2 allows for testing our first hypothesis. The findings indicate that both gender and the social stigma towards business failure has a statistically significant negative effect upon entrepreneurial activity. More specifically, the results show that women are 1.53% less likely to become entrepreneurs as compared to men. Also, individuals that perceive the existence of a social stigma towards business failure are 0.98% less likely to get involved in entrepreneurial activities. This latter result is in accordance with those reported in Wagner and Sternberg (2004) and Simon et al. (1999).

The coefficient of the interaction term that relates gender and the social stigma towards business failure shows as no statistically significant<sup>2</sup>. Consequently, we reject the hypothesis 1 that stated that women entrepreneurs are more negatively influenced by their belief in a social stigma towards business failure, than their male counterparts.

The findings in column three indicate that the variable linked to gender remains as statistically significant. In the case of the role model proxy, we find that the personnel

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<sup>2</sup> The result for the full interaction term varies widely for many observations. However, no observation shows as statistically significant under the conventional levels of acceptance.

knowledge of recent entrepreneurs in individual's social circle increases in 0.71% the likelihood to be involved in entrepreneurial activities. In addition, and consistent with our hypothesis, the interaction term that relates gender to role model indicates that the probability to be entrepreneurially active for women that know an entrepreneurial role model fell 1.56%, as compared to that of men who personally know recent entrepreneurs<sup>3</sup>. This finding is statistically significant, leading to confirm hypothesis two.

The lack of a tradition of positive female entrepreneurial role models may explain this result. This is consistent with Dunn and Holtz-Eakin (1995), Delmar and Gunarsson (2000) and Delmar and Holmquist (2004), who find that the influence of entrepreneurial role models is gender related, an individual being more influenced by another individual of the same sex, as one's aspirations and choices tend to be more influenced by persons of their same sex (Delmar and Holmquist, 2004: 41). Hence, if there has been a lack of positive role models amongst women, or if there mostly have been negative ones, it is comprehensive that, even though women may personally know recent entrepreneurs, they have no influence upon women's decision to become entrepreneurially active.

The results emerging from columns four and five show that gender remains as statistically significant. However, no significant result is found for neither the social acceptance for entrepreneurship nor for the social rewards linked to entrepreneurship. In the case of the interaction terms, none of them indicate that the informal institutional factors have a different impact upon women's decision to become an entrepreneur. These results lead to reject hypotheses three and four; hence neither the social acceptance for entrepreneurship nor the non-pecuniary rewards linked to entrepreneurship exert a different influence on the entrepreneurial activity of women as compared to men<sup>4</sup>.

## 5. CONCLUDING REMARKS

The aim of the present paper was to determine and compare the influence of the informal institutional factors upon the decision to become an entrepreneur among men and women entrepreneurs. Using Global Entrepreneurship Monitor data for Spain we tested a series of hypothesis concerning the impact of informal institutional factors upon female and male entrepreneurship. Adopting a socio-cultural and institutional approach to entrepreneurship, we derived our informal institutional factors as determinants of the entrepreneurial activity of men and women from Veciana's (1988) and Bygrave's (1995) models of the entrepreneurial process.

Our results suggest that Spanish women are less likely to become entrepreneurs as compared to men. Although evidence was found that the existence of a social stigma towards business failure negatively influences the decision to create a business, no significant differences were found between men and women on this issue. Also, no significant differences were found between men and women's propensity to get

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<sup>3</sup> The result for the full interaction term varies widely for many observations. The statistical significance reported remains for all observed individuals.

<sup>4</sup> In this case, only the result for the full interaction term of social reward varies widely for many observations. As before, no observation shows statistical significance under the conventional levels of acceptance.

involved in entrepreneurial activities as a consequence of their perception of social acceptance and social rewards for entrepreneurship.

Findings in the present paper also indicate that in the case of Spanish entrepreneurs, the personal acquaintance of an entrepreneurial role-model exerts a positive impact on the decision to create a business. Moreover, we found that this positive influence of entrepreneurial role models on the decision to start-up a new business is greater for men than for women. This result has important policy implications, as it indicates that in the case of Spain, entrepreneurial role-models have been a stimulating factor explain a larger proportion of men's entrepreneurial activity than women's. This result is in accordance with that reported in Delmar and Holmquist (2004: 7), confirming that the lack of role-models can act as an obstacle for women's entrepreneurial activities. Therefore, this finding gives further arguments for policy makers to design programmes that foster networking between established and potential women entrepreneurs.

Examples of such practices are the *Advisory Center for Female Enterprise Starters* in Germany, the *Women in Focus* programme in Norway, and the *Women Into the Network Programme* in the U.K., all promoting and offering positive entrepreneurial role-models to women entrepreneurs.

Within the literature on gender and entrepreneurship, the variation in men and women's entrepreneurial activity raised the question of what their determinants are and prompted a series of recent investigations focused on the impact that several factors have on male and female entrepreneurship across countries. While several economic and demographic factors have been previously investigated, the socio-cultural and institutional variables received little attention. Hence, an important contribution of the present paper consists in the insights it offers on the effects that certain informal institutional factors have upon men's and women's decision to create a business.

Moreover, we also believe that the results of direct comparisons between countries should be cautiously interpreted due to the different social and economic contexts in each country (Stevenson and Lundström, 2001). Therefore, an additional contribution of this paper is that it offers a separate macro level analysis in a specific national setting, as it may contribute to a better understanding of the differences (if any) between women's and men's entrepreneurial activity and the factors that determine it in each case.

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Table 1: Descriptive Statistics of selected variables

| <b>Variables</b>                            | <b>Women</b>               | <b>Men</b>           | <b>Full sample</b>   |
|---|----------------------------|----------------------|----------------------|
| Gender<br>(1 for woman, 0 otherwise)        | 1.0000<br>(0.0000)         | 0.0000<br>(0.0000)   | 0.5032<br>(0.5000)   |
| Entrepreneurial activity                    | 0.0281 (***)<br>(0.1653)   | 0.0615<br>(0.2403)   | 0.0447<br>(0.2067)   |
| Age (years)                                 | 42.0359 (***)<br>(12.5989) | 40.5947<br>(13.2152) | 41.3199<br>(12.9276) |
| Primary studies                             | 0.3818 (***)<br>(0.4859)   | 0.2992<br>(0.4580)   | 0.3408<br>(0.4740)   |
| Secondary studies                           | 0.3965 (**)<br>(0.4893)    | 0.4305<br>(0.4952)   | 0.4134<br>(0.4925)   |
| University studies                          | 0.1785 (***)<br>(0.3830)   | 0.2328<br>(0.4227)   | 0.2055<br>(0.4041)   |
| Self - confidence in entrepreneurial skills | 0.3867 (***)<br>(0.4871)   | 0.4643<br>(0.4988)   | 0.4253<br>(0.4944)   |
| Social stigma to entrepreneurial failure    | 0.4108 (***)<br>(0.4921)   | 0.3438<br>(0.4751)   | 0.3775<br>(0.4848)   |
| Personnel knowledge of recent entrepreneur  | 0.2653 (***)<br>(0.4416)   | 0.3343<br>(0.4718)   | 0.2996<br>(0.4581)   |
| Perception of business as a career choice   | 0.5640<br>(0.4960)         | 0.5654<br>(0.4958)   | 0.5647<br>(0.4958)   |
| Social reward for entrepreneurship          | 0.4336<br>(0.4957)         | 0.4536<br>(0.4979)   | 0.4435<br>(0.4968)   |
| Observations                                | 2454                       | 2423                 | 4877                 |

Values in brackets represent the standard deviation.

\*, \*\*, \*\*\* = Significant at the 0.10, 0.05, and 0.01 level, respectively (two-tailed).

Table 2: Logit results: Predicted change in the probability to become an entrepreneur

| Independent variables  | Model 1                              | Model 2                              | Model 3                              | Model 4                              | Model 5                              |
|--|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| <b>Entrepreneur's profile</b>                                      |                                      |                                      |                                      |                                      |                                      |
| Gender (one for women, zero otherwise) <sup>(+)</sup>              | -0.0143 <sup>(***)</sup><br>(0.0035) | -0.0153 <sup>(***)</sup><br>(0.0042) | -0.0116 <sup>(***)</sup><br>(0.0044) | -0.0155 <sup>(***)</sup><br>(0.0055) | -0.0096 <sup>(**)</sup><br>(0.0042)  |
| Age (years)  | 0.0001<br>(0.0001)                   | 0.0001<br>(0.0001)                   | 0.0001<br>(0.0001)                   | 0.0001<br>(0.0001)                   | 0.0001<br>(0.0001)                   |
| Primary studies <sup>(+)</sup>                                     | -0.0019<br>(0.0039)                  | -0.0020<br>(0.0039)                  | -0.0021<br>(0.0039)                  | -0.0019<br>(0.0039)                  | -0.0017<br>(0.0039)                  |
| Secondary studies <sup>(+)</sup>                                   | -0.0061 <sup>(*)</sup><br>(0.0035)   | -0.0061 <sup>(*)</sup><br>(0.0035)   | -0.0062 <sup>(*)</sup><br>(0.0036)   | -0.0061 <sup>(*)</sup><br>(0.0035)   | -0.0061 <sup>(*)</sup><br>(0.0035)   |
| Self - confidence in entrepreneurial skills <sup>(+)</sup>         | 0.0731 <sup>(***)</sup><br>(0.0066)  | 0.0735 <sup>(***)</sup><br>(0.0066)  | 0.0733 <sup>(***)</sup><br>(0.0066)  | 0.0730 <sup>(***)</sup><br>(0.0066)  | 0.0726 <sup>(***)</sup><br>(0.0066)  |
| <b>Informal Institutional Factors</b>                              |                                      |                                      |                                      |                                      |                                      |
| Social stigma to entrepreneurial failure <sup>(+)</sup>            | -0.0086 <sup>(***)</sup><br>(0.0038) | -0.0098 <sup>(***)</sup><br>(0.0043) | -0.0086 <sup>(**)</sup><br>(0.0034)  | -0.0086 <sup>(**)</sup><br>(0.0034)  | -0.0086 <sup>(***)</sup><br>(0.0033) |
| Gender × Social stigma to entrepreneurial failure <sup>(+)</sup>   |                                      | 0.0138<br>(0.0118)                   |                                      |                                      |                                      |
| Personnel knowledge of recent entrepreneur <sup>(+)</sup>          | 0.0048<br>(0.0033)                   | 0.0048<br>(0.0033)                   | 0.0071 <sup>(*)</sup><br>(0.0043)    | 0.0048<br>(0.0033)                   | 0.0048<br>(0.0033)                   |
| Gender × Personnel knowledge of recent entrepreneur <sup>(+)</sup> |                                      |                                      | -0.0156 <sup>(*)</sup><br>(0.0120)   |                                      |                                      |
| Perception of business as a career choice <sup>(+)</sup>           | 0.0037<br>(0.0033)                   | 0.0037<br>(0.0033)                   | 0.0037<br>(0.0033)                   | 0.0031<br>(0.0039)                   | 0.0037<br>(0.0033)                   |
| Gender × Perception of business as a career choice <sup>(+)</sup>  |                                      |                                      |                                      | -0.0006<br>(0.0114)                  |                                      |
| Social reward for entrepreneurship <sup>(+)</sup>                  | -0.0052<br>(0.0033)                  | -0.0052<br>(0.0033)                  | -0.0052<br>(0.0033)                  | -0.0052<br>(0.0033)                  | -0.0017<br>(0.0039)                  |
| Gender × Social reward for entrepreneurship <sup>(+)</sup>         |                                      |                                      |                                      |                                      | -0.0127<br>(0.0116)                  |
| Pseudo R <sup>2</sup>  | 0.1447                               | 0.1448                               | 0.1452                               | 0.1447                               | 0.1462                               |
| Log Likelihood   | -761.7042                            | -761.5883                            | -761.2443                            | -761.6628                            | -761.3102                            |
| LR (chi2)  | 148.72 <sup>(***)</sup>              | 153.49 <sup>(***)</sup>              | 153.25 <sup>(***)</sup>              | 149.65 <sup>(***)</sup>              | 147.78 <sup>(***)</sup>              |
| Correctly predicted (Adopters)                                     | 0.8716                               | 0.8807                               | 0.8716                               | 0.8807                               | 0.8394                               |
| Correctly predicted (Non-adopters)                                 | 0.6186                               | 0.6115                               | 0.6177                               | 0.6160                               | 0.6426                               |
| Correctly predicted (Full Sample)                                  | 0.6299                               | 0.6235                               | 0.6291                               | 0.6278                               | 0.6514                               |
| Number of cases  | 4877                                 | 4877                                 | 4877                                 | 4877                                 | 4877                                 |

Values in brackets represent the standard error. Dependent variable: One if the person is identified as being involved in entrepreneurial activity. Women sample size = 2454. Men sample size = 2423. (+)  $\frac{\partial \hat{p}}{\partial x}$  is for discrete change of dummy variable from 0 to 1. Interaction terms are derived as presented in Ai and Norton (2003).

\*, \*\*, \*\*\* = Significant at the 0.10, 0.05, and 0.01 level, respectively.

Appendix 1: Logit coefficients for results reported in Table 2

| Independent variables                               | Model 1                   | Model 2                   | Model 3                   | Model 4                   | Model 5                   | Model 6                   |
|---|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| <i>Entrepreneur's profile</i>                       |                           |                           |                           |                           |                           |                           |
| Gender (one for women, zero otherwise)              | -0.6594 (***)<br>(0.1521) | -0.7007 (***)<br>(0.1550) | -0.5379 (***)<br>(0.1993) | -0.7121 (***)<br>(0.2382) | -0.4535 (**)<br>(0.1933)  | -0.5161 (*)<br>(0.2884)   |
| Age (years)   | 0.0011<br>(0.0052)        | 0.0011<br>(0.0052)        | 0.0009<br>(0.0052)        | 0.0011<br>(0.0052)        | 0.0010<br>(0.0052)        | 0.0009<br>(0.0052)        |
| Primary studies                                     | -0.0921<br>(0.1876)       | -0.0937<br>(0.1880)       | -0.0977<br>(0.1885)       | -0.0929<br>(0.1877)       | -0.0780<br>(0.1878)       | -0.0864<br>(0.1888)       |
| Secondary studies                                   | -0.2931 (*)<br>(0.1716)   | -0.2926 (*)<br>(0.1717)   | -0.2948 (*)<br>(0.1718)   | -0.2906 (*)<br>(0.1713)   | -0.2957 (*)<br>(0.1718)   | -0.2887 (*)<br>(0.1713)   |
| Self - confidence in entrepreneurial skills         | 2.3971 (***)<br>(0.2244)  | 2.4000 (***)<br>(0.2238)  | 2.3956 (***)<br>(0.2246)  | 2.3963 (***)<br>(0.2246)  | 2.4033 (***)<br>(0.2247)  | 2.4036 (***)<br>(0.2243)  |
| <i>Informal Institutional Factors</i>               |                           |                           |                           |                           |                           |                           |
| Social fear for entrepreneurial failure             | -0.4232 (**)<br>(0.1711)  | -0.4831 (**)<br>(0.2144)  | -0.4224 (**)<br>(0.1713)  | -0.4227 (**)<br>(0.1712)  | -0.4242 (**)<br>(0.1713)  | -0.4846 (**)<br>(0.2152)  |
| Gender × Social fear for entrepreneurial failure    |                           | 0.1701<br>(0.3530)        |                           |                           |                           | 0.1735<br>(0.3558)        |
| Personnel knowledge of recent entrepreneur          | 0.2174<br>(0.1440)        | 0.2166<br>(0.1441)        | 0.3110 (*)<br>(0.1744)    | 0.2179<br>(0.1440)        | 0.2170<br>(0.1440)        | 0.3048 (*)<br>(0.1740)    |
| Gender × Personnel knowledge of recent entrepreneur |                           |                           | -0.2995<br>(0.3154)       |                           |                           | -0.2820<br>(0.3151)       |
| Perception of business as a career choice           | 0.1753<br>(0.1575)        | 0.1765<br>(0.1576)        | 0.1739<br>(0.1578)        | 0.1465<br>(0.1870)        | 0.1771<br>(0.1571)        | 0.0813<br>(0.1932)        |
| Gender × Perception of business as a career choice  |                           |                           |                           | 0.0891<br>(0.3088)        |                           | 0.2919<br>(0.3287)        |
| Social reward for entrepreneurship                  | -0.2480<br>(0.1555)       | -0.2480<br>(0.1555)       | -0.2476<br>(0.1558)       | -0.2485<br>(0.1553)       | -0.0823<br>(0.1844)       | -0.0508<br>(0.1905)       |
| Gender × Social reward for entrepreneurship         |                           |                           |                           |                           | -0.5223 (*)<br>(0.3186)   | -0.6183 (*)<br>(0.3340)   |
| Intercept   | -4.2802 (***)<br>(0.3556) | -4.2703 (***)<br>(0.3574) | -4.3144 (***)<br>(0.3553) | -4.2659 (***)<br>(0.3602) | -4.3546 (***)<br>(0.3587) | -4.3425 (***)<br>(0.3619) |
| Number of cases                                     | 4877                      | 4877                      | 4877                      | 4877                      | 4877                      | 4877                      |

Robust standard errors are presented in brackets. Dependent variable: One if the person is identified as being involved in entrepreneurial activity. Women sample size = 2454. Men sample size = 2423.

\*, \*\*, \*\*\* = Significant at the 0.10, 0.05, and 0.01 level, respectively (two tailed).

# **THE MICRO-MULTINATIONAL ENTERPRISE (MME): A GOLDEN OPPORTUNITY FOR ENTREPRENEURSHIP**

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## **ABSTRACT**

Each era presents new opportunities for entrepreneurs. Some of these opportunities are local, and target the needs of a highly specific and limited market. Others are extensive, offering not only immediate opportunity for market entry and revenue generation, but also the prospect of rapid growth. Such opportunities are not present in every generation, and occasionally entrepreneurial opportunities are not as lucrative as they may appear. The rapid rise of the dot-com business model and its even more rapid crash suggests that any age must be cautious when referring to an entrepreneurial opportunity as a “golden” one. This paper contends that there are three criteria that define a “golden opportunity for entrepreneurship”: 1) There must be a large market; 2) There must be opportunity to create sustainable competitive advantage; and 3) It must be possible to enter the market without aggressive competitive response from incumbents. Based on these criteria, the Micro-Multinational Enterprise (MME) appears to present such a rare golden opportunity for entrepreneurship. An MME is an entrepreneurial venture that leverages foreign or “offshore” labor pools to provide business-to-business services. This practice is referred to as business process outsourcing or “BPO”. The MME that provides BPO-based services to small to medium sized enterprises (SME) meets the three criteria cited as necessary to call an opportunity golden.

## **INTRODUCTION:**

### **DEFINING “GOLDEN OPPORTUNITY”**

Entrepreneurs are nothing if not opportunists. In the midst of some of the most depressing economic conditions, oppressive governing regimes, or personally difficult situations entrepreneurs have been able to turn disadvantages into opportunities. In Lagos, Nigeria, a baker with no capital to speak of and only a modest shop became relatively wealthy by selling sliced

and wrapped bread, which was an advance over traditional vendors who only sold unwrapped bread loaves (Melloan, 2005). A peasant woman in China now operates her own business in Beijing providing expatriates good services and familiar foods from home. Her 2004 sales topped \$3 million (Browne, 2005).

Depending on location, circumstances, and personal resourcefulness, the ingredients of success for entrepreneurs will vary. In the example cited above, only someone who was in the baking business would likely notice the need for individual slices of bread. The person down the street cutting hair for a living would likely not notice the potential of bread-slice market. Was the opportunity a golden one? Perhaps it was. But it was a local event that has little general lessons for entrepreneurs elsewhere. What is required is a definition of golden opportunity that enables an entrepreneur to evaluate whether it is worth the time, energy, and financial commitment to pursue it.

This paper attempts to identify and define a presently live golden opportunity for entrepreneurship. It would be relatively easy and quite commonplace to identify the current golden opportunity as the one that is being pursued by the largest number of new entrants, or the one that attracts the most venture capital, or the one that deploys “cutting edge” technology. Doing so would be understandable, but recent experience suggests this approach may lead to seriously wrong prescriptions. One need look back no further than five years to recognize how simply counting new entrants, following the venture capital, or capitulating to the excitement of new technology can lead to misidentifying a business model as a “golden opportunity” when, in fact, it is no such thing.

To avoid making that prescriptive error—which was made frequently during the height of the dot-com boom—several well-accepted theories of entrepreneurship and innovation are used to analyze a currently prominent entrepreneurial opportunity that appears to be a golden one. In order to achieve the lofty title of being “golden” it seems that the opportunity ought at least to meet the following three criteria:

1. It ought to present a large market;
2. It ought to provide opportunities to create sustainable competitive advantage;
3. It ought to enable market entry with minimal competitive response from incumbents.

This paper set out to determine if there is an opportunity for entrepreneurs in the current global economic environment that meets these three criteria. To prove Criterion 1, I relied upon research that I’ve been conducting over the past two years on the phenomenon of business process outsourcing (BPO). More specifically, I’ve been examining the opportunities that exist for entrepreneurs in leveraging offshore labor pools to establish low-cost, high-quality service offerings (Duening and Click, 2005). Entrepreneurial ventures that use offshore labor to provide services to domestic clients have been referred to as micro-multinational enterprises (MME). The BPO revolution is discussed in some detail in the next section. There, the market potential is explored, and the entrepreneurial opportunity is focused squarely on MMEs providing services to domestic small to medium sized enterprises (SMEs).

Criterion 2 is addressed using the resource-based theory of entrepreneurship. This theory states that entrepreneurs (and entrepreneurial managers in large organizations) are able to create sustainable competitive advantage by leveraging resources that have four characteristics: rare, valuable, hard to copy, and no substitutes. The section discussing the resource-based theory of entrepreneurship examines whether leveraging the resources that have enabled the BPO revolution can provide sustainable competitive advantage.

Criterion 3 is examined from the perspective of the disruptive theory of innovation. This theory states that there are two types of innovation in an economic system: sustaining and disruptive. Incumbents within a market tend to follow a strategy of sustaining innovation, opening up markets of overshot customers who are willing to pay less for offerings that have fewer up-market features. These overshot customers can be acquired using a disruptive innovation strategy. The section on disruptive innovation explores whether the SME market can be entered using a disruptive innovation strategy, minimizing the potential response from incumbents.

## **THE BUSINESS PROCESS OUTSOURCING (BPO) REVOLUTION**

Business process outsourcing (BPO) is defined simply as the movement of business processes from inside the organization to an external service provider. With the global telecommunications infrastructure now well-established and consistently reliable, BPO initiatives often include shifting work to international providers. Five BPO international hot spots have emerged,

although firms from many other countries specialize in various business processes and exporting services (Click & Duening, 2004, p. 10):

1. *India*: Engineering and Technical
2. *China*: Manufacturing and Technical
3. *Mexico*: Manufacturing
4. *United States*: Analysis and Creative
5. *Philippines*: Administrative

Each of these countries has complex economies that span the range of business activity, but from a BPO perspective they have comparative advantages in the specific functions cited.

Because of the job shift that accompanies the quest to employ the highest-value talent, BPO has been both hailed and vilified. Business executives and owners praise it as a way to eliminate business processes that are not part of their organization's core competence. Back-office functions such as payroll and benefits administration, customer service, call center, and technical support are just a few of the processes that organizations of all sizes have been able to outsource to others who specialize in those areas. Removing these functions from their internal operations enables organizations to reduce payroll and other overhead. In an era when executives have been admonished by business commentators and analysts to focus on core competence, BPO offers an opportunity to achieve that goal in a dramatic new way.

Like appliance manufacturers that moved production from the Midwest to Mexican *maquiladoras* or apparel firms that moved production to the Far East, businesses of all types and sizes are now shifting back-office processes and jobs to international locations such as China, India, and the Philippines where the labor is inexpensive and highly skilled. In the past several years, companies have turned to these regions for increasingly sophisticated tasks: financial analysis, software design, tax preparation, and even the creation of content-rich products such as newsletters, PowerPoint presentations, and sales kits (Schwartz, 2003).

With the increasing education levels around the world, BPO is no longer confined to routine manufacturing jobs or boiler-room telemarketing centers. Today's outsourcing involves complex work that requires extensive preparation and training. For example, Indian radiologists now analyze computed tomography (CT) scans and chest X-rays for American patients out of an office park in Bangalore. In the United States, radiologists are among the highest-paid medical specialists, often earning more than \$300,000 per year to evaluate magnetic resonance imaging (MRI), CT scans, and X-rays. In Bangalore, radiologists work for less than half that. Not far from the radiology lab in Bangalore, Ernst & Young has 200 accountants processing U.S. tax returns. Starting pay for an American accountant ranges from \$40,000 to \$50,000; in Bangalore accountants are paid less than half that (Schwartz, 2003).

In the next 15 years, Forrester Research predicts that 3.3 million service jobs will move to countries such as India, Russia, China, and the Philippines. That is the equivalent of 7.5 percent of all jobs in the United States right now (Spain and Coombes, 2003). Estimates from leading

research firms more than support this trend. The Gartner Group, a Stamford, Connecticut–based research firm, predicts that:

- 85 percent of U.S. companies will outsource their human resources (HR) functions in the near future and that revenue from these transactions will exceed \$45 billion in 2003 (Sheahan, 2003).
- One in ten jobs at specialty information technology (IT) firms in the United States will move abroad by 2005, along with one in twenty IT jobs at general businesses—a loss of about 560,000 positions (Gartner Group, 2002).
- BPO will reach \$178 billion in revenues worldwide by 2005, representing a compound annual growth rate of 9.2 percent for the five-year forecast period (Gartner Group, 2002).

Additionally, market research firm IDC predicts that finance and accounting outsourcing will grow to nearly \$65 billion by 2006, up from \$36 billion in 2001. Two-thirds of U.S. banks already outsource one or more functions (Beasley-Murray, 2003).

BPO has managers around the world asking not only what it can do *for* them, but also what it might do *to* them. They are excited about the potential for BPO to help manage costs and improve their balance sheets. Under constant pressure from analysts to control headcount, outsourcing back-office activities to contract laborers in remote corners of the world can provide welcome and quick relief. Whether the labor source is in India, Pakistan, China, or someplace else, the prevalence of high-speed Internet provides opportunities for real-time back-office support regardless of the location of the workers.

At the same time, new questions are emerging and new challenges in organizational design and leadership are arising. Many organizational leaders remain skeptical about BPO because of the lingering after-effects of the tech bubble burst. Their memories are still fresh with images of the change the world mentality of the tech bubble and its alarmingly rapid crash. The thought of investing in new business models right now—especially those with a technology or Internet component—is very difficult for many managers to contemplate.

Many leaders are also concerned about the risks of BPO. They are unsure about the information security issues associated with outsourcing back-office processes. For example, in order for a BPO vendor to assist a client in managing employee benefits the vendor must have access to some of the organization's most sensitive and mission-critical information. The thought of shipping this data overseas to be managed and used by individuals who are not bound by the organization's formal and informal controls is enough to keep a manager awake at night.

BPO is based on the fundamental proposition that organizations should focus on what they do best and outsource everything else. If a company markets and sells sporting goods, it should spend substantially *all* of its time doing that and as little time as possible managing its accounting, customer service, and employee benefits plans. In theory, the concept makes a great deal of sense. In practice, it still seems to invite a new set of challenges that may cost more than the problems it is supposed to solve.

It is critical as well to note that BPO is not a technology or a technology system; it is a business strategy. In that regard, to BPO or not to BPO is a question nearly anyone who manages a

business process must now confront. As a strategic choice, the BPO option is a live one for anyone with a budget, limited resources, and decision rights. For some managers, the decision may even involve the continued existence of their own departments and their jobs. No one is likely to decide to eliminate his or her own job, so managers must learn to understand how BPO may fit into their overall responsibilities and develop the skills to manage the BPO transition and maintain it once it is operational.

Taking advantage of business process outsourcing will be a challenge for managers in all types of organizations and at all levels within those organizations. As we move into an age of greater accountability among organizational leaders, boards of directors, and others with fiduciary responsibility, it is imperative for those leaders to ask whether the firm could perform better by adopting new business models like BPO. Furthermore, as firms within an industry adopt BPO, others will be forced to consider it as the traditional cost structure of their industry comes under pressure.

The competitive and regulatory pressures that will compel managers to take a serious look at their BPO options are only beginning to be felt in some industries. But the revolution is upon us, and its will is relentless. Competitive forces that drive each industry to seek the most effective cost-control measures are irresistible, and no management or organizational structure will be able to hold off the BPO revolution. This means that adoption of BPO is virtually inevitable.

Managers must prepare for the changes that are coming by understanding the factors that go into making a sound BPO decision.

In addition to the basic choice of whether to use BPO a host of technological, business process, and human resource issues follow in the wake of an affirmative decision. The technological issues range from the type of electronic infrastructure that will be required to communicate effectively with BPO partners to the integration of new technologies with legacy systems throughout the organization. These difficult issues require the skillful assembly and management of a team of diversely talented individuals. Because BPO is fundamentally a strategic issue, managers cannot simply call upon their firm's CIO or systems administrators to decide how to achieve an outsourcing relationship. The web of relationships that make up successful BPO initiatives will be based on an array of managerial actions and skills that is unlikely to be present in any single manager or executive.

The competitive and regulatory pressures that will compel managers to take a serious look at their BPO options are only beginning to be felt in some industries. But the revolution is upon us, and its will is relentless. Competitive forces that drive each industry to seek the most effective cost-control measures are irresistible, and no management or organizational structure will be able to hold off the BPO revolution. This means that adoption of BPO is virtually inevitable. Managers must prepare for the coming changes by understanding the factors that go into making a sound BPO decision.

As will be made clear below the complexity of establishing a BPO strategy, the difficulty of finding a reliable offshore vendor, the fear of attendant business risks, and the pressure to find ways to wring costs out of the organization all point to an entrepreneurial opportunity.

Entrepreneurs who recognize that they can leverage global assets to provide and scale outsourced

services to clients will emerge in this BPO revolution. Most likely, it will be the small to medium sized enterprise (SME) that will need third party support from entrepreneurial ventures in initiating and managing an outsourcing project. Entrepreneurs will recognize this opportunity and many are already pursuing it. That the opportunity exists is not in question—what is of moment is whether the opportunity is a golden one.

### **THE RESOURCE-BASED THEORY OF ENTREPRENEURSHIP**

The resource-based theory of entrepreneurship was originally devised to account for the observation that managers within large enterprises often act in an entrepreneurial manner (Barney, 1991). As the term “entrepreneur” does not normally apply to an employee embedded within a large organization, a theory was developed to account for the obvious similarities of outcome for entrepreneurs and entrepreneurial-managers working in large organizations. The resource-based theory states that both of these actors leverage resources at their disposal to develop and sustain competitive advantage.

The resource-based theory of entrepreneurship is particularly useful when attempting to highlight the strategic decisions that entrepreneurs take to establish competitive advantage within an economy (Dollinger, 1999). “Competitive advantage” is a term that has been applied to large firms that have well defined strategic intent and whose primary mode of differentiating from competitors is clear to informed observers. To the established enterprise, competitive advantage is something to be defended. To the entrepreneurial enterprise, competitive advantage is something to be earned. The entrepreneurial achievement of competitive advantage must begin

with an overview of the existing competitive landscape with an eye towards defining niches that can be entered and exploited with minimal response from incumbents.

To establish competitive advantage with existing resources the entrepreneur must find ways to leverage resources that have four fundamental attributes:

- Rare
- Valuable
- Hard to copy
- Have no good substitutes

Under this theory, the entrepreneur is the individual who recognizes and deploys resources that either have these characteristics; or by virtue of their being combined gain these characteristics. In many cases, the entrepreneur is the originator or inventor of the rare, valuable, etc., resource, but not always. It is not imperative that the entrepreneur also be the inventor, patent holder, or behind-the-scenes thinker. The entrepreneur can also be the mobilizer and organizer of resources that appear disconnected or non-combinatorial to others.

In the case of BPO, the entrepreneur is certainly not the originator of the enabling resources—the technologies and social factors—that have precipitated the BPO revolution. In fact, the BPO revolution is not the result of any individual's or nation's specific intent. Business analysts have traced the origin of offshore outsourcing to a September 1989 breakfast meeting in India between then GE CEO Jack Welch and top government advisors (Solomon and Kranhold, p. A1). At the

meeting, Mr. Welch was asked to send some of GE's software development work to India. Recognizing the potential cost savings and other compelling advantages associated with this approach, Welch agreed. Today, India earns more than \$17 billion from companies worldwide who seek its low-cost talent through BPO contracts.

BPO wasn't created by any single individual or nation, but each of its primary drivers was intentionally developed. The six driving factors of BPO are:

1. Educational attainment worldwide
2. Broadband penetration
3. Improved Internet security
4. Near infinite, low-cost data storage
5. Online analytical processing
6. Managerial acceptance of the core competency strategy

The resource-based theory of entrepreneurship does not focus on who created the resource, it focuses on how those resources are organized and deployed. Doing BPO, especially when using an offshore strategy, is exceedingly difficult. Mastering these drivers, leveraging ancillary technologies, and developing the capacity to climb a steep learning curve are potentially sustainable competitive advantages. The difficulty of launching an outsourcing initiative, locating a reliable vendor, mitigating business risk, and controlling the process to produce cost advantages and quality parity are compelling reasons to seek a service provider. The

entrepreneur that learns to bring these disparate resources together and meet customer expectations on one or more business processes can develop sustainable competitive advantage.

For example, Tele-SalesForce (TSF) is a rapidly-growing MME that provides lead-generation services to SME clients across the United States. TSF helps its clients outsource their lead generation processes to a call center in Calcutta, India. In less than one year of operation, TSF has signed up more than 21 clients. TSF has developed a training program for each agent. The program explains the role of lead generator to the agent in terms of stores and manufacturers she is familiar with in India. The TSF project manager describes the business relationships and chemistry, and why is she calling the decision makers of those companies. This education and the resulting conviction in her voice resulted improving from two leads per week to three leads per day.

In addition to TSF's careful training, its call center partner in Calcutta is equally committed to quality performance. A five-year old company, the India call center used the services of Ernst & Young at its founding to ensure that it installed best practices call center technologies and procedures. The firm maintains its quality edge by getting regular audits from E&Y.

Tele-SalesForce is anticipating sales in excess of \$1 million for 2005, with growth projected to reach over \$7 million by 2008. With the risk-mitigation approach the company is taking to call-center outsourcing, it stands a strong chance of meeting and even exceeding its own growth expectations (Duening and Click, 2005).

## **THE DISRUPTION THEORY OF INNOVATION**

One of the most significant challenges facing any entrepreneur or new venture management team is market entry strategy. Rare is the new venture that emerges onto the economic scene into a pristine market not currently being served by incumbent competitors. Quite the contrary, most entrepreneurs find their markets already to be occupied by incumbents who have the dual advantages of brand equity and cash on hand. Entering markets where the opportunities remain great tend to elicit aggressive competitive response from incumbents (Mullins and Walker, 1996).

Rather than going head-on with incumbent competitors, the theory of disruptive innovation suggests that there are market opportunities for new ventures that often can be exploited without provoking intense competitive response. The theory predicts that, as markets mature, incumbents tend to focus energies on high-margin clients. This tends to create a market of “overshot customers” who are less interesting to incumbents and who can be served by new entrants (Christensen, Anthony, and Roth, 2004). Overshot customers are those who are interested in “hiring” the products or services provided by incumbents to solve business problems. However, overshot customers often do not hire the incumbent offerings because they are too expensive, including features that are not necessary, or have a delivery structure not conducive to their business model.

According to Christensen, there are two types of innovation that characterize competitive markets: sustaining innovations and disruptive innovations (Christensen, 2003). Sustaining

innovations are used by incumbent firms to enable them to retain customers for long periods. They are also used by incumbents to maintain their advantage over new entrants in markets that are the most favorable for their business model and that provide the greatest profit margins. Usually, incumbents who rely upon sustaining innovations must continuously move up-market to larger and larger customers as their product's feature set grows and becomes increasingly difficult for smaller customers to afford. Exhibit 1 illustrates these two types of innovation.

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Figure 1 About Here  
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Disruptive innovations are used by new entrants who recognize the “innovator’s dilemma” posed by incumbents who must rely on sustaining innovations. Disruptive innovations recognize that there are overshot customers who want to hire the solutions offered by the incumbents, but are not interested in the price or quality features provided. Overshot customers are very willing to pay for a less expensive, lower-quality product to help them achieve the same thing the incumbent product does. Recognizing this as an opportunity, the entrepreneur can exploit the overshot customer market by creating a down-sized version of the incumbent’s products and provide solutions that meet the customer’s less extensive needs.

For example, Kia automobiles entered the highly competitive U.S. market using a disruptive innovation strategy. Kia entered the U.S. automobile market with models that were relatively inexpensive. The features sets on the Kia models were less elaborate than competitor offerings, but good enough for many low-end buyers. Most importantly, Kia avoided the mistakes made by its predecessor at the low-end of the U.S. car market—Yugo. Unlike Yugo, Kia did not target

low-income buyers. Instead, Kia focused on buyers who prefer to economize on automobile spending. This market has substantial disposable income to spend on cars, but prefers to economize on monthly automobile and travel expenses. Included in this market are buyers such as college students and their parents, suburban homeowners who have either no or only a short commute to the office, and lower-middle class buyers who aspire to move up in their income bracket over time.

Kia initially served this overshot market by offering low-price vehicles that had robust feature sets. To distinguish itself from others in this market, Kia created the perception of quality by offering limited warranties that are among the best in the business—100,000 miles or 10 years. The value shopper likes the expensive look of the Kia automobile, the relative peace of mind that is associated with the lengthy warranty, and standard features that include such items as electric windows and door locks, cruise control, and CD players.

Kia's market entry did not draw an aggressive response from the incumbents in the U.S. market. Instead, they ceded the low-end market to Kia, believing that Kia's vehicles would not affect their core business. Of course, Kia had larger aspirations and is now making good on them. Having entered the U.S. market primarily to serve the driving needs of the overshot market, it is now venturing up-market as many customers within the value-shopper category it had originally targeted move up in income bracket. For example, the college students who purchased a Kia as their first vehicle are now seeking more expensive models and are inclined to remain loyal to their original brand.

Overshot customers exist in nearly every competitive market where incumbents have been following a sustaining innovation strategy to grow. Incumbent outsourcing service providers are following primarily a sustaining innovation strategy in their provision of outsourcing services. Their outsourcing services unit is usually an added service to an extensive array of other management and strategic consulting services offered to clients. Because of this, the outsourcing consulting is usually provided using the same model as the firm's other consulting services. Service to the client usually begins with extensive analyses of current state, followed by briefings and recommended actions. Such client services can run into the hundreds of thousands of dollars prior to any outsourcing of business processes.

The large consulting firms that offer outsourcing services typically seek clients that will engage their services beyond the single project. Andersen Consulting, Cognizant Technologies, KPMG Peat-Marwick, and others must sustain high overhead costs and are not interested in single-project, low margin clients. This leaves a wide swath of the market available to entrepreneurs who, like Kia, are interested in quality customers who prefer to economize on spending in a particular area. In this case, the opportunity is BPO services to SMEs. From the perspective of disruptive innovation theory, there is a large set of overshot SME customers who are competing in markets where outsourcing is changing the cost structure for all participants. The SME needs outsourcing support. That is an opportunity for entrepreneurs.

**GOLDEN OPPORTUNITY FOR ENTREPRENEURSHIP:  
THE MICRO-MULTINATIONAL ENTERPRISE (MME)**

Entrepreneurs must leverage resources in new ways to earn competitive advantage in the marketplace. The primary resources at the disposal of the new venture consist of the usual economic factors, including:

- Land
- Labor
- Capital

These resources or factors of production are the most commonly cited ingredients for the production of goods and services within an economic system. More recently, scholars have identified several other important factors that can be leveraged to earn competitive advantage within a system. These include:

- Intellectual capital
- Technology
- Time

Intellectual capital is typically conflated with the term “human capital”, and rightly so. Intelligence, for all of the advances in computing and artificial intelligence, is still primarily resident within the people of an organization. Thus, a rich new source of earned competitive

advantage for entrepreneurs is proprietary or unique access to intelligence (people). Intellectual capital is exceedingly difficult to measure. One effort that gained credence in the late 1990s was referred to as Tobin's Q. This metric examined the net asset value of company and compared it to its market value (market capitalization for public companies). The difference between the net asset value and market value could be attributed, in large measure, to the intellectual capital "owned" by the company. This metric, commonly expressed as a ratio calculated by taking the difference between market value and net asset value and dividing by market value, does provide a useful means of comparing one company's intellectual capital to another's (Villalonga, 2004).

Intellectual capital, expressed as a quantity in the manner of Tobin's Q, will thus be a function of two variables: the quality of the intellectual capital (as measured by the market) and the quantity owned by the company. Increasing either variable increases the Tobin's Q metric for a company. Competitive advantage is gained by leveraging the resources available in an economic system in new ways. Entrepreneurs who seek to enter a market by leveraging intellectual capital can either contract with a highly intelligent person (quality) or with a lot of smart people (quantity). Either approach leverages intellectual capital for competitive advantage.

Technology has played an important role in increasing the productivity of individual workers within organizations of nearly all sizes and within nearly every industry. Today, it would be ludicrous to report for work at a new job only to have the supervisor ask if you will need a computer. Computers in the workplace have become ubiquitous. They have made the transition from providing advantage to those who could afford and deploy them, to a basic tool for conducting business. Since that transition has occurred, various other technological innovations

have been marketed as the next competitive revolution for business. Solution sets that include both software and hardware upgrades and innovations are routinely described as having the potential to help firms separate from the pack or establish competitive advantage.

Most of these marketing messages ring hollow. Technological advances centered on computing, the Internet, or corporate networking are no longer regarded as capable of providing sustainable competitive advantages. The same transition from revolutionary potential to fundamental tool of business characterized the evolution of the use of the telephone, wireless communication, and air travel. Each of these technologies provided brief advantages to early adopters, and then they became fundamental tools that are as basic to good business practice as paying people for a day's work.

Computing, networking, the Internet, and the communications technologies associated with these innovations are now background tools for conducting business (Carr, 2004). Entrepreneurs may find ways to revolutionize computing and networking to develop unique and defensible business models, but that approach bears the risk of rapidly diminishing returns. Moore's Law has held up for several decades, and was aggressively and prosperously leveraged for competitive advantage by firms, such as Intel. But Moore's Law is a physical law, and like all physical laws it speaks not only of possibilities but also of inviolable limitations. If Intel is basing the next ten years of its corporate strategy on Moore's Law it will increasingly become less competitive. The costs associated with manufacturing microprocessors with ever-increasing speed become a limiting factor because the physics (mostly related to heat issues in ever-smaller spaces) are difficult to overcome.

Similarly, the claims by companies such as SAP to have solved the puzzle of enterprise data integration and efficient information flows are growing increasingly stale as company after company struggles to realize the promised advantages. That is not to say that basic computing/networking technologies will not continue to advance and provide incremental advantage—they undoubtedly will. But, the era of disruptive advantages based on computing and networking are likely over.

The technologies that enable global information exchange and communications have become prosaic, but there are golden opportunities that await the entrepreneurs who can now leverage this global infrastructure for competitive advantage. As stated above, one of the factors that make a resource valuable is that it is rare. There is nothing rare about the installed base of fiber optic cables, satellites, and transmission towers that connect the globe to the Internet and wireless networks. However, it is rare within the history of economics that a powerful enabler of commerce is available to everyone at nearly zero cost. Try to think of another enabler of commerce that is available to everyone at little or no cost. Roads, bridges, telephone systems, energy, all have associated costs. The Internet is largely free, and the savvy entrepreneur seeking to establish a venture with global reach can take advantage of tools that enable nearly free communications and virtual work spaces. Some examples of these enablers include:

- Microsoft NetMeeting
- ICQ
- Skype

- FTP Software

Entrepreneurs who learn to leverage these technologies to produce cost structure advantages are likely to be able to sustain this advantage over time. Combining existing technologies to develop operating efficiencies can create disruptive and sustainable advantages just as creating wholly new technologies can do so. New ventures that build and then scale their operations around a unique combination of software and hardware are exceedingly difficult to duplicate. New entries will always be behind the learning curve, and incumbents are usually unable or, at least, find it very difficult to rearrange their current operating structures. Thus, entrepreneurs who focus on leveraging existing technologies in new and novel ways can enter and compete in markets largely unopposed unless they lower their guard and slow their pace of learning.

Finally, the resource of “time” has been recognized as a major factor in the success and failure of ventures. Time has several different meanings, each of which is important in venture development. One connotation of time concerns the speed at which the venture is able to gain access to a market. This is often referred to as “speed to market” or “time to market”. During the dot-com bubble it was widely believed that “first mover advantage” was a predominate factor in the success of an Internet venture. While speed to market remains an important factor, it is now widely recognized that being the “first mover” in many markets is not a critical success factor.

In that regard, time has a second connotation to the new venture, referring to the “moment” and “context” in which a market is entered. This is more commonly referred to as “market timing”. In other words, there is a confluence of factors that, when present, make it more favorable for a

venture to enter a market. The savvy entrepreneur learns to time the venture's market entry to increase the potential for success. Many have observed that market timing is a fool's errand; and that those who attempt to read the signs indicating when it might be appropriate to enter a market are more likely to miss the opportunity than those who randomly enter when they're ready. Nonetheless, it is now accepted that the timing of market entry is a critical factor in a venture's success, whether the timing was intentional or accidental.

The final use of "time" is unique to the advent of a truly global economy. It concerns the notion of a "work day" and the push-pull of economic activity within a closed system. In the United States, for example, the work day largely coincides with the opening and closing of the major stock markets on Wall Street. The majority of large economic transactions occur during this period of time. We may refer to this as the "transaction zone". The transaction zone in any given economic system will have fuzzy margins as most systems will have round-the-clock economic activity (late night restaurants and bars, hotels, gaming facilities, etc.). Still, the concept of a transaction zone is useful because it is that part of the 24-hour daily clock within an economic system where the vast majority of transactions are occurring.

The transaction zone for the global economy has often been characterized as "24/7". That is, it has been said to operate 24 hours per day, seven days per week. While it is true that global economic activity is constant, it is a stretch to conflate this fact with the routines of economic agents acting within a subset of the global system. In other words, while most Americans are aware that economic activity is continuous around the globe, and even though some people actively monitor international bourses through the night, it would be hyperbolic to suggest that

the transaction zone in the U.S. has shifted radically as a result of the growing impact of the global economy.

The Micro-Multinational Enterprise (MME) is a type of venture that leverages these new resources to create rapid and sustainable competitive advantage. The MME leverages the intellectual capital of the global labor pool. Engineers, scientists, MBAs' and many other advanced-degreed individuals are ready and eager to put their talents and skills to work, regardless of where the work comes from.

The MME also takes advantage of the enabling technologies of the BPO revolution, without having to become a "technology company". The MME is not selling a "technology solution" it is leveraging existing technologies to provide services. The worldwide penetration of broadband, especially in outsourcing hot-spots such as India and China, enables the delivery of digitized work processes to nearly anywhere in the world. Another important enabler of the outsourcing revolution is advances in information security technology and policies.

In the past, many ventures were reluctant to conduct business transactions over the Internet or beyond their own four walls because they felt the security risks outweighed the value proposition. However, in today's world of ever-changing technology advancements, most executives are more computer savvy and better understand the security protocols now available. With these new technical breakthroughs, companies can now work within virtual walls with the same level of security they enjoyed within physical walls.

In addition to the security innovations at the technical level, there have been significant changes at the policy and regulatory levels. Most organizations have enacted internal policies to protect sensitive data and information, including institution of security access to physical facilities and requirements for employees to wear identification badges. At the regulatory level, national governments have instituted laws regarding data security. For example, the Indian IT Act of 2000 addresses privacy-related issues and attempts to define *hacking* and *computer evidence*. It also strongly prescribes the implementation of digital signatures and Public Key Infrastructure (PKI) for facilitating secure transactions. The data protection laws enacted by the United Kingdom and the European Union (EU) are considered to be benchmarks in international privacy laws.

The new laws governing data protection, organizational policies, and new technologies have converged to create a highly secure—although still imperfect—communications infrastructure. Although hack-proof systems have yet to be constructed, the ever-more-complex barriers erected to prevent cyber-espionage and cyber-crime make them increasingly less attractive projects for weekend hackers and an expensive undertaking for anyone else.

## **CONCLUSION**

The MME is the golden opportunity for entrepreneurship in the current global economic system. The resource-based theory of entrepreneurship clearly defines the conditions required for developing sustainable competitive advantage. Entrepreneurs launching MMEs are able to leverage global intellectual capital, take advantage of an installed based on enabling

technologies, and provide unique global time-difference advantages to domestic firms that establish a second-shift of operations. Entrepreneurs who are able to establish business processes that provide consistent and reliable quality are rare, valuable, hard to copy, and have few substitutes. This combination of factors is identified by the resource based theory of entrepreneurship as essential to establishing sustainable competitive advantage.

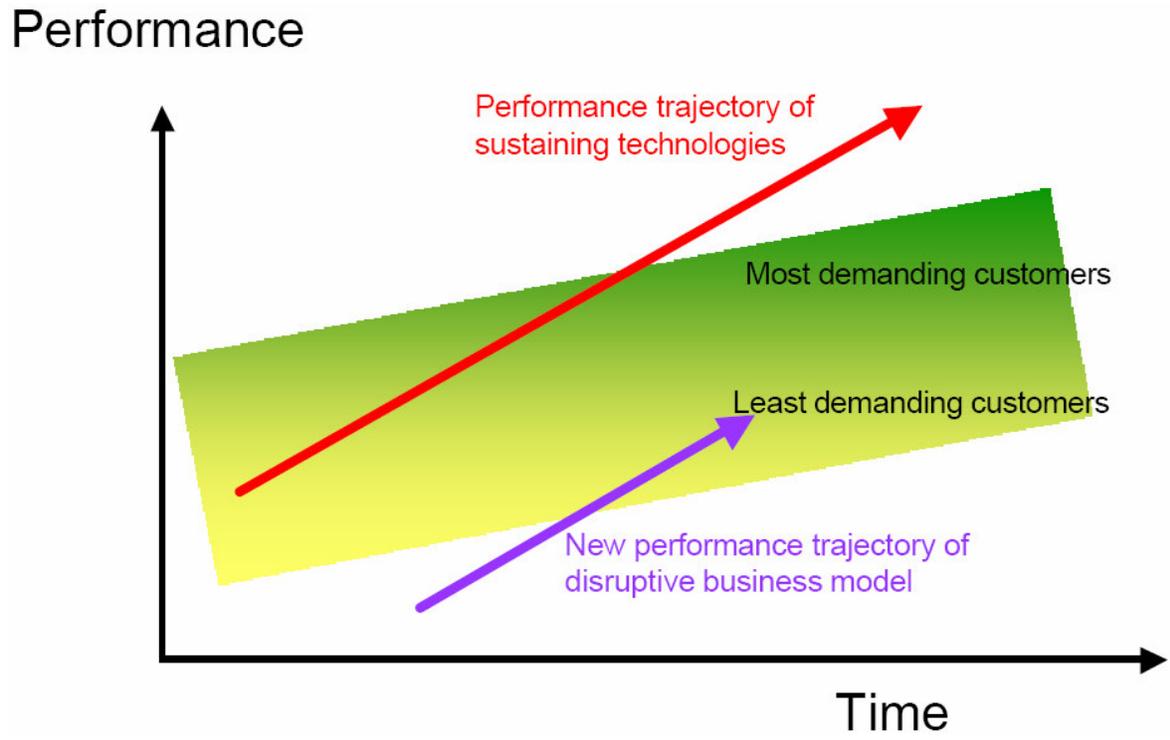
Another critical element in describing an opportunity as Golden is the ability to enter a market without inciting aggressive competitive responses from incumbents. Further, it is imperative that the market entered is large enough to support the growth objectives of the venture. Under the disruption theory of innovation, entrepreneurs can enter overshot customer markets without generating a major competitive response from incumbents. In the case of the MME, the overshot market are the small to medium sized enterprises that want to take advantage of outsourcing, but are unwilling to pay the high prices of the large consulting firms or uncertain about the risks of going it alone. The MME that can unobtrusively and seamlessly integrate an SME's business processes into a BPO model can win rapid market share and sustain it over time. The value proposition that an MME can bring to the SME is almost always compelling and can lead to rapid decisions. With promised savings of 20-30 percent over current costs with no diminution in deliverable quality, the MME can acquire customers rapidly.

As entrepreneurial opportunities go, the MME seems to have the earmarks of a rare golden opportunity. There is little doubt that the outsourcing revolution will continue to grow in the coming years, spreading ever wider into business processes that can be digitized and delivered to the lowest-cost labor pool. By organizing the technologies, management techniques, contracting

nuances, and quality control methods required for successful BPO, the MME that gets a head start in a service category can develop sustainable competitive advantage. Finally, by entering the SME market that is overshot by the large BPO service providers, the MME can anticipate only minimal competitive response as the major players have largely ceded these markets to smaller firms. Combining these factors, and assuming that the three criteria for defining a golden opportunity are correct, the MME business model is currently a golden opportunity for entrepreneurship.

# EXHIBIT 1

## The Disruptive Innovation Model



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**AUTHOR AND INSTITUTION PRODUCTIVITY IN THE JOURNAL OF SMALL  
BUSINESS MANAGEMENT FROM 1994 TO 2003**

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## **AUTHOR AND INSTITUTION PRODUCTIVITY IN THE JOURNAL OF SMALL BUSINESS MANAGEMENT FROM 1994-2003**

### **ABSTRACT**

**This study provides concrete insight into which individuals as well as institutions contributed most to the JSBM during the last ten years. It examines the authorship and institutional affiliations of all the articles appearing in the JSBM from 1994 to 2003 (vol. 32 to 42.) There were a total of 326 articles published with 619 author appearances representing 270 different institutions. Tables show the most prolific authors as well as most represented academic institutions.**

### **INTRODUCTION**

Despite tumultuous changes within higher education in the last few years, the quantity and quality of research output are still of vital importance to an academic career, according to Henthorne, LaTour and Loraas (1998) in a review of advertising scholarship (p. 53). Practitioner author contributions are also vital in providing cross-fertilization of ideas between academics and business.

Following the theme of scholarly applied research, there is little doubt that the Journal of Small Business Management, as one of the senior specialty journals in its field, has bridged the gap between academe and business. As the official journal of the International Council for Small Business and in association with the Small Business Institute Directors Association it has served as the primary reference for those advancing the application of theory and education in a small business context.

Following the precedent of previous ranking studies (Barry 1990; Henthorne, LaTour, and Loraas 1998; Honeycutt and Paul 2004), this study provides concrete insight into which individuals as well as institutions have been heavy contributors to the field of small business management.

### **IMPORTANCE OF ASSESSING A DISCIPLINE'S PRIMARY SPECIALTY JOURNAL OUTPUT**

There is little question of the relevance of research output, both in terms of quantity and quality, to an academic career (Hunt, Neese, and Bashaw 1997). Promotion and tenure, as well as merit pay increases, are constantly tied to research productivity. Today, there is ever-increasing emphasis being placed on teaching and bridge-building to the business community for faculty of business schools since state-funding sources are drying up (Mason 1995).

Many universities that were state-supported are now only state-assisted. This significant reduction in funding has heightened the need to link from academe into industry, and business schools are scrambling to become centers for cutting-edge research dissemination.

There is a growing recognition of the synergistic effects of faculty research programs which bring creative thinking and problem-solving skills to practical business settings and which, in turn, bring real-world relevance into the classroom (Ruch 1995; Shughart 1997). As a result, business school administrations must be sensitive to the evaluation of programs that take research productivity and relevance into consideration.

The need for accountability is at an all-time high for administrators, and evidence must be presented as to the value that has been created by the schools and their faculties and staff in exchange for the operating monies that have been provided (Henthorne, LaTour, and Loraas 1998; Mason 1995). A viable way to accomplish this is the use of productivity studies which reflect knowledge generation and dissemination in high quality journals (Hunt, Neese, and Bashaw 1997; Urban, Wayland, and McDermott 1992).

## **THE STUDY**

This study utilizes the methodology previously employed by Barry (1990), Ford, LaTour, and Henthorne (2001), and Honeycutt and Paul (2004). In this study we examined all of the articles (editorial and peer-reviewed) appearing in the Journal of Small Business Management from 1994 to the end of 2003. The purpose of this study was to examine the authorship and affiliations in the Journal of Small Business Management over the previous ten-year period. We also wanted to examine the total appearances of a particular author.

While we are concerned with recognizing relative individual contributions, it should certainly be noted that co-authorships benefit the discipline through the enhanced perspective on the subject matter provided by multiple authors. There is definitely a synergistic effect that could go beyond the proportional attribution that is accomplished by having multiple authors.

## **RESULTS**

Over the period of the study (1994 through 2003, volume 32 through 41), approximately 32 articles were published annually. There were a total of 326 articles with 619 author appearances, or an average of 1.90 authors per article. The total number of discrete author appearances was 508. Single authored pieces totaled 129, two-authored articles totaled 137, and three-authored articles accounted for 51, while articles with four or more authors contributed the remaining 16.

### **Contribution by Rank**

During the time period covered by our study, approximately 93% of the articles published were submitted by academics. Table 1 indicates that, of that contribution, 25% can be attributed to Assistant Professors. Additionally, Associate Professors were responsible for 23% and Full Professors for approximately 25%. The remaining 20% can be contributed to individuals holding 'other' appointments within the university system.

**[Insert Table 1 about here]**

### **Most Frequent Contributors**

Only 21 authors had three or more appearances over the course of our study. These 21 authors represent only about 4% of total authors who made appearances. More significantly only nine authors had four or more appearances. For each of these nine authors, their total number of appearances, their absolute ranking (based solely on the number of appearances), their adjusted number of appearances (based on partial contribution), and their weighted average ranking are shown in Table 2.

The nine top contributors, in terms of total appearances, were Dana (15 appearances), Miller (5), Morris (5), Castrogiovanni (4), Deshpande (4), Hornsby (4), Kuratko (4), Mathews (4), and Van Auken (4). When co-authorship was taken into consideration, this ranking changed substantially, with Dana maintaining his original position. Van Auken moves into 2<sup>nd</sup> position, while positions three through five were taken by authors with less than four total appearances. Associatively, it can be seen that Miller, Morris, and Deshpande all drop to a tie for 6<sup>th</sup> position. It should be noted that these results make no distinction between peer and editorially reviewed articles. During this ten year period about 60 percent of the articles published in the JSBM were peer reviewed.

**[Insert Table 2 here]**

### **Institutional Affiliations of Contributors**

The institutional affiliations for contributors may be found in Table 3. As before, the appearances are listed along with the absolute rankings (based on total appearances), the adjusted number of appearances (based on partial contribution), and weighted average. The top seven schools, in terms of total appearances, were Iowa State (17 appearances), McGill (15), Ball State (14), and Western Michigan (10). Again, we see the rankings change somewhat when looking at weighted averages. When fractional contribution is included, Iowa State drops to 2<sup>nd</sup> position, while McGill moves into the number one spot. Table 3 highlights the institutional rankings and changes due to fractional contribution.

**[Insert Table 3 about here]**

## **DISCUSSION AND CONCLUSIONS**

The primary purpose of the Journal of Small Business Management is to publish quality research articles in the fields of small business and entrepreneurship from around the world. It has been recognized as a premier journal by academics and business leaders for many years and this review of articles published from 1994 through 2003 verified the global reach of the JSBM.

Authors from every continent and dozens of countries solidified the JSBM's claim to be one of the world's preeminent small firm research periodicals.

This study provides a benchmark for assessing the academic output of both individuals and institutions relative to the field of small business. This kind of benchmark gives some concrete evidence of the type of scholarship necessary for both individuals and institutions. The absolute number of total contributors (508 different authors) and institutions (over 275 from around the world) indicate that the JSBM is truly representative of the International Council for Small Business.

As with any study, there are a several limitations which must be noted. First, since the JSBM publishes both peer reviewed and editorially reviewed articles (at least it did during the time period examined) some could make an argument that not all articles should be considered equal. However, since the number of editorial reviewed articles was so large (121 versus 205) we chose to simply count them all. Further research could distinguish between them. Another limitation is that we did not do any analysis of the subsequent impact of the published articles through some form of citation tracking. This could also prove useful. Another limitation to the university affiliation ranking is that we did not do any analysis of the relative size of institutions. This could alter the relative contributions if taken into consideration. While these are serious limitations, hopefully this research has given some insight into the publishing trends and output efforts of small business researchers.

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**Table 1**  
**Percentage Author Contribution by Academic Rank**

| <b>Rank</b>  | <b>Percentage</b> |
|--------------|-------------------|
| Assistant    | 25                |
| Associate    | 23                |
| Full         | 25                |
| Other Ranks  | 20                |
| Non-Academic | 7                 |

**Table 2**  
**Top Frequent Contributors by Total**  
**and Adjusted Appearances and Ranks**

| <b>Author Name</b>      | <b>Total Appearances</b> | <b>Rank</b> | <b>Adjusted Appearances</b> | <b>Adjusted Rank</b> |
|-------------------------|--------------------------|-------------|-----------------------------|----------------------|
| Leo Paul Dana           | 15                       | 1           | 14.0                        | 1                    |
| Nancy J. Miller         | 5                        | 2           | 2.0                         | 6                    |
| Michael H. Morris       | 5                        | 2           | 2.0                         | 6                    |
| Castrogioranni, Gary J. | 4                        | 4           | 1.83                        | 16                   |
| Deshpande, Satish P.    | 4                        | 4           | 2.0                         | 6                    |
| Hornsby, Jeffrey S.     | 4                        | 4           | 1.11                        | 30                   |
| Kuratko, Donald F.      | 4                        | 4           | 1.11                        | 30                   |
| Mathews, Charles H.     | 4                        | 4           | 1.67                        | 19                   |
| Van Auken, Howard       | 4                        | 4           | 2.75                        | 2                    |

**Table 3**  
**Most Frequent Contributors' University Affiliations**  
**by Total and Adjusted Appearances and Ranks**

| <b>University</b>          | <b>Total Appearances</b> | <b>Rank</b> | <b>Adjusted Appearances</b> | <b>Adjusted Rank</b> |
|----------------------------|--------------------------|-------------|-----------------------------|----------------------|
| Iowa State University      | 17                       | 1           | 8.22                        | 2                    |
| McGill University          | 15                       | 2           | 14.0                        | 1                    |
| Ball State University      | 14                       | 3           | 3.86                        | 6                    |
| Western Michigan Univ.     | 10                       | 4           | 5.5                         | 3                    |
| Flinders University        | 8                        | 5           | 4.0                         | 4                    |
| Univ. of Wisconsin-Oshkosh | 7                        | 6           | 3.0                         | 8                    |
| Tennessee State University | 7                        | 6           | 3.0                         | 8                    |
| Louisiana State University | 6                        | 8           | 3.16                        | 7                    |

# **SUCCESSION PLANNING IN FAMILY BUSINESS: A REFLECTION ON WHAT WE KNOW AND HOW WE CAN FIND OUT MORE**

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## **ABSTRACT**

Our recent survey of the existing family business literature was prompted by rising community interest in family business succession planning. The resulting report shows that much useful and interesting information on this topic has accumulated in recent years and research continues. However, the reality remains that despite having gathered significant amounts of information on many specific factors, processes and relationships that affect succession planning, there are still numerous areas which require further exploration. Little work appears to have been done to more fully explore the function of personal and social dynamics in succession planning and the manner in which the web of relationships in family business impact upon both individual and business behaviour. Others have also recently noted that there has been limited exploration of both the social and business context surrounding family business succession. In this paper we argue that, in order to make significant advances in understanding this subject, more needs to be done to understand succession planning from the perspective of relationships. Moreover, we suggest that employing social capital as a conceptual tool offers one method of proceeding with this task and we offer examples illustrating its potential. By adopting such an alternative lens of analysis we hope that family business researchers can extend their knowledge in a manner that lends insight into business conduct more broadly.

## **INTRODUCTION**

In the Australian business community there is a rising interest in information about succession and how it can be effectively planned. This awareness results from the increasing age of business owners and that a growing number of businesses can expect to undergo some form of ownership or management transfer in the near future. A wide ranging survey of the existing literature (Dunemann and Barrett, 2004) ascertained that given succession planning has been a core concern of family business research since its inception, there is abundant relevant material. The resulting report (Dunemann and Barrett, 2004) documented the many factors, processes and relationships which influence succession planning along with several succession planning models.

Arising out of this process was an acknowledgement of the great value of the existing research on this matter, yet also a strong sense that important gaps in our knowledge and research focus need to be addressed. It is clearly evident that more emphasis needs to be placed upon the difficult to examine 'human' factors in succession planning. Indeed, we should focus more of our research emphasis upon the ways relationships, personal and social dynamics, and the overall context surrounding family businesses influence succession planning (Dunemann and Barrett, 2004: 40). Recognition of the need to more seriously address these aspects of family business and succession planning is evident in recent research (Le Breton-Miller, Miller and Steier, 2004; Sharma, 2004; Zahra and Sharma, 2004).

Following Fox, Nilakant and Hamilton (1996), we believe that the key to successful succession planning lies in relationships. To emphasise the centrality of relationships for operating a family business and throughout succession planning processes is to make a simple, even anodyne point however, we suggest that this commonplace insight might actually offer family business researchers a useful alternative approach for understanding what happens during family business succession planning. Moreover, it holds potential for facilitating advances in our analysis of family firm conduct in general. Relationships are about connections, ties and the myriad webs and networks arising from them; in other words they go to the heart of the socially embedded nature of business behaviour and the context which surrounds family business.

Family business research needs a constructive method of approaching succession planning from the perspective of relationships which will open up new insights into the contextual and socially embedded nature of family businesses. The related concepts of 'social capital' and 'social network analysis' appear to be most suitable for this purpose. They represent a conceptual approach with enough flexibility to enable us to view succession planning through other 'lenses' that might clear away some of the impasses and allow us to further build our research on the substantial foundations already laid by others.

In the first section of this paper we briefly cover what can be found in the existing literature on succession planning and what this indicates about what we presently know and do not know. In the middle section we discuss the emergence of relationships as a primary perspective for understanding succession planning and argue for family business research to more fully use the conceptual approach offered by the notion of social capital. Finally, we provide a section outlining examples of research employing these approaches to stimulate some new thinking about our research agenda. Applying social capital's conceptual lenses to the problem of succession planning may assist us to prise open some of the 'layers of embeddedness' – of family context within business context within social context – which complicate our understanding of family businesses.

## **DISCOVERING WHAT WE KNOW AND DO NOT KNOW**

In this initial section we will outline the material gathered in our recent survey of the extant literature on succession planning in family business. Existing family business research contains information on many factors, processes and relationships that influence succession planning. Also to be found are attempts to devise a general model for engaging in family business succession planning. However, in line with other recent research, we would conclude that

significant gaps currently remain in our overall research agenda and knowledge regarding succession planning (Le Breton-Miller et al., 2004; Sharma, 2004). While this is not completely good news, we wish to emphasise just how much useful work has been done in building our current family business research canon. Our message here is less about ‘problems’ in our research than it is about the existing opportunities to augment, understand and interpret what we already know about succession planning.

Numerous influences on succession are identified in the literature and they can be categorised in numerous ways, and Venter, Boshoff and Maas’ (2003) distinction between ‘hard’ and ‘soft’ issues is one recent example. For the purposes of this section though, we only intend to sketch the outlines of the existing literature to illustrate our knowledge strengths and weaknesses. A more exhaustive discussion of these influences can be found in Le Breton-Miller et al. (2004) and Dunemann and Barrett (2004). Research has focussed upon the importance of good quality communication in succession planning (Hamilton, 2003; Janjuha-Jivraj and Woods, 2002a; Lansberg, 1999; Thomas, 2002) and on maintaining an environment conducive to good communication (Paisner, 1999). Psychological influences also feature, often with examples of research covering the effect of individual perceptions regarding roles, intentions and attitudes (Sharma, Chrisman and Chua, 2003), emotional and relationship obstacles (Kirschner and Kirschner, 2000), psychological conflict (Grote, 2003), and various incumbent personality types (Poza, 2004).

On offer are also many examples investigating the effects of the different stages of the life cycle in which individuals and firms may find themselves during succession (Janjuha-Jivraj and Woods, 2002b; Lansberg, 1999; Miller, Steier and Breton-Miller, 2003). Research on the preparedness levels of the principal individuals also appears frequently (Barach, Carson et al, 1988; Fritz, 1997; Morris, Williams, Allen and Avila, 1997; Sharma, Chua and Chrisman, 2000) as does that on the importance of having a preparation process for each person (Cadieux and Lorrain, 2003; Cohn, 1992; Levinson and Wofford, 2000) and the preparations of these individuals (Allred and Allred, 1997; Fiegener, Brown, Prince and File, 1996; Garcia-Alvarez and Sintas, 2003).

Material articulating the important influence exerted by goals and value systems (Chrisman, Chua and Litz, 2003; Chrisman, Chua and Zahra, 2003; Garcia-Alvarez and Sintas, 2003), as well as that of the business and family cultures (Belardinelli, 2002; Garcia-Alvarez, Lopez-Sintas and Gonzalvo, 2002; Gatrell, 2003; Goffee, 1996; Longenecker and Schoen, 1978) in planning for succession, also exists. Discussions about the crucial role of management systems in family business succession planning (Dyck, Mauws, Starke and Mischke, 2002; Hamilton, 2003; Lee, Lim and Lim, 2003; Morris et al., 1997; Taylor, Norris and Howard, 1998), and the influence of financial (Kimhi, 1997; Thomas, 2002) and business environment factors (Bjuggren and Sund, 2002; Burkart, Panunzi and Shleifer, 2003; Shen and Jr, 2003) can also be found.

Despite this array of material we argue that there are many things we do not know or at least do not understand or explain well enough. Others agree with us, for example, Sharma (2004) who suggests that we need to better comprehend how and why family firms so readily endure in diverse locations and to improve our understanding of their societal interactions. Sharma (2004) also calls for more efforts to explore interorganisational relationships and how firms develop

culture and vision. Zahra and Sharma (2004: 335) have also indicated that the family business research focus is too narrow and that this has resulted in a family business research base which is “fragmented and descriptive” (p. 344), leaving us with many gaps in our knowledge.

In terms of understanding succession, Le Breton Miller et al (2004) argue that little has been done to address the issue of context, which includes the family, social, industry, and business context. They argue that many succession studies include only a few variables, concentrate on easily investigated aspects of succession, and focus more on individuals than organisational dynamics. Furthermore they argue that it is more often the anecdotal material which is used to grapple with the “under-explored categories” (Le Breton Miller et al, 2004: 319) of succession planning, which are those involving context and interactive processes. Unfortunately, they point out that a less research time appears devoted to exploring these gap areas in recent years than was previously the case (Le Breton-Miller et al., 2004: 322).

Little is known about how complex factors in succession fit together and interact. For example not enough is known about the dynamics of nurturing and developing successors (Le Breton-Miller et al., 2004). What are the advantages of gaining experience internally versus externally? How do we create the appropriate cultures and value systems? How do these actually influence outcomes? As a result we cannot adequately explain or understand much of what happens around these issues which involve high degrees of social and personal dynamics. What we require are methods that can illuminate these matters and allow us to investigate more fully the “tacit and social knowledge” (Niemelä, 2004: 320) which are crucial to understanding family business behaviour. In the next section we will discuss how the allied notions of social capital and social network analysis offer us the potential to grapple with these most pressing family business matters.

## **NEW PATHWAYS**

Despite an array of factors and processes involved in succession planning there remains a pertinent sense of the centrality of relationships to succession planning. Following Fox et al. (1996), we suggest that the key to successful succession planning lies in relationships. Good succession planning outcomes are more likely when we more fully understand and are better able to manage family business relationships generally. As such, furthering our understanding of succession planning entails examining succession planning through a ‘relational prism’.

If we can better grasp what happens during succession processes from the perspective of relationships more generally, then our comprehension of so much that happens is likely to be enhanced. One reason for this is because the complex web of relationships which exist within family business is, in some senses, synonymous with the overall context, both social and business, that underpin the conduct of family business, a dimension which is presently little understood. Better understanding matters at this level could assist us in fitting what we already know into a broader framework of analysis. This requires us to employ and test different research tools and we consider ‘social capital’ and ‘social network analysis’ to be the best concepts available at present. Others have already begun applying these ideas to various problems in organisational research and they appear to offer the most potential for better understanding succession planning and family business practice more broadly. For example, Mustakallio, Autio

and Zahra (2002) have made some use already of this idea saying that “social capital theory appears to be highly applicable to the study of family firms” (Mustakallio et al, 2002: 219).

The notion of social capital and social network analysis stem from the work of a wide variety of researchers and is often linked with the early efforts of figures such as Granovetter (1973), Burt (1982), Bourdieu, Coleman, and Putnam (Schuller, Baron and Field, 2001). Social capital can be considered as a “set of resources rooted in relationships” with a central premise that “networks of relationships” are valuable in conducting social affairs (Nahapiet and Ghoshal, 1998: 243). In this sense “social capital is the contextual complement to human capital” Burt, 1997: 339), the content of what exists as a result of the positioning, interaction, and interplay between the various individual entities. Three facets of this have been identified as the structural, relational and cognitive aspects which respectively relate to: the overall position of actors within any network structure (location), the quality of connections and relations (eg. trust), and common frames of reference and action (having a shared paradigm) (Nahapiet and Ghoshal, 1998).

This ability to analyse various aspects of the behavioural influences emerging from the pattern of relations between individuals, as opposed to that due to individual factors, is a real strength of this approach (Schuller et al., 2001: 35). It allows us to view succession planning and family business behaviour from fresh perspectives that accommodate the “complex and multi-faceted nature of social reality” (Schuller et al., 2001: 23). This is particularly useful when analysing succession which often unleashes “complex relationship issues” (Zahra and Sharma, 2004: 334) latent within the firm. Social capital can be used to avoid both ‘over’ and ‘under’ socialised views of human action (Granovetter, 1985) which can blind us to the reality of family business behaviour. In viewing matters from several angles simultaneously (Schuller et al., 2001: 29) we may avoid the limitations of more linear approaches (Schuller et al., 2001: 30) and move beyond our continued reliance on the same well used methods of research and analysis which have left us struggling to advance our knowledge and understanding (Zahra and Sharma, 2004).

An example of the insights to be gained can be found in Coleman’s (1988) work on education where he links the levels of closure or openness in a particular network of relations with the capacity to reinforce values and cultures. This is one example of the way in which social capital can be used as a conceptual tool to reinsert value into family business research and to explore the affects of relationship quality (Schuller et al., 2001: 36). Also noteworthy is the ability to use social capital to link various levels of analysis and to handle ambiguity such as is found in relationships experiencing both conflict and cooperation (Schuller et al., 2001: 35). Probably most important of all, however, is the “heuristic quality” (Schuller et al., 2001: 36) of social capital which promises to open up fresh and unexpected paths in our research of family business.

## **USING SOCIAL CAPITAL: SOME EXAMPLES**

This final section of our paper will be used to provide some examples of research undertaken using social capital and network analysis as conceptual approaches. The first example is Steier’s (2001) work where he directly applies these ideas to a particular issue in family business succession planning. Further examples are used to show the way these notions have been utilised in other areas to open up new perspectives on matters of interest to that research discipline. These are offered as a way of assisting researchers in family business studies to begin

considering whether and how the concept of social capital might be applied to improve our grasp of various aspects of succession planning and business conduct in general.

Steier (2001) adopts the importance of relationships and the notion of social capital as a starting point in his study of the way social capital is managed within family businesses. To begin he emphasises the distinction between physical capital (i.e. equipment, land or cash), human capital (such as individual's knowledge, capabilities or physical appearance) and social capital (the assets embedded in various relationships) (Steier, 2001: 259). Each of these, variously, contributes elements of value that together comprise the accumulated assets contained within a firm. This is important as most succession research only focuses upon wealth transfer and asset management in family businesses as it relates to physical and human capital. This study seeks to understand the third dimension of wealth transfer and its impact upon succession in family firms (Steier, 2001: 260). Through a series of interviews with family business successors, Steier (2001) identifies four different modes of social capital transfer within family firms: a) that which occurs when a succession is sudden and unplanned, often the result of an unexpected death; b) that which is rushed, perhaps due to a family illness or divorce; c) a natural immersion over a long period; and d) where a conscious effort to transfer these assets is undertaken (Steier, 2001: 265-7). He also uncovers seven means by which families manage social capital within the business. These are 1) "deciphering existing network structures"; 2) "deciphering the transactional content of network relationships"; 3) "determining criticalities"; 4) "attaining legitimacy"; 5) "clarifying optimal role"; 6) "managing ties through delegation and division of labour"; and 7) "striving for optimal network configuration" (Steier, 2001: 265). Through exploring the accumulation and movement of social capital within family firms this work illustrates the "importance of relational assets" (Steier, 2001: 275) in family business and concludes by suggesting further questions to be investigated.

In a recent paper, Nicholson, Alexander and Kiel (2004) employ the notion of social capital to explore how the operation of company boards affects overall corporate performance. Working with a 'resource dependence theory of corporate governance', which examines the role played by a board in providing a company access to resources, they attempt to distinguish between the effects of the corporate network and the networks that exist at the level of personal directors on a company's access to resources (Nicholson et al., 2004: 54) They examine the impact on corporate performance of individual linkages as opposed to linkages at the level of the firm (Nicholson et al., 2004: 57). The multidimensionality of social capital is acknowledged as a conceptual approach and they focus their efforts upon the 'structural' dimension of social capital – the links or bonds between actors. They use publicly available data to determine what linkages exist at the personal level between company directors and the proximity of those connections in both Australia and the USA (Nicholson et al., 2004: 61). They found interconnections at the corporate level were similar in the two countries, however, significant differences emerged at the personal level with interactions between directors in the USA much higher than those in Australia (Nicholson et al., 2004: 64). As a result they suggest that if a large part of a board's social capital and access to resources comes through personal, rather than firm level connections, then these differences could have implications for understanding any comparative studies on corporate performance. Particular questions of interest that arise include 'Given the greater personal integration of company directors in the USA, could we expect to see faster and better diffusion of innovations?', 'Does more social pressure also accentuate negative effects such as

malfeasance?’ and ‘Do minority directors in the United States wield more influence?’. As a consequence, Nicholson et al (2004: 65) call for further research in these areas.

A further insightful example of the use of social capital as a research approach is found in the work of Fernandez, Castilla and Moore (2000) who use it to better understand the process of employing new staff through referrals by existing workers. They argue that also this matter has been previously explored using social capital this has focused on supply-side issues only (Fernandez et al., 2000: 1288), and their research addresses this matter from the demand side – the employer’s perspective. Fernandez et al (2000) examine the hiring records of a large telephone company and show that a ‘return’ (in better hiring outcomes) of \$416 for every \$250 of ‘social capital’ investment (in the form of paying existing employees a referral bonus to recruit staff) is realised. They therefore ‘prove’ social capital as a concrete form of capital and provide good reasons for understanding why firms might hire in this way (Fernandez et al., 2000: 1351). They also suggested that a social capital perspective offered support for two prevailing economic theories – ‘the richer pool process’ and ‘the social enrichment process’ – but little to support the ‘post hire better match story’ (Fernandez et al., 2000: 1351). While admitting that more work is needed, they emphasise in their conclusion how this social capital approach can provide empirical evidence for certain hypotheses. Fernandez et al (2000) encourage others to conduct empirically grounded case studies as a way of augmenting our theoretical knowledge (Fernandez et al., 2000: 1352-3).

Other examples where the notion of social capital is used to further explore research questions are found in three further papers. The first is by Pennings, Lee and van Witteloostuijn (1998) who examine historical data in Holland to determine if levels of social capital and human capital can be implicated in firm dissolution. They look at variables such as the number of firm partners who had experience working in different industries and, particularly, in industries like those of their client base in order to ascertain levels of social capital (Pennings et al., 1998: 430). They found that levels of social capital strongly predicted firm survival, with higher levels of social capital associated with firm persistence (Pennings et al., 1998: 437). This study only focuses on a particular industry and the authors caution that more research should be undertaken (Pennings et al., 1998: 439).

Brass, Butterfield and Skaggs (1998) also employ a network analysis to investigate unethical behaviour in organisations. This paper examines the role relationships might play in determining the formation of shared norms and values in organisations. Brass et al (1998) suggest that the network of relations can both constrain and enable opportunities for unethical behaviour. They argue that by focussing on the relations between actors in an organisation then ways of understanding where problems might arise can be provided which can be helpful in devising methods to mitigate the emergence of unwanted behaviour (Brass et al., 1998: 25-26).

The third of these papers is by BarNir and Smith (2002). They examine the links between a propensity for networking and the creation of interfirm alliances in small businesses. Using propensity to network, the strength of ties, and network members’ prestige as factors BarNir and Smith (2002) survey small businesses and correlate the results with the number of alliances made by a firm (BarNir and Smith, 2002: 228). For these small businesses they find that the number of interfirm alliances is positively associated with higher degrees of social networking, when

considered from the perspective of the quality of those linkages. Where firms have low quality but a larger scope of linkages, the association is negative (BarNir and Smith, 2002: 229).

In providing a brief overview of some already existing research using social capital as an analytical tool we have demonstrated how the work of others might give glimpses of new research openings for research into succession planning in family business. By linking our research with the efforts of others we may all benefit from expanding the scope of our research agenda and sharing common research problems. New lines of inquiry could be made in tandem with other disciplines which may prove fruitful for all concerned. This could help address a concern raised by Bagby (2004) that interaction between disciplines on common concerns such as succession planning is too limited. As well, we may discover information that applies to family business research more broadly and perhaps, even to research outside our discipline. This would go some way to allaying the concerns of Zahra and Sharma (2004) in their recent reflections on the state of family business research. Our adoption of a bold new research agenda may be part of wider efforts needed to raise the profile of family business studies and to more fully communicate with sister disciplines.

## CONCLUSION

Initially, our purpose was simply to review the family business succession planning literature in order to service the needs of Australian family businesses which are increasingly concerned with how to actually go about making plans for succession. What emerged was recognition of some critical gaps in our research knowledge and of the opportunities that now exist to augment and systematically build upon the excellent work already done. As a consequence of these efforts we realised, as well, how much of the extant literature pointed to the centrality of relationships in succession planning, a point clearly noted by Fox et al. (1996). Good succession planning lies in managing relationships and we recommend more efforts to understand the nature and influence of relationships in succession planning. Most promising for this purpose are the conceptual tools offered by social capital and social network analysis. They enable us to explore the substantive nature of the ties and interconnections that operate within family businesses as well as ways in which relational dynamics influence succession and family firm performance in general. Early examples of the application of these concepts to business and organisational research indicate the potential and we encourage family business researchers to more thoroughly explore its potential. Social capital and social network theory have to expand our understanding of family business succession and behaviour in family business more generally.

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# **WHAT IS THE USE OF FINANCIAL COMPLIANCE? THE CASE OF SMALL BUSINESS IN AUSTRALIA**

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## **ABSTRACT**

The purpose of this paper is to explore the nature and type of financial records being kept in small businesses in Australia. The paper considers the Australian requirements for financial record keeping and the context in which small businesses are required to record and report. The research literature on the benefits of record keeping and the use of the financial information that they can generate for small businesses is considered. The findings from 121 responses to 1000 mailed survey questionnaires are considered and a discussion of these results includes comparison of the findings in the literature. The financial data used by these small businesses in their business performance evaluation is compared to what is known in the literature. These results have highlighted areas for further research via case study analysis.

## **INTRODUCTION**

Small businesses are important in the global economy, despite variations in how they are defined. In the UK for example small firms (businesses with less than 250 employees) represent over 90% of the business population and provide nearly two-thirds of the national employment (Mitchell and Reid, 2000). In Norway small businesses (1-19 employees) represent “(a)bout 95% of Norwegian firms” (Gooderham et al 2004, p. 6). America defines small business as businesses employing fewer than 500 employees (Holmes 2001) and it is estimated that in 2002 there were 22.9 million small businesses, employing 50.1% of the private work force and represent 99.7% of all employers (United States Small Business Administration 2005).

The Australian Bureau of Statistics (ABS 2002) estimated that in Australia during 2000-01 there were 1.2 million small businesses (employing less than 20 employees), with a total employment of almost 3.6 million people. This represents 97% of all private sector businesses in Australia. Small businesses dominate all industrial sectors although numbers are greater in the services sector in comparison to the manufacturing sector.

The small business sector makes a significant contribution to the Australian economy by providing employment, personal wealth, supply of goods and services and utilization of resources. However, while entry into small business is a simple process requiring an investment of individuals' resources, time and skills, as there are no minimum standards or qualifications required to be met prior to business entry, remaining in business can be difficult and requires meeting ones debts as required and complying with legislation relevant to business operations. The business owner's skills and knowledge may not extend beyond those relevant to their

industry. Financial skills may be very limited and hence, understanding financial requirements and how they can use financial information for performance purposes may also be very limited (Thomas and Evanson 1987; Holmes and Nicholls 1988). This can be problematic as “the compliance costs of taxation comprise the largest single element of the compliance burden by businesses” and government regulations have been “claimed to be one of the major obstacles to business success” (Chittenden et al. 2003, p. 94).

The purpose of this paper is to ascertain what record keeping and financial reporting small business owners use in their business. This is an important issue in the context of GST and annual taxation reporting as well as the introduction of International Accounting Standards. In order to better understand the role of financial record keeping and reporting this paper will explore the benefits found from record keeping and financial reporting, the impact or effect of the GST on the nature and type of record keeping, information available from record keeping, and the use of that information and what understanding can be gained from the use of such information. A study of small business in one Australian region was conducted to explore some of these issues and is reported in this paper. The type and size of small business revenues and expenses can vary significantly: from many transactions of small to medium dollar amounts to fewer transactions of greater dollar amounts. It is therefore important to consider if the record keeping, reporting and information used within businesses differ. The current recording and reporting requirements and their subsequent role in small business will be examined in detail in order to determine the use of financial information and possible improvements within current reporting requirements.

In the following sections the paper details the introduction of the Australian GST, benefits of record keeping and financial reporting to contextualize the research. In these sections the literature on small business financial recording and reporting together with the importance of financial management skills to small business success are considered.

## **THE GST, COMPLIANCE AND RECORD KEEPING IN SMALL BUSINESS IN AUSTRALIA**

### **The GST: Its Introduction and Effect**

On July 1, 2000 the Australian Commonwealth Government introduced a Goods and Services Tax (GST) of 10%. While the GST replaced a range of other Australian taxes, its introduction was met with much resistance from the business community generally. GST compliance requires accurate recording and reporting records regardless of the level of financial skills of small business owners and managers. The GST has increased the level of reporting of transactions and the frequency of reporting even though previous legislation did require all businesses to keep records which “record and explain” (ATO 2002) all business transactions.

The GST has made business an integral part of the taxation collection system and small business self assess their taxation obligation. The self assessment is dependent on the record keeping and financial information. The reporting timeframe to the Australian Taxation Office (ATO) has increased from annual taxation returns to monthly or quarterly taxation Business Activity Statements (BAS) in addition to the annual taxation returns. The timing of the BAS is dependent on how the small business registered for the GST. The BAS details the business receipts and payments together with the GST received and paid for the period.

This increased reporting has focused attention on the need for accurate recording and reporting of business operations in financial records. To overcome this, in the period prior to the introduction of the GST, the ATO and the accounting profession provided business advice to assist small business in understanding their role in the GST and the new recording and reporting requirements.

While the ability of small business to comply with the GST system is currently being researched together with burden of compliance, the question of whether the type of records are kept rather than simply issues of compliance has not yet been addressed. This is important as Melbourne newspapers have reported that the ATO is implementing additional investigations and audits to curb and reduce the perceived tax avoidance and continuing cash economy (Crawford 27 June 2003).

Further studies on the impact of the GST, for example that by CPA Australia, found there is “an incentive to keep up-to-date with record keeping” and produce reports regularly (CPA 2003, p. 6). However, this study did not address the nature or type of record keeping and/or reporting used by small business owners. CPA Australia reported that the ATO has identified poor record keeping as one of the major causes of tax compliance problems for small business. This has recently been reinforced in media articles from the ATO (Lawson 8 February 2005). CPA Australia also found that the role and volume of assistance provided by the accountancy profession had increased; with 50% of CPA Australia members experiencing service increases and 41% of small businesses experiencing an increase in their accounting costs as a result of compliance. These costs extended from recording of transactions to the preparation of compliance reports.

Petzke and Murphy (2001) examining the impact of the GST on small business, and hence argued that the goods and services tax was perceived by small business owners to be extremely costly for them in the first year following its introduction, both financially and in terms of the demand on the owners' time. This research found little evidence of the benefits that the Government claimed would accrue to small business with the introduction of the New Tax System (p. 20). Since the introduction of the GST the Australian government has tried to simplify the reporting in response to business backlash. This continues to be discussed and debated in business and government circles. Whilst it is encouraging that the GST has increased the timeliness of record keeping and reporting to the ATO, the use of financial information by small business needs further considerations.

### **Financial Management and Reporting: Benefits and Issues**

A range of research has found poor accounting systems strongly contribute to financial problems in small business by (for example McMahon 2001a; 2001b; McMahon and Davies 1994; McMahon and Holmes, 1991) and others. For example in his research into the different life cycles of small business, McMahon (2001a) found that of all financial problems encountered by small business, poor accounting systems account for 32% and poor cash flow 26%

Other research has linked improvements in business performance through use of financial information. McMahon and Holmes (1991) write that “the clearest and most startling distinctions

between successful and discontinued small businesses lie in their approach to the uses which can be made of accounting information” (p. 19). They go on to argue that “sound financial management is crucial to the survival and well-being of small enterprises of all types. Studies of reasons for small business failure inevitably show poor or careless financial management to be the most important cause (p. 19).

While there is clearly a relationship between business failure and financial management which relies on accounting information, the questions must be asked as to ‘what accounting and financial information is recorded and maintained in small business’ and ‘how is it managed?’. Also the question as to ‘what information do small business owners use to run and grow their business?

Answering such questions are important given the Australian Taxation Office state that micro-businesses (turnover less than A\$2 million) represents 12% of tax revenue but accounts for 68% of debts owed to the ATO, forming the highest compliance risk area. They stated that these businesses “struggle to keep up to date with their record keeping and will have difficulty with changes to the revenue system” (Lawson 8 February 2005). The variation in definitions re small and micro businesses blurs this picture, however the micro or smaller small businesses fall well within this group of concerning ATO clients.

To decrease the burden on small business perhaps compliance reports could be modified to be beneficial to small business owners in running their business? Or could it be that more timely financial information is sufficient benefit? Compliance taxation or modified reports may assist business in their monitoring of business performance if these reports contain the information small business use to monitor performance.

How small business can best use financial information to evaluate business performance is not addressed well in the literature. Although the GST has increased the volume of work for Accountants and small business themselves, CPA Australia argues that “few small businesses would dispute the need for regulation; the majority find its impact on their ability to operate to be quite substantial” (CPA 2003, p. 4). They go on to say “three quarters of small businesses claim that compliance obligations act as an incentive to keep up-to-date with record keeping and that they run financial reports regularly to manage the business” (CPA 2003, p. 6). However the questionnaire that was used to provide this finding did not identify what financial reports were produced and how were they used to manage the business: In other words the information that small business owners actually use to monitor performance has not been identified in detail. The next sections consider some ways in which records can be kept and the types of information contained within them.

## **Record Keeping**

McMahon (1999; 2001a; 2001b; 2003) considered financial reporting and its benefits for small business, particularly general purpose reports (Profit and Loss, Balance Sheet and Cash Flow statements) and the use of some figures from these reports for performance measurements. The research did not detail which of the figures or how the performance measurements from these reports were performed. In a study of manufacturing small businesses in Australia it was found that financial planning and control processes had a significant correlation with higher growth in

sales (Wijewardena and Zoysa, 2001). However these studies were based on small business in the manufacturing industry, which is only one of the many industries in which small business operate. In fact this industry represents only 7% (or 88,200 businesses) of small businesses in Australia in 2000-01 (ABS 2002), and hence the nature and type of financial management issues in this industry may be industry specific and may not be applicable to all small business operations.

Argilés and Slof (2003) found that financial reports were useful in the agricultural sector to improve performance, but only where the costs of obtaining the reports was less than the expected gain in performance from the use of these reports. In the case of the smaller farms, the cost was found to not always being worthwhile (Argilés and Slof, 2003). This research did not discuss how the farmers used the financial reports or what figures were important to the business owners to assist in the understanding of “*how* accounting information enhances performance” (p. 263). Other research by Kirby and King (1997) considered the role of the accountant assisting small business and identified the mismatch of expectations between the business owner’s and the accountant’s view of their roles.

In the literature review conducted by McMahon and Holmes (1991) of the North American small business financial management practice they discuss DeThomas and Fredenberger’s (1985) survey of 360 small businesses in Georgia, USA. This research found that 81% of those small businesses produced summary financial reports and of those, 91% produced general purpose reports. This review also discussed Thomas and Evanson’s (1987) study of 398 small pharmacies in the US. Thomas and Evanson found that 62.5% produced quarterly (at least) profit and loss and balance sheet statements. Of note over 85% from this sample outsourced the statement preparation to accountants. The ratio calculations and preparation of balance sheets were considered in relation to business performance and indicators of business performance. The findings at times were contrary to what was expected such as “less frequent preparation of balance sheets was associated with greater earnings” (p. 567). In their limitations they noted it is one thing to produce the information, another to use it, and if these statements are to be useful they must be understood by small business owners/managers (p. 569). The authors argue that the business owners “lack of association between financial ratio use and either survival or profitability may also indicated the level of sophistication in use of ratios has not reached” sufficient levels in business owners to make “discernible difference” (p. 570). DeThomas and Fredenburger (1985) found only 11% used financial statement information in their managerial evaluation even though 61% felt the information could be used for planning and decision making. Also they found 2% performed financial ratio analysis and performed historical comparisons of performance and position. This is a harsh finding for the 81% producing summary financial reports that only 11% use the financial statement information in their managerial evaluation. However it is consistent with the findings of Thomas and Evanson. Often short term planning is performed informally even “in the back of their minds” or “on the back of envelopes” (McMahon and Holmes, 1991 p. 22).

However given American small businesses are much larger than Australian small businesses transferring findings from one country to another may be problematic therefore it is important to gain a greater understanding of what small business are doing in relation to record keeping, how they are doing it and why they are doing it, in order to be able to better meet their needs and assist the longer term survival of the sector.

## **Compliance Requirements**

Taxation law require all businesses to keep records which “record and explain” all business transactions (ATO 2002, p. 33). The ATO recently advised that small businesses will be fined for poor record keeping (Lawson 8 February 2005), however did not define poor records. Accounting records could be as basic as a collection of receipts and cheque butts (often referred to as ‘shoe box’ accounting) or as sophisticated as a computerized accounting package (packages such as Mind Your Own Business [MYOB] or Quick Books) which are capable of detailing every transaction including all amounts owed to and owing by the business. The size and type of the business will impact on the level of record keeping most appropriate to that business, together with the importance placed on the recording by the business owner. Fewer transactions would allow for less sophistication in the recording system whilst larger volumes would require more.

Accounting professionals assist small business with their record keeping and compliance reporting and some small businesses may involve the accountant to prepare or review compliance reports produced by small business. These issues further vary the level of record keeping. Hence research must be able to differentiate findings involving record keeping and reports produced by accounting professionals to those maintained and produced solely within the small business. In quantitative research this can be done by incorporating a section on “accounting professional involvement” as a means of providing a control sample of the sound record keeping and compliance reporting.

## **Information Record Keeping can Provide**

Whilst a collection of receipts and cheque butts allows for the production of compliance reports, it is most difficult to produce performance reports without summarization. Computerized systems on the other hand allow for reports to be produced ‘at the push of a button’ but their value is dependent on both having accurate information entered into the program and owner/management having the skills to read and interpret the information produced.

Accounting education, accounting profession and literature at length, focus on the production of business performance reports and their benefits to business. This focus includes the production of performance evaluation reports including profit and loss determinations (Profit and Loss Statement - Statement of Financial Performance), statements of business worth (Balance Sheet - Statement of Financial Position) and statement of Cash Flows. Currently Australian legislation (Corporations Act) requirements for small business require only incorporated small businesses, that is, companies, to produce business performance reports. Given that is estimated that some 50 percent of small business are incorporated (Senate EWREC 2003), the remainder are sole traders, partnerships, and trusts who are not required by legislation to produce performance reports.<sup>1</sup> Therefore the ATO compliance reporting (BAS and Annual Income Tax returns) are at present the only required record of business reporting for all small business. These compliance reports are not business performance reports rather a report that allows the ATO to calculate business tax (payable or refundable) and statistical data. The ATO uses this data to identify business averages as well as to select businesses for taxation audits.<sup>2</sup>

Business reporting is an important issue to consider at present as Australian reporting entities move to the adoption of International Accounting Standards (IFRS) from January 2005, changing the financial reporting currently in place. As the business environment and media are currently focusing on financial reporting, consideration of small business financial reporting should also be made. For most Australian small businesses there are no specific accounting standards and legislation as noted above does not require small business to produce performance reports, which McMahon and others found to be important. At present only reporting entities and private companies defined as large by the Corporations Act are required to comply with Accounting Standards according to Chief Accountant of the Australian Securities and Investments Commission (ASIC) (Andrews 17 Feb 2005). All companies within Australia are required to lodge with ASIC annual financial statements however these maybe simple financial statements as only the defined large companies are required to comply with accounting standards. Where accounting professionals are used for the production of these financial statements (both small and large companies), the compliance with Accounting Standards may be performed even though the business may not be considered by ASIC and hence does not have to comply with IFRS. At present there is confusion and disputes in opinions as to the impact of the introduction of IFRS. Britain and other European Union countries are also introducing IFRS, however Australia is the only country in which the standards being introduced may apply to unlisted companies (Andrews 2005).

Despite the requirement to produce GST compliance reports and the research findings on the importance of financial management skills, it is unclear whether and how (if at all) Australian small businesses use the information contained within compliance reports to help them manage their business. There is a need to consider in more detail the role of compliance reports and the possible link of compliance reports to performance reporting. Research needs to examine both the practice and attitudes: where practice refers to how information is recorded, what information or complexity of information is recorded, financial management skills (or use of accounting professionals) to produce reports and utilise financial information, and attitudes refers to the owner's motivation for business as well as the importance they ascribe to financial information in determining business success. Research has focused on accounting professionals as advisors and service providers to small business, but there is a need to identify what small business want and understand from accounting information. The question of whether small business people view the importance of utilising performance reporting needs to be asked. Answering these questions will enable the attitude to information and operational use of reports to be better understood and will provide important insights for both academics and practitioners. These are important issues to consider from both an academic and practitioner perspective as financial management skills or lack there-of play a significant role in the small business failure rates.

The key question being addressed by the study in this paper is to identify how small businesses are recording financial transactions and what financial summaries and reports are produced from this information. The small business characteristics are considered in the nature and type of recording and reporting being performed is identify if these factors impact on the recording and reporting. The research methodology and approach to a study of small business financial information reporting and use is in the following section.

## **RESEARCH PROGRAM AND METHODOLOGY**

Twenty-four per cent of the 1.23 million private sector small businesses (or of the 97% of the Australian business population) are located in the state of Victoria, which is the second highest state based population of small business in Australia (ABS 2002). A random sample of 1000 small businesses were selected from the regional towns in Gippsland in South East Victoria via the public business phone records dated 2003 (Telstra White Pages 2003). Businesses were selected from each major town in this area so that each town was represented in the sample. However due to the dynamic nature of the small business sector, these records may not be an accurate listing of all businesses operating at any point in time.

A questionnaire was developed in three sections.

- Section One - Size and Nature of small business asked questions to identify business demographic data including number of owners, length of ownership, age of business, number of employees, annual business turnover, industrial sector and business structure.
- Section Two - Nature and type of financial records and reports in small business addressed questions including business receipt and payment methods, record keeping methods source of the production of taxation reports, summarization of financial information its timeliness. The existence and use of business plans were also included.
- Section Three - Use of financial information in business addressed the issues of business performance evaluation and usefulness of financial statements and other reports if produced.

The questionnaire was piloted prior to its finalization by sending it to business owners to complete or by the researcher sitting down with the business owner as they completed the questionnaire. This enabled the researcher to consider any language or interpretation issues and address these as they were raised. The final questionnaire was mailed to 1000 businesses with an explanatory letter and a follow-up letter was forwarded to all non responding businesses two weeks later.

From the 1000 sample, 103 questionnaires were returned to sender, and 156 replies were received. This reflected a response rate of 17.4%. Of the 156 replies, 121 small business responses were useable and have been considered in the subsequent analysis and discussions. Only businesses employing less than 20 employees were selected for continuation in the study. The low response rate may reflect the perceived sensitivity of the questions. While no financial figures were requested in the questionnaire, some unusable returns did indicate that the questions were perceived as being intrusive.

## **RESULTS**

Of the 121 businesses, 31% were aged 10 to 20 years, 41% were aged 20 years or older. A significant proportion of responding businesses were long established businesses: only 18% were aged between five to 10 years and 7% were less than five years old. Some 33% of the businesses had been run by the current owner for 10 to 20 years (33%) and another 29% had been operated by the current owner for 20 years or more. Again this indicates that the businesses were well established with only 21% of respondents operating their business for 5 to 10 years and 14% operating their business for less than five years.

Most responding businesses (69%) employed between 0-4 Equivalent Full Time employment (EFT), and therefore these businesses are also micro businesses. The business turnover was found to be well spread between various ranges: 13% had a turnover of less than A\$50,000 11% had a turnover of between A\$50,000 to A\$99,999, 16% were in the A\$100,000 to A\$199,999 range, 25% were in the A\$200,000 to A\$499,999 range, 19% in the A\$500,000 to less than A\$1 million and 10% had a turnover of A\$1 million or more. In 84% of cases this business was the business owner's main source of income. In 97% of cases the business records were maintained within the business.

In Table 1 it is possible to see that the receipt of monies and payment of monies varied with most small business owners accepting multiple receipt methods and making payments by multiple methods. The use of electronic means for both receipts and payments was found to be well used in these long established businesses.

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Insert Table 1 about here

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Table 2 details the many records used to record receipts and payments. In Table 2 we see that accounting software is used more for the recording of receipts than for payments. Eighty-six businesses or 71% of respondents advised the use of accounting software for receipts whilst only 77 or 64% used software for payments.

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Insert Table 2 about here

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Table 3 details the production of the taxation compliance reports. Fifty-eight percent of small businesses produce their own BAS and 11% produced their annual taxation return. Thirty-one percent of business owners used their accountants to produce their business BAS and 87% to produce the business annual taxation return.

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Insert Table 3 about here

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Table 4 shows the type of business financial summarization performed in the businesses. The summarization of revenues is performed more extensively than the summarization of any one cost category. The summarization of revenues is also performed more extensively than net profit summarization.

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Insert Table 4 about here

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Table 5 details the production of financial statements in small business. The profit and loss statement is more likely to be produced than balance sheets or cash flow statements.

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Insert Table 5 about here

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Of the 121 businesses, 83% of business owners advised they did not have a business plan and only 17% of businesses said that they did have a business plan.

Business owners were asked to rate the usefulness or otherwise of the various statements and reports for their business. Table 6 shows their responses. The profit and loss report was rated by businesses to be the most useful report. The balance sheet and cash flow were noted to be useful to varying degrees. BAS was found to be the least useful statement. Not many businesses owners said they produced other business reports to assist in their performance evaluation.

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Insert Table 6 about here

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How the business owners knew their business was performing is provided in Table 7. The most frequent response was 'by knowing money in the bank' with 54 responses and 'performance evaluation using financial statements and financial information' ranking second with 35 positive responses.

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Insert Table 7 about here

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## **DISCUSSION**

These findings assist in explaining what small businesses are doing with respect to financial recording and reporting. The use of accounting software was noted to be high, which is consistent with research on impacts from the introduction of the GST (Breen et al. 2004). It would appear from these findings that business owners do not utilize the cost or expenses information to the extent that they utilize revenue information. The lower use of accounting software and less summarization of cost categories could imply less focus on business expenses. This requires further investigation.

The usefulness of financial statements responses requires further comment. The sum of the useful and very useful responses for profit and loss reports was 87% (or 105 businesses), however only 69% (or 84 businesses) said they had this statement. Similarly with the balance sheet the favorable responses totaled 68%, (83 businesses) yet only 53% (or 64 businesses) had these reports. The most noticeable difference was in cash flow opinions where 70% (84 businesses) reflected favorable views yet only 36% (43 businesses) had this report. Thus while business owners had a favorable view of these reports, they do not necessarily have or use these reports.

The introduction of the GST in Australia, whilst increasing record keeping and reporting, could be argued to be of some assistance for small businesses. From the responses it is clear that small business owners are more likely to produce the BAS report than use an accountant. This would suggest that business owners are looking at their own financial reports and information each reporting period. These periods are more often than the annual taxation report and so could give regular and timely information to the business owners about performance.

The high percentage of businesses with financial statements, found by this study, compares favorably with the results from DeThomas and Fredenberger (1985) and Thomas and Evanson

(1987) studies. However in this study summaries were found to be mainly produced by the business and the reports are reviewed by the business owner. Whilst in some businesses the production of reports is outsourced, only 12 businesses or 10% advised that they outsourced the summarization function. Eighty-seven respondents (72%) advised that the owner reviews the summaries.

Argilés and Slof (2003) found financial reports to be worthwhile if the costs were less than the benefits. It could be argued that for Australian small business that the benefits are possible as the costs to generate financial reports from the records being maintained would not be large. The use of accounting software already in existence in small business allows for the generation of financial statements without further costs (apart from a push of the button and a few pages of paper)!! For those businesses with manual recording, much summarization is taking place and the formalizing of these summaries to financial statements would not be too onerous.

With accountants being the largest source for annual taxation returns, the production of financial statements by these professionals from the business records should be possible for minimum costs. These professions are in a very sound position to assist small business in the review and evaluation of financial statements to gain the insight of business performance from the statements.

In a further examination of the responses from businesses with business plans it was found that a higher majority of these businesses stated they knew how their business was performing through performance evaluation than those without business plans. These businesses (with a plan), on the face of the questionnaire responses, also had higher levels of financial summarization and made greater use of financial statements.

Limitations were experienced in this study through the self completing of the questionnaires by businesses. Also business owners who are weaker in the areas of record keeping and their use may not have completed the questionnaire therefore the findings may be biased as a consequence. Due to the number of responses received from the sample population it is not possible to make generalizations about small business recording and reporting. Whilst all industrial sectors and business types and variations in business ownerships were represented in the responses, the number of replies was not large enough to be statistically representative of any one group or of small business in general.

The benefit of this program of research is to gain a greater understanding of the role of recording and reporting in terms of the following issues:

- How might accounting standards, which are currently not specific to small business be improved?
- What is the potential for accounting practitioners to increase the usefulness of accounting information?
- How may ATO reports be adapted to increase their likelihood to contain information within them to be useful for performance management?
- What is the potential for including key data information fields as identified by small business in ATO reports?

- How may advice currently given by the various government agencies and consulting entities to new and existing small business on the usefulness and role of accounting information be improved?

## CONCLUSION

The purpose of this paper was to outline a research program to explore the nature and type of financial information used by small business to produce accurate taxation returns and whether small businesses use this financial information for other purposes. Financial information has been considered for its two key elements: record keeping and reporting. Record keeping refers to what records are maintained and what they record. Reporting of these records was also considered in the context of the introduction and operation of the GST regime.

The research program focused on reporting, as required by legislation, to identify the minimum standards that should exist in all small businesses. It was found that 97% businesses maintain their business records and it is from these records that financial information is gathered. The role of general purpose financial reports and compliance reports was considered in terms of their benefits and use within small business. Whilst businesses advised that they produce financial statements to varying degrees, the usefulness of the reports was much higher rated than the actual existence of the statements. To better understand why this is the case and how the statements are used in business performance evaluation and performance management further research is required. The research will also consider the assistance provided by accounting professionals in the recording and reporting process. Benefits of the small businesses' involvement in the taxation system have been considered and whilst record keeping is a compliance issue, it has enabled small business to have financial information sufficient for business evaluation. This positive aspect should be expanded upon to assist in educating small business of the value and role of financial information in the evaluation and how they may use this information to improve and monitor operations.

## ENDNOTES

1. Where accounting professionals are involved in the production of compliance taxation reports would usually be a matter of course to produce Profit and Loss reports and Balance Sheets for all business clients. These reports are available for performance evaluation and monitoring of performance, but the question remains unanswered as to whether they are used by small business.
2. Deductions or income allowable for taxation purposes vary from usual accounting treatment in many areas. Depreciation charges is a good example where amounts claimed for taxation does not reflect the business use or consumption of the business asset. Cash accounting may be applied for taxation purposes whilst accrual accounting may more appropriately reflect business operations. That is all cash received and paid may be advised to the taxation office rather than the business transactions that occurred in the financial year. Thus ATO compliance reports vary from performance evaluation reports and may be of limited benefit to small business for performance management.

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## TABLES

Table 1 Methods for business receipts and payments

|                     | Monies Received |     | Payments Made |     |
|---------------------|-----------------|-----|---------------|-----|
|                     | %               | N   | %             | N   |
| Not attempted       | 8               | 10  | 4             | 5   |
| Cheque              | 4               | 5   | 21            |     |
| Cash                | 2               | 2   |               | 25  |
| Electronic receipts | 4               | 5   | 2             | 2   |
| All                 | 57              | 69  | 33            | 40  |
| Cheque & Cash       | 13              | 16  | 10            | 12  |
| Cheque & Electronic | 10              | 12  | 29            | 35  |
| Cash & Electronic   | 2               | 2   | 2             | 2   |
| Total               | 100             | 121 | 100           | 121 |

Table 2 Methods for recording receipts and payments

|                                   | Record of recording receipts (N) | Record of recording payments (N) |
|-----------------------------------|----------------------------------|----------------------------------|
| Did not attempt                   | 5                                | 4                                |
| Receipt book                      | 35                               | N/A                              |
| Cheque butt                       | N/A                              | 83                               |
| Exercise/Memo book                | 6                                | 10                               |
| Cash register                     | 25                               | N/A                              |
| Cash book/Accounting printed book | 23                               | 20                               |
| Accounting software               | 86                               | 77                               |
| Other                             | 11                               | 7                                |
| Total                             | 191                              | 201                              |

Table 3 Producer of Taxation compliance reports

|                  | Who completes the BAS |     | Who completes annual taxation return |     |
|------------------|-----------------------|-----|--------------------------------------|-----|
|                  | %                     | N   | %                                    | N   |
| Not attempted    | 2                     | 2   | 4                                    | 5   |
| Business         | 58                    | 70  | 9                                    | 11  |
| Accountant       | 31                    | 37  | 87                                   | 105 |
| Outside provider | 6                     | 7   |                                      |     |
| BAS not required | 4                     | 5   |                                      |     |
| Total            | 100                   | 121 | 100                                  | 121 |

Table 4 Summaries of Financial data

|                       | Yes |    | No |    |
|-----------------------|-----|----|----|----|
|                       | %   | N  | %  | N  |
| Transaction summaries | 81  | 98 | 19 | 23 |
| Sales/revenues        | 76  | 92 | 24 | 29 |
| Gross Profit          | 59  | 71 | 41 | 50 |
| Wages                 | 54  | 65 | 46 | 56 |

|                    |    |    |    |    |
|--------------------|----|----|----|----|
| Net Profit         | 50 | 60 | 50 | 61 |
| Cost of Goods Sold | 49 | 59 | 51 | 62 |
| Utilities          | 45 | 54 | 55 | 67 |
| Rent               | 34 | 41 | 66 | 80 |
| Premise costs      | 31 | 37 | 69 | 84 |
| Other Costs        | 26 | 31 | 74 | 90 |

Table 5 Financial statements produced.

|                 | Yes |    | No |    |
|-----------------|-----|----|----|----|
|                 | %   | N  | %  | N  |
| Profit and Loss | 69  | 84 | 31 | 37 |
| Balance Sheet   | 53  | 64 | 47 | 57 |
| Cash Flow       | 36  | 43 | 64 | 78 |

Table 6 Business evaluation of the usefulness of financial statements and compliance reports

|                       | Did Not Rate |     | Not Useful |    | Useful |    | Very Useful |    |
|-----------------------|--------------|-----|------------|----|--------|----|-------------|----|
|                       | %            | N   | %          | N  | %      | N  | %           | N  |
| Profit & Loss         | 10           | 12  | 3          | 4  | 35     | 42 | 52          | 63 |
| Balance Sheet         | 19           | 22  | 13         | 16 | 42     | 51 | 26          | 32 |
| Cash Flow             | 25           | 30  | 6          | 7  | 35     | 42 | 35          | 42 |
| BAS                   | 11           | 13  | 33         | 40 | 43     | 52 | 13          | 16 |
| Annual Tax Return     | 12           | 14  | 13         | 16 | 44     | 53 | 31          | 38 |
| Other Business Report | 90           | 108 | 0          | 0  | 2      | 3  | 8           | 10 |
| Other Business Report | 95           | 115 | 0          | 0  | 1      | 1  | 4           | 5  |

Table 7 Affirmations of how businesses know how they are performing

|                         | Number     |
|-------------------------|------------|
| Money in bank           | 54         |
| Performance evaluation  | 35         |
| Knowledgeable guess     | 26         |
| Just know               | 18         |
| Gut feel                | 17         |
| Other business location | 11         |
| Did not attempt         | 5          |
| Other                   | 5          |
| <b>Total</b>            | <b>171</b> |

## **ENTREPRENEURSHIP AND ECONOMIC DEVELOPMENT IN DISTRESSED NEIGHBORHOODS: DISTRESSING OUTCOMES**

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### **ABSTRACT**

Current research examining economic development in distressed areas has frequently adopted Porter's 1995 Model of Competitive Advantage. According to this approach, a business located in the inner city could accrue such advantages as: critical location, local market demand, potential for integration with regional clusters, and availability of human resources. In addition, stakeholders may view the firm's investment as a socially responsible act resulting in an enhanced image. However, businesses in distressed, urban neighborhoods have their own special set of needs. Examples include: lack of economic engines, limited access to marketing and capital, safety and security, education, and viable leadership. Subsequently, long-term resident firms may cease to create jobs; their revenue may decline; and overall revenue that might have flowed into the neighborhood, either through jobs for area residents or purchased goods and services, may decline. This paper describes the results of a recent study performed in a distressed neighborhood in the Inland Northwest. The results are typical of other such neighborhoods across the United States. Some activities are suggested for amelioration.

## **INTRODUCTION**

Economic development is a priority and challenge for most communities and their stakeholders. Local governmental bodies are interested in providing jobs to their citizens, improving their tax base, and ideally, developing a contagion effect whereby new businesses are attracted to the area. Whereas the emphasis is directed toward distressed, urban neighborhoods, there are additional, potential benefits such as decreasing the need for public assistance among local residents and improving the quality of the workforce through increased job opportunities.

There appears to be greater urgency to develop low-income, urban neighborhoods as a means to address social issues such as crime, poverty, and government dependency as an alternative to government controls. Greater impetus was added when the federal government adopted stricter regulations dealing with the receipt of public assistance benefits (Sherraden et al., 2004).

Across the U.S. a positive response toward an improved economic environment has come from the neighborhood residents themselves. In reaction to disappointing experiences in the workplace, such as layoffs or inadequate pay, some individuals have taken the initiative to create their own opportunities through entrepreneurship. In sufficient numbers, this approach may be a significant part of an overall strategy to improve many distressed areas.

## **BACKGROUND**

The nature of this research is quite varied, reflecting different research questions from

various stakeholders; different forms of economic development and assisting agencies; and different definitions of success. For years, governmental bodies have been a primary stakeholder involved in economic development as a matter of policy. Attempts to influence the actions of business typically have come in the form of tax breaks for relocating its business units or for hiring “hard to employ” individuals; reducing restrictive regulations; and consideration in improving an area’s infrastructure. Over the years, the government has also supported social programs which have attempted to train individuals with few or no job skills as a means to reduce their dependency on public assistance and to improve the skill level of the local labor market. Many of these actions have been controversial, and their value questioned both by the public and government representatives.

### **Economic Development Modeling**

Porter (1995) offered an economic model as an alternative to the social investment approach whereby the private sector assumed the leadership role rather than the government. His premise was that the competitive advantage of inner city businesses is the key to business success. In order to achieve this objective, businesses would need to approach these inner city locations as business opportunities and to forge relationships with businesses and people located there. The government’s role would be to develop a strategic approach to developing an area’s infrastructure and to funding economic development programs.

Thus while Porter (1995) posited that the chief advantages of inner city businesses were: strategic location; local market demand; integration with regional clusters; and motivated human resources. Businesses in distressed areas have their own special set of concerns.

Examples include: lack of economic engines; limited access to marketing and capital; safety and security; education, and viable leadership.

### **Microenterprises**

Another current approach to economic development focuses on microenterprise in a low-income area. According to this view, a small business owner, operating from a low-income household could experience such benefits as: increased financial assets; increased flexibility in order to manage financial responsibilities; and personal growth, autonomy, and new business prospects (Sherraden et al., 2004). These positive outcomes help to establish the foundation for a successful entrepreneurial experience in a distressed area.

Challenges inherent in this form of entrepreneurship include: only modest increases in income; lack of business knowledge and experience; and lack of capital; long hours, stress, and insecurity (Sherraden et al., 2004). As a result, business owners may revert back to traditional forms of employment.

Over time microenterprise programs have been developed to reduce some of these barriers to success. Typically, a microenterprise development program (MDP) includes: business training, particularly in the area of financial management; counseling and support to deal with job demands and challenges; and networking, in order to forge important relationships among other business owners, and other important contacts such as representatives from educational institutions, banks, local government, and economic development groups. Various programming elements then attempt to focus on the critical needs of the new entrepreneur.

Studies examining the performance of microenterprise programs have identified characteristics

that appear to be critical to success. Servon and Bates (1998) found that well-educated, skilled, and experienced entrepreneurs were more likely to be successful than less skilled counterparts.

While the educated group may not fit one's impression of the typical entrepreneur in a distressed area, they may represent a significant segment of the population.

Sherraden et al. (2004) suggested that modeling and experience might be a more accurate predictor of success. Other important variables included nontraditional types of businesses rather than the more typical small retail and personal service forms and participation in a large scale business operation (Servon and Bates, 1998). Bailey (1993) reported that financial assistance in securing loans for ambitious and talented participants and emotional support for them were critical activities. Sherraden et al. (2004) supported these findings and also identified thoughtful goals and a good market as being important. Bailey (1993) identified factors that impinged on the success of the program participants, the major one being government regulations dealing with public assistance that served to penalize the entrepreneur during the critical startup period. Business loans and capital equipment were included in the evaluation of personal assets and could result in a loss of benefits.

According to Sherraden et al. (2004), "business decline is associated with poor product choices, a poor local economy, poor business skills, and lack of business infrastructure, especially access to markets and transportation (p. 124). Overall, the literature reveals that there is a complex web of issues that need to be addressed by participants, educational institutions, established businesses, and government in order to achieve success in inner-city entrepreneurship

## **Incubators**

Incubators attempt to increase the survival rate of businesses. They provide a sheltered environment for a business, with early operational costs reduced, and critical support networks are provided (Allen and Rahmen, 1985).

## **THIS WORK**

The purposes of this work were threefold: first to review the relevant literature in order to identify instructive issues, approaches, and remedies; second, to understand the nature of the firms in a distressed area and what their needs are; and third, to provide intervention assistance that would help to ameliorate their condition, if needed, and thus support strategic economic development of the neighborhood.

## **METHODOLOGY**

Spokane, Washington's East Central Neighborhood was one of the first entitlement neighborhoods for HUD Community Development Block Grants (CDBG) in the city, and remains an urban neighborhood with extreme poverty, high crime, low business success rate, and low employment levels. As a result of a recent HUD grant

([http://66.102.7.104/search?q=cache:MvhII\\_tUeVEJ:eastcentral.spokaneneighborhoods.org/documents/](http://66.102.7.104/search?q=cache:MvhII_tUeVEJ:eastcentral.spokaneneighborhoods.org/documents/), March 9, 2005) community leaders in collaboration with the city and local colleges and universities identified three critical need areas: 1) workforce development and job training; 2) business development and sustainability to promote job creation and retention; and 3) neighborhood revitalization through the development and adoption of a neighborhood plan which addressed the issues of poverty, housing, community facilities, and services within the neighborhood.

The College of Business and Public Administration's Business Resource Center at Eastern Washington University developed a survey questionnaire in order to link neighborhood businesses and their training needs; to establish a basis for communication necessary to respond to their needs; and to develop a neighborhood business profile in order to identify broader issues of the business community.

In order to support the overall goal of the survey, questions were designed to address issues in key areas: demographic data, neighborhood marketing, employment and hiring, and neighborhood concerns. Demographic data included: firm size, firm age, property ownership, and measures of business success such as use of business plans and e-commerce.

To define their marketing activities and strategy, there were questions relating to marketing reach and short and long-term goals. Questions concerning employment and hiring addressed whether or not the business owners hired from their own neighborhood. Lastly, business owners were asked to: define the problems they saw in their neighborhood; suggest solutions; describe their knowledge of neighborhood organizations; and state if they would participate in neighborhood revitalization activities.

Respondents were solicited via direct mail to approximately 1400 known business addresses and by personal interviews. Fifty-eight businesses responded to the initial mailing, and an additional twenty-five through direct interviews. The researchers attempted to reach a broader constituency by a second direct survey of targeted business districts within the neighborhood and fifty-six additional surveys were obtained. A total of 139 surveys were returned from the East Central Neighborhood of Spokane, Washington, presenting a

| 9.3% response rate. While non-response error and a sample not being representative of the population, the results of the survey are similar to those reported in many research papers.

## RESULTS

The results indicated that the East Central businesses surveyed are small, with 56.8% having less than six employees, and only one having 100 employees (Figure 1).

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Insert Figure 1 about here.

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Thirty-seven percent (36.7%) have been at their present location for one to five years, with 13.7% having survived for over twenty-five years (Figure 2).

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Insert Figure 2 about here.

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Nearly forty-two percent (41.7%) reported that they owned their business property. When asked about business planning 61.2% said that they had a business plan. When questioned about e-commerce, 31.6% indicated that they have a webpage, and of those 86.4% used it to promote a product. Most East Central businesses (65.5%) had a regional marketing focus, compared to 56.8% that had a local market focus (Table 1).

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Insert Table 1 about here.

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When asked about business strategy and goals most said that their highest priority was to introduce new products; 22% are thinking about expansion in the short term, and 28% in the long term. Nine percent of the businesses were considering a move out of the neighborhood in the near term, and 13.7% in the long term (Figure 3).

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Insert Figure 3 about here.

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Fifty-nine percent of East Central businesses surveyed reported that they did not hire from the neighborhood, while 5% said they hired entirely from the neighborhood. Over 57% indicated that they do not plan to hire in the next six months, while 38.8% said they would. Additionally, 73% answered that they could not find trained employees in the neighborhood with teamwork skills as the most needed attribute followed by communication skills (Figure 4).

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Insert Figure 4 about here.

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## **DISCUSSION**

How does one break the cycle of poverty in a distressed neighborhood? One government funded direction was “welfare to work.” Microenterprise programs were another (Schreiner, 1999). A third had to do with planting small business incubators in distressed areas (Allen and Rahmen, 1985) leading to self employment (Dennis, 1996). Certainly distressed neighborhoods suffer from familiar challenges that developing countries face: lack of economic engines, poor access to education, lack of access to marketing channels, and low and no capital. Studies have shown that the segment of the population that benefits from

government sponsored programming are the better educated middle class that take advantage of the programming (Schreiner, 1999; Servon and Bates, 1998), taking profit from the neighborhoods and not creating significant numbers of new jobs. Further, education is identified as an important ingredient of future change for distressed area citizens (Bates, 1998).

Consistent with previous research (Schwartz et al., 1990) little has changed over the years. The major implication for distressed neighborhoods continues to be that any form of economic intervention, but without the right combination of owners, business types, and a healthy local economy that has not yet permeated the distressed areas, there is continued failure. The firms in the present study are largely survivors, and have maintained, but that does not help the area grow and prosper.

The business owners themselves provided some insight into the character of their neighborhood and the changes they would like to see. When asked about safety issues in the neighborhood, the replies overwhelmingly indicated that personal crimes were an issue. Drugs and prostitution were mentioned most frequently, and problems with transients and the homeless were second and third respectively. According to business owners, streets and related maintenance issues were a major concern in the neighborhood, followed by general cleanup. They indicated that they wanted a cleaner and more appealing looking façade. Other responses in this category ran the gauntlet, but generally indicated that the look of the neighborhood was important to attracting and keeping business.

While the survey results lend support to general strategies for neighborhood revitalization: 1) stabilize existing businesses and help them grow; 2) recruit new

businesses to the neighborhood; 3) identify and help those in the neighborhood grow new ventures, problematic is the failure of the firms to grow and the low numbers of neighborhood residents as employees coupled with the lack of interest in educational experiences that the literature indicates is critical for viability and growth. Most of the concerns then, were tactical in nature.

One result was that in the distressed neighborhood firms were generally smaller compared to the rest of the nation's firms in similar industry (NAICS) codes and the firms that had been there the longest were the smallest. The firms survived but were also not growing. Perhaps they were no-growth companies and adding more of the same type of firms with the same type of owners will not improve the economic conditions in the neighborhood.

On business planning, academic research has demonstrated that those businesses with business plans have better success rates and higher revenues. While over 60% of the respondents had a business plan, there was no strong statistical relationship between firm longevity and having a business plan. Again, though these were survivor firms. Perhaps business planning was helpful in maintaining the firm.

On e-commerce, while over 60% of the firms in the U.S. now employ e-commerce, due to the nature of the respondent firms and their goods and services or the lack of skills of the business owners related to e-commerce, only slightly over 30% of the firms reported that they maintained a webpage. The majority of the remainder indicated that they would like to use e-commerce. In addition to assistance in getting on-line and utilizing e-commerce, additional research is needed to determine the lack of interest in e-commerce.

On job creation and utilization of neighborhood residents in area businesses, almost 60% of the surveyed firms do not hire from the neighborhood. This could be due to many issues and is a topic for further study. If growing firms in a neighborhood do not result in neighborhood jobs, then how are the distressed neighborhoods helped? Bates (1989)

suggested that unless capital and education are provided in low income areas, business growth will be stultified in inner cities in the U.S. While much progress has been made in the provision of microenterprise and inner city support, development of firms in distressed areas remains a challenge, as the current study again demonstrates.

Servon (1998) discussed the importance of microenterprise programs and their networking impact on social capital. She suggested that while the networking itself was not sufficient, it was necessary to being the turnaround of the neighborhood. As a result of the networking, both internal to the stakeholders, and external to the neighborhood, recent attention has been paid to the neighborhood in terms of a potential \$100,000 reward for its efforts in the social and economic development of the area. This result supports Servon's argument. The full impact on the neighborhood firms remains for the future.

### **SUMMARY/CONCLUSIONS**

Nowak (1977) concluded that successful economic development in distressed areas is supported by appropriate public, private, educational partnerships that serve to impact the areas. Thus, without such partnerships, success will likely be more happenstance than circumstance. The local area studied had no over-abiding strategy in place. It is likely that the poor will continue to remain poor until at least a strategic focus for economic development is realized and then continued network support remains in place.

“Exulting the ‘hidden’ strengths of inner city businesses and locations is not enough to increase sales and job growth within these neighborhoods” (Weber and Schell, 2003 p. 162), contrary to what Porter postulated in 1995 (Porter, 1995). The authors found that simply facilitating networking to couple inner city firms with their ‘locational advantages’ to larger partner firms was not sufficient. Rather, they found that minority firm contacts for the large firms were an important adjunct of their work and that important linkages could be made. Of the firms studied by Weber and Schell (2003), their reasons to remain in their neighborhoods were similar to those found in this work, i.e., undercapitalization, inertia, etc. These firms were not “the beacons of growth (Weber and Schell, 2003 p. 162)” with related job creation that governments and foundations focused on for economic development hoped for. The present research results are similar.

Perhaps the conclusion is that some self selection for change is important and no matter what the nature of outside interventions is applied, only those firms that care to change will change. While not a pleasant thought, perhaps programming should only then be available to those who seek it out, and only provided as a broad brush stroke of intervention by those having the funding to support such widespread inner city development. However in the U.S. citizens are dedicated to helping those who have difficulty helping themselves, and while the reality of distressed neighborhood outcomes may continue to be distressing, helping is the “right” thing to do.

A major “bright” spot of all the neighborhood activity is the very focused group of citizens, governments, educational institutions, and outreach organizations that may

very well serve to change in a very positive way the overall neighborhood for the good of an entire city and region. That change will be the subject of a future paper.

### **IMPLICATIONS**

Results of this study are important because they suggest a means to bridge the gap between two theoretical approaches, cluster development and microenterprise development. One can recognize that there is value in small business ownership for individuals in the form of personal freedoms: improved income, independence, and flexibility. By meeting the needs of entrepreneurs and small business owners through education, training, counseling, and networking, as well as attempting to improve the general environment through crime prevention strategies, one can encourage the success of the individual small business. Importantly, a series of individual business successes, coupled with an improved business environment, where education, communication, safety and security, and partnering among public and private agencies is developed, could create a contagion effect for further economic development. On a practical scale, the study provides further elucidation of urban economics as well as the impact on an area providing some direction to those who seek to change similar distressed neighborhoods.

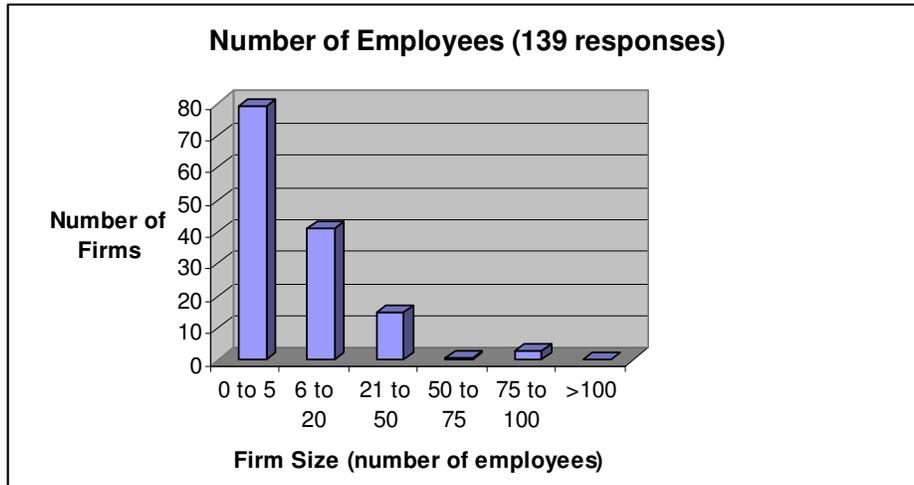
### **ACKNOWLEDGEMENTS**

Special thanks to our Urban Planning Department colleagues (Professor Dick Winchell in particular) who brought us into the East Central activity; Jerry Numbers, East Central Committee Chair et al. who welcomed us; and Ms. Rhosetta Rhodes, of the Community Colleges of Spokane, who has directed the entire program. This activity was and is an overall community activity with many important players, *the most important of all are the East Central people themselves.*

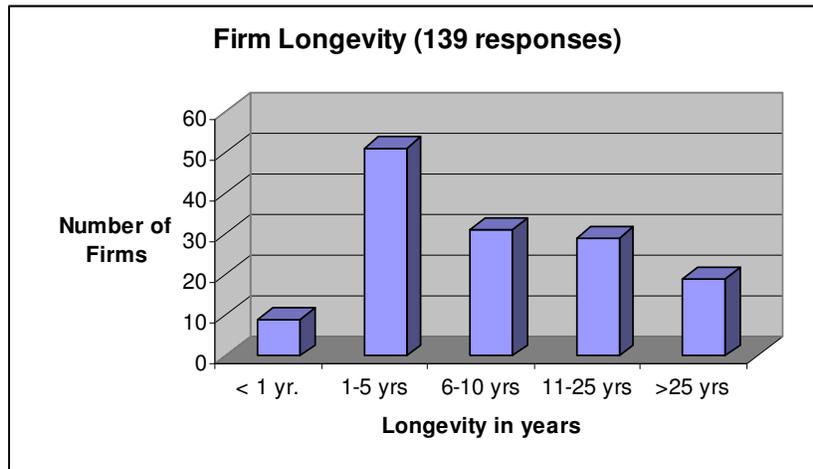
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**Figure 1**



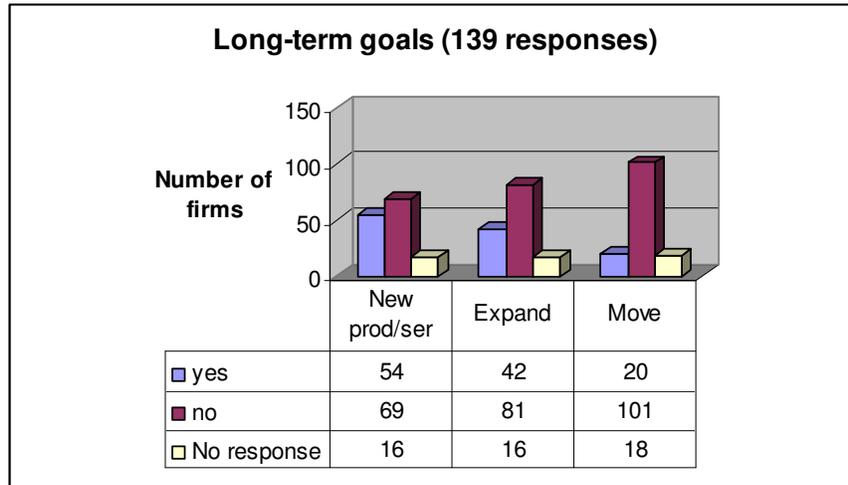
**Figure 2**



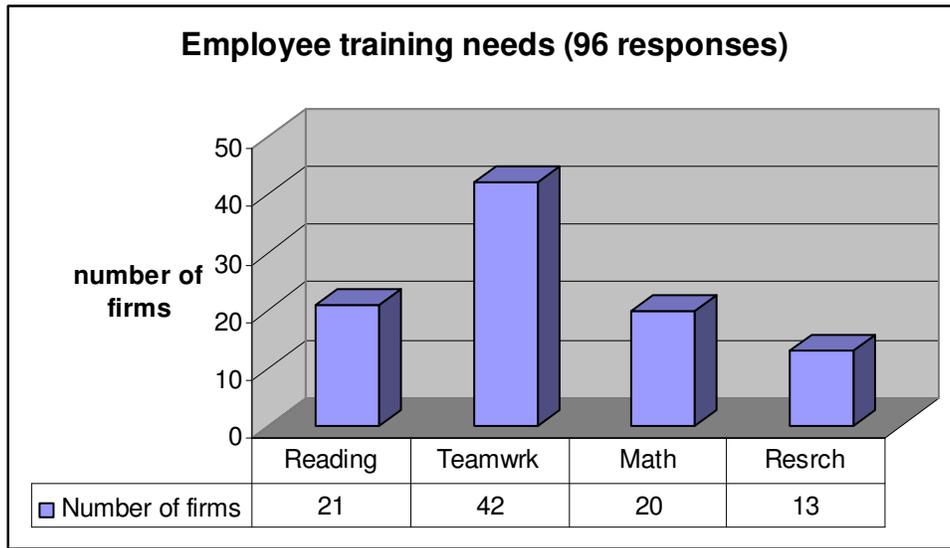
**Table 1. Market Area**

| Market Area |       |      |          |      |          |      |               |      |
|-------------|-------|------|----------|------|----------|------|---------------|------|
|             | Local |      | Regional |      | National |      | International |      |
|             | n     | %    | n        | %    | n        | %    | n             | %    |
| Yes         | 79    | 56.8 | 91       | 65.5 | 25       | 18.0 | 15            | 10.8 |
| No          | 56    | 40.3 | 44       | 31.7 | 109      | 78.4 | 119           | 85.6 |
| No r        | 4     | 2.9  | 4        | 2.9  | 5        | 3.6  | 5             | 3.6  |
| Total       | 139   | 100  | 139      | 100  | 139      | 100  | 139           | 100  |

**Figure 3**



**Figure 4**



# **THE INVESTMENT DECISION-MAKING PROCESS IN SMALL MANUFACTURING ENTERPRISES: THE CASE OF PRINTING AND CLOTHING INDUSTRIES IN THE UK**

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## **ABSTRACT**

*This study is concerned with the investment decision making process in small manufacturing enterprises in the printing and clothing industries. The focus is on the actual decision-making behaviour of owner-managers, using 'Insider accounts' as a qualitative methodology which involves in-depth, semi-structured interviews and direct observation, conducted longitudinally in 8 case study companies. It is a research method which includes detailed accounts from the actors themselves, incorporating the actual motives and behaviour of owner-managers based on the philosophy that the 'objects' studied are in fact 'subjects', who produce accounts of their world.*

*The results suggest that owner-managers use 'bootstrapping' techniques for their investment appraisal instead of formal methods recommended in the financial management literature. 'Bootstrapping' represents an approach to decision making that is grounded in previous experience of key decision makers and their organisations and the largely informal routines that they develop from this. By which owner-managers rely on experiential learning when making investment decisions, rather than formalised methods. As a result, conceptualising small firm investment decision making within the context of an organisational learning approach holds promise as an explanatory framework for investment behaviour in small firms.*

## **INTRODUCTION**

Despite the increased attention paid to owner-managers in the small firm sector, little is known about the process of financial management and decision-making in small firms and the entrepreneurship process (Deakins, Morrison & Steel, 2000). This paper attempts to shed light on the process issue by investigating how decision makers in small manufacturing enterprises behave compared with what the theories and the literature have suggested about investment decision-making. It uses a methodological approach that incorporates the actual motives, values, beliefs and intentions of owner-managers. To understand fully the process of investment decision-making in small firms, it is necessary to understand first the barriers faced by these firms and the motivations of owner-managers. These barriers are inherent in the small firm sector and range from limited resources (including investment finance and managerial expertise) to varied objectives and the concentration of decision making in the hands of one or two owners, who are closely involved in the day to day operation of the business (Burns, 1996). It is also necessary to understand the uncertain and risky nature of the small firms' operating environment (Jarvis, Kitching, Curran & Lightfoot, 1996) since investment decisions must not be considered in isolation of the barriers faced by these firms (Pike & Neale, 1993).

This paper examines the motivations and informalities of owner-managers as a logical first step to understanding the actual investment decision-making behaviour in the context of small firms. The core finding in this paper is that small firms use 'bootstrapping' techniques (Winborg & Landstrom, 2001) in their investment decision-making instead of formal methods recommended in the financial management literature. These are largely informal routines providing 'satisficing'

solutions, which although not explicitly rational, are boundedly rational. In other words, they are rational within the context of owner-managers' perceptions, knowledge and experience.

In this context the more specific aims of the paper are to:

- analyse the investment decision-making process of small manufacturing enterprises and to assess the methods actually used in relation to those that could be used.
- assess the extent to which investment decisions in small firms are based on previous learning experiences of decision makers.

Following a review of previous literature and methodology employed in the study, the findings from 8 case studies is presented. The final section summaries the main themes emerging from the findings.

## LITERATURE REVIEW

### Investment Appraisal

The search for reliable techniques for investment decision-making is currently discussed in the literature as existing traditional mainstream techniques (such as discounting cash-flow (DCF) and payback) are said to be inadequate in certain situations (Akalu, 2003). These situations include the evaluation of investment in research and development (R&D) and technological innovations, mainly because of the intangible nature of the benefits involved (Irani & Love, 2002; Shank, 1996; Slagmulder, Bruggeman & van Wassenhove, 1995); and coping with the uncertainties of the environment (Akalu, 2003; Thomas, 2001). In this regard, DCF is found incomplete and may lead to decisions that destroy the value of the firm. Consequently, the management is led to select such projects on intuition, experience and rule of thumb methods (Shanks, 1996). This issue is not only a matter of concern for academics or managers but is also becoming more and more important to stakeholders of a company (Akalu, 2003).

The use of DCF, in its principal form of net present value (NPV) and internal rate of return (IRR), has been given much attention in the literature. The textbook method for establishing a business case for a project is to perform DCF analysis, using the most likely cost and benefit estimates (Thomas, 2001). In DCF analysis, the value of a project to an investor is its NPV, which is the net stream of cash flows attributable to the project, discounted at the opportunity cost of capital. The theory holds that one should pursue a project with a positive NPV (i.e. an NPV greater than zero).

The Payback method estimates the period of time taken for the future net cash inflows to match the initial cash outlay. In other words, it measures the length of time taken to recoup the original investment. Whilst theory have condemned the use of payback as misleading in making investment decisions because of its theoretical weaknesses, which include ignoring all cash flows beyond the payback period and failing to take account of the time value of money, it continues to be widely applied as an appraisal technique (Brien, 1997). Whereas more sophisticated techniques attempt to model the uncertainty surrounding investment returns, payback assumes that risk is time related; that is, the longer the period, the greater the chance of failure (Lumby, 1994).

The continuous application of traditional methods reveals significant limitations in their capacity to address the above basic problems of investment appraisal (Akalu, 2003; Lefley, 2000). Even within large firms other techniques have been proposed that can provide meaningful guidance since traditional techniques have fallen short (Graham & Harvey, 2001; Arnold & Hatzopoulos, 2000).

Such techniques include the Real Option technique, which is based on the market priced risk and return embodied in the asset value (Cho, 1996; Dixit & Pindyck, 1995). It also includes economic value added technique (EVA), which is defined as a technique that provides unambiguous metric-value upon which an entire organisation is built (Stewart, 1991). These techniques are condemned for their inability to measure the shareholder value creation in a company (Fernandez, 2001).

The above methods are based on Neo-Classical assumptions namely that the objective of the firm is to maximise profits, and that the firm operates within a perfectly competitive market. These approaches to investment decisions assume that there are capital projects to be appraised; that cash flows from projects aim to maximise owners wealth; that management always act in the owners' best interest; that the future cash flow can be isolated/estimated; and that cash flows are discounted at the opportunity cost of capital. However, this type of literature hardly deals with how projects are generated and why projects are considered. It is usually assumed that there are capital projects to appraise (Shank, 1996).

These problems are even more acute in the small firm context than in large firms. Firstly, the small firm's financial and operational environments are more unstable (Jarvis et al, 1996). Secondly, the investment decision-making of small firms may be more influenced by behavioural factors, focusing on what firms actually do, with organisational perspectives including the influence of firm characteristics (Deakins et al, 2000). These approaches are referred to as the behavioural/organisational theories of the firm. The behavioural theory of the firm states that a firm is a coalition of participants with disparate demands, changing foci of attention, and limited ability to attend all organisational problems simultaneously (Cyert & March, 1963). Organisation theory is an extension of the behavioural theory of the firm which places considerable emphasis on the study of processes i.e. what goes on in an organisation, and the organisational decision-making processes (Cyert & March, 1963).

Unlike neo-classical theory of the firm, the behavioural and organisational approaches emphasise that, in fact, the firm is a complex organisation where information is far from perfect, with decision makers possessing varying abilities and a range of motives with both economic and social dimensions that cannot so easily be reduced to a simple profit maximisation motive (Spence & Rutherford, 2001). It is argued in this study that in small firms (whether it is a one-person firm or it has other employees) there are various interest groups such as the stakeholders who have legitimate interests in the activities of the firm and a good deal of influence in how it operates, and therefore there is an organisational aspect to decision-making.

The core argument in this study is that although the behaviour of small business owners is not explicitly rational, it is boundedly rational because their knowledge is acquired through experience and the learning process, and their actions and decisions are also based on what they have learned through experience and interaction with stakeholders. In the literature, this process is referred to as organisational learning.

### **Organisational Learning in Small Firms**

Organisational learning is one of the neglected areas of the small firm research (Chaston, Badger, Mangles & Sadler-Smith, 2001). Consequently, Deakins (1998) argues that our knowledge and understanding of the interaction of learning and the entrepreneurship process is limited. The ability of the owner-manager to learn from decisions, from mistakes, from experience and from their networks is crucial to their decision-making behaviour and the ability of the small firm to survive

(Gibb, 1997). This type of learning entails not only reacting or adapting to the environment in order to cope with it and survive but it also entails "generative" learning which embodies the capacity to create and 'bring forward' experience, rather than wait for (and learn from) it" (Gibb, 1997, p.17). Organisational learning involves the acquisition, distribution, storage and interpretation of information (Boussouara & Deakins, 2000). Thus, learning does not necessarily have to result in changes in behaviour, rather it offers the potential to behave differently (Cope & Watts, 2000). Polanyi (1967) distinguishes between tacit knowledge or implicit knowledge which is not codified and explicit, formal knowledge which is codified.

Therefore, learning in small firms is a complex process of continual trial and error (Williams, 2001). It is often unintentional, incidental or accidental (Matlay, 2000b). It is also a process of learning from peers; of learning by doing; of learning from feedback from customers; of learning by copying; of learning by problem solving and opportunity taking; and of learning from mistakes (Gibb, 1997).

## **METHODOLOGY**

In recent years there has been an increasing call for a greater use of qualitative methodology in small firm research. This study uses qualitative methodology because it is about the study of decision-making process (Deakins et al., 2000; Gummerson, 1991) and because the 'how or 'why' questions are being asked about contemporary set of events over which the researcher has little or no control (Yin, 1994). Gibb (1997) argues that objective studies of business requirements using questionnaires and check-lists, and generally positivist-type approaches, do little to help answer the basic questions relating to process. Without answering these questions it is impossible to recommend how practices can become more effective.

Moreover, a qualitative methodology, based on detailed accounts of the actions of owner-managers, was judged to be the most appropriate since the aim of the present study is concerned with investigating the process of investment decision making within the context of organisational learning. The behaviour and actions of owner-managers as they occur in everyday life were also observed (Curran & Blackburn, 2001; Shaw, 1999). Therefore, in order to develop an understanding of the process and capture the 'full range of data nuances and conditionality' when decisions were actually being made (Mason & Rogers 1997, p.31), a strategy known as 'insider accounts' was developed and used as the appropriate qualitative research method (Hammersley & Atkinson, 1995).

As operationalised in this study, 'insider accounts' involved in-depth, semi-structured interviews and direct observation, conducted longitudinally in 8 case study companies. The philosophy underpinning 'insider accounts' is that the 'objects' studied are in fact 'subjects', and they themselves should produce accounts of their world. Therefore, 'insider accounts' can provide a basis for understanding the behaviour of small firms and the motivation of owner-managers, thus helping to answer basic questions relating to process. An important feature of the approach is its capacity to elicit descriptions, explanations, and evaluations of every aspect of owner-managers' actions. Thus, 'insider accounts' generate owner-manager's knowledge which can be tapped and treated as the basis of an alternative conception of appropriate techniques for smaller businesses.

## **EMPIRICAL EVIDENCE AND DISCUSSION**

The term 'process' is used in this study to mean how and why decisions are made. It involves identifying key elements in decision-making and how they interrelate with each other. The

analysis of the evidence suggests that investment decision in small manufacturing enterprises involves mainly the evaluation of alternatives and the choice of alternatives, although in practice, these elements are not necessarily separately identifiable.

### **Evaluating Alternatives**

A key element in the investment decision-making process in small firms in the study was the evaluation of alternatives. Evaluating alternatives involved comparing the specifications of all the machines involved, as well as the resale value of the machines and their relationship to the development strategy of the business. This process typically included attending demonstrations, which provided an opportunity to see the specifications and prices of equipment, as well as to talk to other people in the industry and to learn from their experience. This is captured by the owner-manager of Company 2's description of the investment decision-making process of his company:

*"We attend demonstrations and talk to other people in the industry to know what they have got and what problems they have had".*

This analysis also established that demonstrations also provide the opportunity for a 'trial run' of the work the machine would be used for. An extract from a tape-recorded interview with the owner-manager of Company 3 provides an insight into this process:

*"At demonstrations we take what we consider to be the most difficult job and ask them to do it on the press for me and the operator to see how it works and how the various components work. If it looks okay and does what we consider to be a difficult job easily that goes to prove that it is a good machine".*

Therefore, from the above quotes it can be seen that investment evaluation in the case study firms was based more on the technical reliability of the equipment rather than the cost-benefit analysis suggested in the literature. This is mainly because, for a small business owner, equipment must be technically reliable, easy to maintain and capable of producing good quality products. In other words, the informality is appropriate to needs and encourages flexibility. It not only seems to work, but it is effective and based on learning by doing rather than something which is formally taught. The usefulness of attending demonstrations is illustrated by the following comments from the owner-manager of Company 3 during the third interview:

*"You learn a lot from demonstrations, from the experience of the suppliers. The ability to stand back to see what the machine can do is very important and very useful".*

This owner-manager believes that the underpinning knowledge gained in taking part in demonstrations has been critical when faced with 'real life' incidents and, importantly, believes that it enables him to reflect and intellectualise any learning that took place.

### **Choosing From Alternatives**

Another element of the decision-making process is choosing between alternatives. For non-routine investment decisions, owner-managers typically relied on feedback from customers, as well as on technical advice from equipment suppliers and machine operators. The respondents

cited examples of how they had learned skills and insights from stakeholders, particularly equipment suppliers and key employees.

*(i) The role of customers*

The ability of owner-managers to respond speedily to customer demands was particularly important in the printing sector. In Companies 1 and 2, for example, customers increasingly wanted just-in-time printing which required the acquisition of new technology equipment, including direct digital colour and computer-to-plate (CTP) equipment, which were expensive, compared to clothing firms where equipment typically cost much less. In some of the clothing firms, the influence of customers on investment decisions was direct, when equipment was purchased to meet the needs of specific customers. For example, in Company 6 the bulk order for casual wear required the use of twin-needle machines, which the firm did not previously have but was compelled to acquire. In the 'cut-make-and trim' (CMT) clothing firms, a subcontract relationship existed with customers, which involved major customers having a direct impact on investment decisions, when the changing requirements of major customer affected long-term bulk contracts, with possible implications for the equipment required.

Learning from customers took place through a continuous feedback process between customers and management. This was the case in Company 5 where the owner-manager was able to ascertain the standard of the quality of their products through feedback from customers, which in turn determined the need for their investment. Thus owner-managers learned from customers as part of a network and use them to scan the wider business environment and to define, meet and bring forward their future needs (Gibb, 1997).

*(ii) The role of equipment suppliers*

The role of equipment suppliers in the investment decision-making process became clearer by the time of the third visit, because initially some owner-managers denied that equipment salesmen were an important influence. For example, the owner-manager of Company 1 (as well as others) initially denied receiving advice from equipment suppliers, but in the third interview when he 'opened up', it became apparent that their role was considerable. With new technology assets, such as CTP and direct digital colour presses particularly, the owner-manager of Company 1 was found to rely more on the equipment supplier in terms of seeking information and assurances, than in the case of conventional equipment because they were much less familiar with digital printing technology. This liaison is conceptualised in this study as a learning process where the owner-manager draws from the experiences of others because he is not familiar with the situation. Equipment suppliers are much larger companies than their customers and therefore are able to invest in research as digital printing technology is still being refined (Smallbone et al, 2000).

The owner-manager of Company 1 revealed the extent to which the advice received from equipment suppliers was useful after the purchase of the 'computer-to-plate' (CTP)<sup>1</sup> equipment. He revealed during the third interview that he had not only learned from the experience of the equipment suppliers, but that their advice actually fed into the choice of alternatives. The owner-manager explained:

*"They helped tremendously not only by providing us with advice about the CTP but also by providing technical support and training. They 'll probably continue to offer us with the benefit of their experience for a long time".*

This illustrates a continuous learning process, which has been identified as a key influence of competitive success (Sullivan, 2000). When asked specifically about what was learned from the equipment suppliers the owner-manager emphasised:

*"The advice and support gave us more confidence when we were going to buy our B2 Xeikon digital press. Our heavy dependence on them (equipment suppliers) has lessened as we now feel more able to cope with the technology ourselves. I now feel more confident to make these decisions myself".*

This owner-manager believes that the skills and knowledge gained in taking advice from equipment suppliers during the purchase of the CTP had been critical when subsequently faced with the purchase of the B2 Xeikon digital press<sup>2</sup>. He believes that the advice enabled him to dissect, reflect, learn and act on the critical incident, thus leading to a change in behaviour.

### *(iii) The role of key employees*

There were varying degrees of involvement of key employees in all stages of the investment decision-making process, but was prominent at the evaluation stage, when key employees would attend demonstrations with owner-managers to check out equipment specifications and prices. They also inspected equipment in action in an ideal working environment with owner-managers to determine their technical reliability. This emphasises that investment appraisal did not involve cost-benefit analysis but rather simply appraising whether or not the equipment could do the job that it was supposed to do. In other words, the process was a technical appraisal rather than financial appraisal.

Whilst the management style of owner-managers often tends to be autocratic and underpinned by a reluctance to delegate decision-making (Burns, 1996), key employees in Companies 1, 2 and 3 in the printing industry and Company 5 in the clothing sector were substantially involved in the investment decision-making process. The owner-manager of Company 1 indicated that he, together with the production manager, inspected equipment in an ideal or working environment:

*"We [the owner-manager and the production manager] go and see some demos and look at different pieces of kit...and think, well, will it work for us?" [Owner-manager - Company 1].*

The above claim was verified in a separate interview with the production manager. His involvement in the decision-making process is demonstrated in the following extract:

*"We [the production manager and the owner-manager] go and look at different pieces of kit and then we say which one will slot in the easiest into the way we work already, and how much time is it going to take us to get us up and running on it and working a 100%" [The production manager - Company 1].*

The above extract from the interview with the production manager illustrates the nature of the feedback process and the extent to which his opinion and assessment was actually taken into

account. The use of the word 'we' by both the owner-manager and the production manager in the above quotes suggests a form of 'collective activity' (Wyer et al, 2000). The extent to which the opinion of the production manager was taken into account was apparent when the owner-manager revealed a "*major incident*" that took place a couple of years back where he, contrary to the advice of the production manager, purchased a fully computerised Dainippon Camera<sup>3</sup> for £18,000 which is hardly ever used. The owner-manager recalled that at that time he had the problem of recognising and trusting the ability of key employees. The result was that the owner-manager not only made a poor investment decision, but the business suffered because of the tension, confusion and the internal conflict that the situation created. The owner-manager reflected on the situation and how he has learned from it:

*"I have learned to trust him basically and to recognise that he is a huge asset to the company. I don't ignore him any more. I have come to respect his views and opinions, I have completely changed"*.

This owner-manager has actually learned from his mistakes and has changed (Gibb, 1997). He has now learned to delegate and to trust his key employees for their technical expertise.

## CONCLUSIONS

The findings in this study revealed that what the owner-managers were actually doing was finding their own solution to a problem. They did this by using an approach that may be characterised as 'making do' or 'patching things' together, where instead of using established methods or procedures they found ways round problems. This approach is conceptualised in this study as 'bootstrapping' techniques (Winborg & Landstrom, 2001). Bootstrapping represents an approach to decision making that is grounded in the previous experience of key decision-makers and their organisations and the largely informal routines that they develop from this. The concept of bootstrapping is not simply a way of owner-managers finding a solution to a problem or a sort of 'fire-fighting', it is a notion of what they are bringing to solve the problem i.e. reliance on past experience. In this sense, bootstrapping is a form of learning behaviour. It is essentially a trial and error learning process which brings knowledge, skills, values and attitudes together and provides owner-managers with an opportunity to evaluate outcomes associated with investment based on previous experience.

Although not a policy paper, the evidence presented here does have some implications for policy. The evidence suggests that rather than focusing on formalised training courses teaching prescriptions, a more productive approach might be to place entrepreneurs into potential learning situations. This means creating a decision making environment which is sensitive to the motives and values of owner-managers. It also involves gearing training activities to practical problems, tailor-made and specific to the business in an informal manner.

## NOTES

1. CTP is a printing press that enables digital input into the plate-making process and speeds up the workflow between pre-press and press.
2. B2 Xeikon digital press is a direct digital printing press that allows digital pre-press information to flow directly to the press, facilitating variable image printing for just-in-time (JIT) short-run personalised jobs.

3. Dainippon Camera is a fully computerised camera with 'densometer' checking for halftone values used for taking pictures of design and artwork.

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**Capturing Variations in Attitudes and Intentions:  
A Longitudinal Study to Assess the Pedagogical Effectiveness of  
Entrepreneurship Teaching Programs**

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The multiplication of Entrepreneurship Teaching Programs (ETP) and the increasing level of resources allocated to these initiatives has generated a growing interest from funders and academics about the effectiveness and efficiency of ETP programs as well as the identification and diffusion of best practices. Realizing the underlying complexity of ETP program assessment, several researchers have explored new and alternative methods to program evaluation, taking into consideration direct programmatic impacts, such as new venture and job creation, as well as indirect impacts (increasing entrepreneurial spirit) on economic development. According to several studies, limiting the evaluation of ETPs to direct micro-economic impact (new venture and job creation) can often be misleading and short-sighted. Because the impact of these programs on participants is diversified across several disciplines, industries, and markets, the effectiveness of ETPs may not be readily or immediately apparent.

Furthermore, ETPs can vary widely across countries and educational institutions, in terms of short term objectives, target audiences, format and pedagogical approaches. For this reason, a need exists to design and develop a common framework to evaluate, compare, and enhance the structure of those programs. The proposed framework should include both a set of clearly identified criteria and a methodology for effective measurement. At the same time some authors underscore the need for developing new assessment indicators (Moro, Poli and Bernardi, 2004; Hytti and Kuopusjärvi, 2004).

Based on these observations, our paper will present a study of a new methodology designed for ETP assessment. This methodology will use the theory of planned behaviour (Ajzen, 1991 and 2002), as described by Fayolle (2005). The first study was reported by Fayolle and Gailly in 2003. The objective of our research is to apply our theoretical and methodological framework to

an study consisting of a 3-day- pedagogical process, with a sample of 275 French students working on a Specialised Masters in Management.

Our research sample is composed of students who recently started a one-year specialised management program at a business school ranked among the top four in France. This business school has been promoting and diffusing the entrepreneurial spirit throughout its program and curriculum over the past twenty years. Before attending the specialised masters, students have received a degree at the Master of Science level, usually in technological disciplines from French engineering schools and technological universities.

At the beginning of the masters program, students are intensively trained for several weeks to acquire fundamental managerial skills and competencies. Upon completion of this portion of the program, they are trained and educated according to their chosen specialty. During their first weeks in the masters program students are all engaged in a 3-day case study related to entrepreneurship. We have used this pedagogical event as a study for our research program, applying our methodology in a longitudinal way to capture student variation in attitudes and intentions through the 3-day program. To begin our *first phase of research*, we administrated a questionnaire at the beginning of the program, to measure attitudes (antecedents of intentions) and the level of entrepreneurial intentions. All antecedents and measures were derived from literature focused on theory and previous empirical research on intentionality.

In our *second phase of research*, we administrated the same methodological conditions in a follow-up questionnaire to measure the same variables, with a specific emphasis on assessing the influence of the pedagogical process on the eventual variation of entrepreneurial intentions.

The results have been analysed for the entire group as well as through a segmentation of the sample into sub-groups based on various factors influencing entrepreneurial intention.

In a first section of our paper, we study the entrepreneurship literature dealing with issues of ETP impact. The second section presents our theoretical approach which is based on the theory of planned behaviour. It is important to note that the theory is used not as a predictor of the entrepreneurial behaviour, but as a powerful model of conceptualising entrepreneurial intention and its antecedents. The third section describes the details of our study, including the sample and the research material. It also presents and discusses our results. In the conclusion, we develop the theoretical and practical implications of the research, commenting on its limitations and avenues for future research.

## **1. THE IMPACT OF ENTREPRENEURSHIP EDUCATION PROGRAMS**

Throughout the world, student interest in entrepreneurship as a career choice is growing (Brenner et al., 1991; Hart and Harrison, 1992; Fleming, 1994; Kolvereid, 1996), while interest in traditional professional employment in big business is gradually declining (Kolvereid, 1996). The orientations and behaviours of students and young graduates are influenced by a number of personal and environmental factors (Lüthje and Franke, 2003). Empirical research has shown that the presence of entrepreneurship education programs (ETPs) and a positive image of entrepreneurs within the university are both incentives for students to choose an entrepreneurial career. Johannisson (1991) and Autio and al (1997) underscore the impact of students' perceptions of entrepreneurship,, along with resources and other support mechanisms available in the university environment, on positively influencing student attitudes towards entrepreneurial careers. Other research has shown the importance of the social status of entrepreneurial activities and situations (Begley and al., 1997) and the statistical link between the level of entrepreneurial intention and the number of management courses taken by students enrolled in other programs (Chen and al., 1998).

Entrepreneurship education and training influence both current behaviour and future intentions (Kolvereid, Moen, 1997; Tkachev, Kolvereid, 1999; Fayolle, 2002). In other words, there are significant differences between students who have taken entrepreneurship courses and those who have not. However, the question is if the causal relationship between the educational variables (course content, teaching methods, teacher profile, resources and support, etc.) and the direct intentional and/or behavioural antecedents (attitudes, values, knowledge, etc.) can really be explained in detail? While findings of researchers who have attempted to do this are summarized below, we still believe there is a need for further conceptualization and testing.

Attempts have been made to compare the intentions and/or behaviours of students from different groups. For example, Varela and Jimenez (2001), in a longitudinal study, chose groups of students from five programs in three universities in Columbia. They found that the highest entrepreneurship rates were achieved in the universities that had invested the most in entrepreneurship guidance and training for their students.

Noel (2001) looked specifically at the impact of entrepreneurship training on the development of entrepreneurial intention and the perception of self-efficacy. The students in the sample had all taken an entrepreneurship education program and were graduates in entrepreneurship, management or another discipline. Noel's findings at least partially confirmed the assumption that the entrepreneurship graduates were more likely to launch businesses and had a higher level of intention and a more developed perception of self-efficacy than students in the other two groups.

Other researchers have tried to explain the relationship between entrepreneurship programs and individual characteristics, such as need for achievement and locus of control (Hansemark, 1998) or the perception of self-efficacy (Ehrlich and al., 2000). They found that entrepreneurship education had a positive impact, enhancing these characteristics and the likelihood of entrepreneurial action at some point in the future.

However, less attention has been paid to educational variables. Dilts and al. (1999) attempted to show that certain teaching methods (traineeships and field learning) are more successful than others at preparing students for an entrepreneurial career. Lüthje and Kranke (2003) discuss the importance of certain contextual factors within the university environment which hinder or facilitate access of technical students to entrepreneurial behaviours. Their findings confirm those of Autio and al. (1997) and Fayolle (1996), which were obtained using similar samples.

## **2. THE THEORETICAL MODEL OF THE RESEARCH**

The above contributions show that it is possible and relevant to use the theory of the planned behaviour to study the emergence and development of entrepreneurial intention. Regarding specific research focusing on students, while some considered the role of institutional surroundings as significant (Autio and Al, 1997), the type of training and programs was not explicitly taken into account. Little is known about the impact of such variables connected to the formation of entrepreneurial intention, based on the antecedents of the model of Ajzen (1991; 2002).

The theory of planned behaviour is an extension of the theory of reasoned action (Ajzen and Fishbein, 1980), including the factor of "perceived behavioural control".

The central factor of this theory is the individual intention to perform a given behaviour. Intention is the cognitive representation of a person's readiness to perform a given behaviour, and is considered to be the immediate antecedent of behaviour. The first claim is that intention is the result of three conceptual determinants:

- *Attitude toward behaviour.* The degree to which a person has a favourable or unfavourable evaluation or appraisal of the behaviour in question (Ajzen, 1991). When new issues arise requiring an evaluative response, people can draw on relevant information (beliefs) stored in

memories. Because each of these beliefs carries evaluative implications, attitudes are automatically formed.

- *Subjective norms*: Perceived social pressures to perform or not to perform the behaviour (Ajzen, 1991); in other words, the subject's perception of other people's opinions of the proposed behaviour. It is possible for these pressures to have a strong or weak role in creation of intention. For example, in France, the failure of a company is often negatively perceived whereas in the United States, a person can often undergo several failures and still undertake new attempts at creating a successful business.
- *Perceived behavioural control*: Perceived ease or difficulty of performing a behaviour (Ajzen, 1991). This concept was introduced into the theory of planned behaviour to accommodate the non volitional elements inherent, at least potentially, in all behaviours (Ajzen, 2002). Krueger and Dickson (1994) show us that an increase of perceived behavioural control increases the perception of opportunity.

The model used to assess the impact of ETP is presented below (Figure 1). In this model, an ETP is assessed based on its impact on participant's attitudes and intentions regarding entrepreneurial behaviour (Fayolle and Gailly, 2003; Fayolle, 2005).

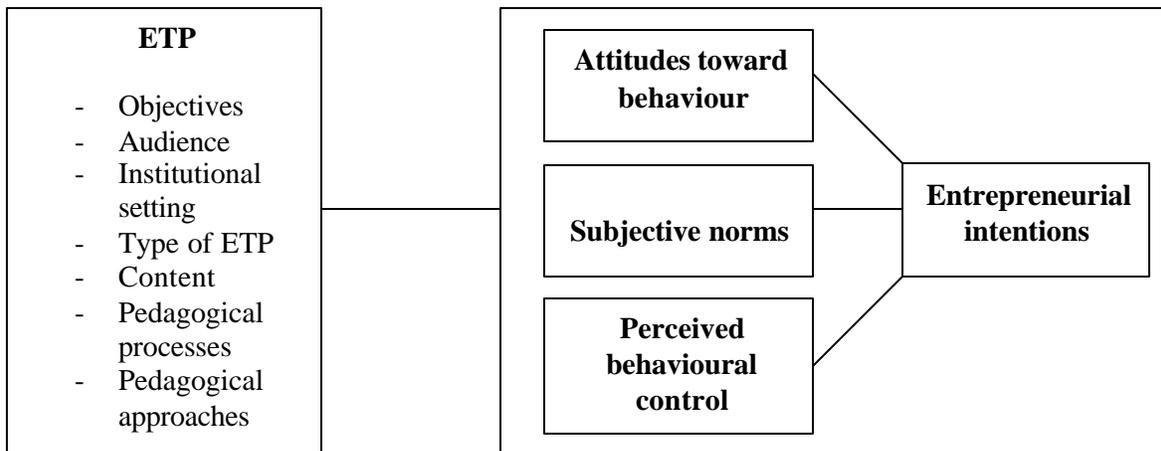


Figure 1: ETP Assessment model

In this model, the independent variables are the characteristics of the ETP that one wishes to assess or compare. These variables can be related to the ETP itself (whether or not it was attended) or to some specific dimensions related to its objectives, content (Gibb, 1988; Wyckham, 1989; Gasse, 1992; Ghosh and Block, 1993), teaching approach, audience or institutional settings (Safavian-Martin on, 1998).

In particular, Johannisson (1991) identifies five content levels for the development of entrepreneurial knowledge that can be used to characterize the content dimension of ETP: the know-why (attitudes, values, motivations), the know-how (abilities), the know-who (short and long-term social skills), the know-when (intuition) and the know-what (knowledge). Similarly, (Develay, 1992) distinguishes three dimensions of teaching approaches: content strategies, relationship strategies and acquisition strategies.

The dependent variables in the model relate to the antecedents of entrepreneurship behaviour as defined using Azjen's theory, i.e. measures of attitude toward the behaviour, subjective norms,

perceived behavioural control and intention. Those are measured through surveys of the participants completed before and after the ETP.

The key strength of this approach is that it does not attempt to assess the impact of ETP specifically in terms of specific entrepreneurial behaviour, which is difficult to evaluate because it is multidimensional, subject to delayed effect and strongly influenced by environmental factors. In particular, entrepreneurial behaviour tends to be more affected by external factors than the examples cited by Ajzen (1991), which are behaviours that can be mostly controlled by the individuals concerned. Examples of these types of behaviours include the decision to stop smoking, short-term elective preferences or the choice of whether to breast-feed a baby. The impact of the ETP is measured in terms of changes in attitudes and intentions, which are antecedents of the behaviour and for which the theory of planned behaviour and its applications provide validated measurement methodologies (Kolvereid, 1996). Furthermore, the changes in those dependent variables can then be correlated with the independent variables, i.e. the specific characteristics of the ETP considered.

This allows measurement and/or comparison of the impact of specific ETP while also testing whether that impact is affected by specific aspects of the design and/or execution of the ETP. The latter implies that this framework can be used not only to assess, but also to improve the design and execution of ETP, by linking specific characteristics of the program with particular outcomes of participant attitudes and intentions.

### **3. EXPERIMENTATION AND EMPIRICAL RESULTS**

In this section, we will present the experimentation and the main empirical results from the survey we conducted both before and after students followed an entrepreneurship training program. We describe the sample and test several hypothesis regarding the intention model and how its antecedents are effected by the ETP and student background, using standard statistical procedures (SPSS).

#### **Study**

Our study is a short-time one. It is supported by a 3-day seminar focusing on the evaluation of new venture projects, mainly through their business plans. This seminar aims to increase student awareness of entrepreneurship and to help them understand some main issues in relation to entrepreneurs and their own entrepreneurial projects. The seminar covers many of the key dimensions of the entrepreneurship and specifically the context of new venture projects. Students work in small groups (4-5) and interact with entrepreneurs and professors specializing in entrepreneurship, during the seminar.

At the beginning of the program, we administrated a questionnaire to the 275 participants in order to capture their attitudes and measure the level of their entrepreneurial intentions. As discussed earlier, we used measures derived from social psychology literature. At the end of the 3-day program, we measured these same variables in similar methodological conditions.

The two questionnaires (before and after the ETP) were sent to 275 students and included 47 Likert-scaled items related to the parameters of Ajzen's intention model (attitudes towards the

behaviour, subjective norms, perceived behavioural control and intention) and 23 questions related to the students background (age, gender, entrepreneurial experience, etc.). Our research material is derived from the questionnaires developed and validated by Kolvereid (1996), for the measure of the parameters of Ajzen's intention model. Each item is scaled from 1 to 7 and different model parameters are measured as the average score of a predefined set of items.

As stated above, the research material also included items related to what is usually called "demographic" variables (Robinson et al., 1991) and students background variables (previous entrepreneurial experiences and exposure). Finally, we also measured the extent to which entrepreneurial knowledge and skills are acquired by participants, using a specific approach developed by Johannisson (1991).

### **Sample analysis**

Among the questionnaires, 131 answers out of 275 were incomplete or inconsistent (52% valid response rate). An answer was considered inconsistent if the standard deviation of the items related to one of the parameter of Ajzen's model was greater than 2 (given the 1 to 7 scale).

The average age of the respondents was 25 and all but 7 were French.

The main statistics regarding Ajzen's model parameters before and after the ETP are presented below:

Table 1 : Survey results.

| Measure                                       | Number of items | Average score | Standard deviation | Crombach's alpha |
|---|-----------------|---------------|--------------------|------------------|
| <i>Before the ETP</i>                         |                 |               |                    |                  |
| Attitude towards the entrepreneurial behavior | 32              | 5.01          | 0.54               | 0.86             |
| Attitude related to subjective norms          | 6               | 3.69          | 0.96               | 0.77             |
| Attitude related to perceived control         | 6               | 3.86          | 0.75               | 0.7              |
| Entrepreneurial intentions                    | 3               | 3.90          | 1.24               | 0.83             |
| <i>After the ETP</i>                          |                 |               |                    |                  |
| Attitude towards the entrepreneurial behavior | 32              | 5.00          | 1.52               | 0.87             |
| Attitude related to subjective norms          | 6               | 3.67          | 0.91               | 0.75             |
| Attitude related to perceived control         | 6               | 3.95          | 0.76               | 0.75             |
| Entrepreneurial intentions                    | 3               | 3.97          | 1.25               | 0.86             |

Before testing the impact of the ETP, we tested the validity of Azjen's model (i.e. whether the antecedents were good predictors of the entrepreneurial intention) before and after the ETP. The result of the corresponding linear regression is presented below. Please note that the measures of the antecedents were significantly correlated (correlations ranging from 0.3 to 0.6,  $p < 0.01$ ).

Table 2 : Validation of Azjen's model.

| Variable                                      | Value | Standard deviation | Significance |
|---|-------|--------------------|--------------|
| <i>Before the ETP</i>                         |       |                    |              |
| Attitude towards the entrepreneurial behavior | 0.40  | 0.17               | 0.02         |
| Attitude related to subjective norms          | 0.57  | 0.09               | 0.00         |
| Attitude related to perceived control         | 0.23  | 0.12               | 0.06         |
| <i>R-square</i>                               | 0.36  |                    | 0.00         |
| <i>After the ETP</i>                          |       |                    |              |
| Attitude towards the entrepreneurial behavior | 0.34  | 0.14               | 0.04         |
| Attitude related to subjective norms          | 0.56  | 0.06               | 0.00         |
| Attitude related to perceived control         | 0.27  | 0.10               | 0.01         |
| <i>R-square</i>                               | 0.51  |                    | 0.00         |

These results allow us to validate the use of Azjen's model to predict the entrepreneurial intention of the students surveyed. We also note that the regression increases after the ETP, which could be interpreted as a refinements of student's attitudes and expectations as a result of the ETP.

### **Analysis of the impact of the ETP**

To test whether the ETP had an impact on students' intentions and attitudes, we used a mean comparison T-test and analyzed the correlation of the mean difference with other factors related to the students background.

As indicated in Table 1, there were limited differences observed as a result of the ETP when considering the entire sample. Among the three antecedents of the entrepreneurial intention, only the attitude related to perceived control was significantly influenced by the ETP (mean difference = 0.09,  $p < 0.05$ ) when considering the whole sample of students.

The two other measures of attitudes were not significantly affected by the ETP. However, there is a significant correlation between the impact (mean difference) of the attitude towards entrepreneurial behavior and intention and between the impact on the attitude related to subjective norms and the attitude related to perceived control (respectively 0.20 and 0.30,  $p < 0.01$ ).

When considering the entrepreneurial intention, the absolute impact of the ETP is not statistically significant (mean difference = 0.06,  $p < 0.36$ ). However the relative impact (mean difference divided by mean before the ETP) is significant (relative mean difference = 4%,  $p < 0.05$ ).

When considering all the respondents, the ETP appears therefore to have a significant impact only on attitudes related to perceived control and only, in relative terms, on entrepreneurial intention. Moreover, there are significant correlations between the impact observed, which might indicate a strong interdependence between how attitudes are affected by the ETPs.

Considering this apparent interdependence and the difference between absolute and relative effects, we have tested whether these results remain valid when considering only a subset of the respondents, taking into account their initial situation and backgrounds.

### **Analysis of students initial situations**

We first analyzed whether some student characteristics that are known to influence entrepreneurial behavior had an impact on the results presented above. To do so, we considered subsets of our sample based on the socio-demographic data we had collected and tested whether the results obtained on those sample differed from the results presented above (Table 3).

Table 3 Analysis of students background

|                               |             | Impact of ETP (mean difference) |          |       |         |           |
|-------------------------------|-------------|---------------------------------|----------|-------|---------|-----------|
| Sample                        | Sample size | Initial intention               | Behavior | Norms | Control | Intention |
| All students                  | 144         | 3.90                            | 0.00     | 0.02  | 0.09**  | 0.06      |
| Entrepreneurs in family = Y   | 90          | 4.05                            | -0.01    | -0.04 | 0.06    | 0.12      |
| Entrepreneurs in family = N   | 54          | 3.67                            | 0.00     | 0.02  | 0.15*   | -0.04     |
| Association experience = Y    | 78          | 4.09                            | -0.03    | 0.03  | 0.15    | 0.09      |
| Association experience = N    | 65          | 3.72                            | 0.02     | -0.07 | 0.01    | 0.03      |
| Foreign experience = Y        | 68          | 3.95                            | 0.00     | -0.04 | 0.09    | 0.07      |
| Foreign experience = N        | 76          | 3.87                            | -0.02    | 0.00  | 0.10    | 0.06      |
| Entrepreneurship training = Y | 33          | 4.28                            | -0.03    | -0.10 | -0.04   | 0.05      |
| Entrepreneurship training = N | 111         | 3.80                            | 0.00     | 0.00  | 0.13    | 0.07      |

\*  $p < 0.10$ , \*\*  $p < 0.05$

Using mean comparison T-test to compare the subsets considered above, the impact in terms of controllability appears to be somewhat higher for students that did not have any entrepreneurship training ( $p < 0.13$ ) or experience with an association ( $p < 0.14$ ). On the other hand, the presence of a role model, such as an entrepreneur in the family, appears to decrease the impact of the ETP in

terms of entrepreneurial intention, although not significantly from a statistical point of view. ( $p < 0.25$ ).

An international experience (more than six months spent abroad) had no impact on the influence of the ETP.

By comparing subsets of students with increasing initial levels of entrepreneurial intentions (Table 4), we tested whether the initial perspectives of the students about entrepreneurial intentions influenced the impact of the ETP,

Table 4 Analysis of students initial intention

|                 |             |                   | Impact of ETP (mean difference) |       |         |           |
|-----------------|-------------|-------------------|---------------------------------|-------|---------|-----------|
| Sample          | Sample size | Initial intention | Behavior                        | Norms | Control | Intention |
| All students    | 144         | 3.90              | 0.00                            | 0.02  | 0.09**  | 0.06      |
| First quartile  | 36          | 2.39              | 0.00                            | -0.08 | 0.11    | 0.25**    |
| Second quartile | 36          | 3.39              | 0.09                            | 0.05  | 0.19**  | 0.27*     |
| Third quartile  | 36          | 4.29              | -0.05                           | -0.01 | 0.03    | 0.09      |
| Fourth quartile | 36          | 5.56              | -0.07                           | -0.04 | 0.06    | -0.36***  |

\*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

These results indicate that the initial student perspectives on entrepreneurial intention does have a strong influence on the impact of the ETP, ranging from significantly negative to significantly positive. This calls for further research in terms of student selection and an equation of programs with specific students profiles.

In particular, initially identifying students for which the ETP will have no or a negative impact in terms of entrepreneurial intentions could be very valuable. While using a measure of intention as a

selection criteria might lead to biased results because of self-selection, using student background as criteria can provide potentially useful results, as there are significant differences in terms of initial intentions among the subsets of students considered (Table 3). In particular, students that have an entrepreneur in their family, with an experience in an association or having already followed an ETP, tended to have a higher initial entrepreneurial intention (mean differences equal respectively 0.39, 0.37 and 0.47, significance respectively of 0.08, 0.07 and 0.10).

#### **4. CONCLUSION**

In this research our main aim was to capture and understand variations in attitudes and intentions of students throughout a 3-day seminar focusing on entrepreneurship.

Looking at our results, and trying to extract from them key elements, we can identify a set of very interesting outcomes.

First, it seems that for the entire sample, the impact of the studied ETP on entrepreneurial intention is significantly correlated with perceived behavioral control. Other research has underlined this kind of relationship between intention and self-efficacy or perceived behavioral control. This could lead to further research aiming at testing relationships between perceived behavioral control and educational or pedagogical variables to understand the influence of such variables. These variables could concern, for example, pedagogical methods or types of trainers.

Secondly, taking into consideration subgroups of students selected from their initial proximity to entrepreneurship (coming from a family of entrepreneurs, having developed experiences involving entrepreneurial behaviors, having been exposed for a long time to international context), additional outcomes are evident. We found a positive impact of ETP on perceived behavioral control and on entrepreneurial intention for the following subgroups: students having not previously attended a course in entrepreneurship, students having not been exposed to

entrepreneurship through their family and students having not actively participated in the founding and the development of students associations. In the other cases we did not find an impact.

Third, in one of our most interesting results, we found that the impact of the ETP on entrepreneurial intention is significantly dependent on the student's perspective on entrepreneurial intention (see the table 4). This means that for students in the first quartile (those having the lowest level of entrepreneurial intention), the impact of the ETP is significantly positive and for the fourth quartile students (those having the highest level of entrepreneurial intention), the impact is significantly negative. In other words, the ETP could have some strong effects for some students, depending on their background and initial perspectives on entrepreneurial intention. At the same time, the ETP could actually decrease the level of entrepreneurial intention for other students.

These results lead us to ask some new and important research questions. For example, depending on the type of ETP, are there some ways and tools for selecting students and orientating them to the appropriate ETP for their profile and background? In some cases, ETPs aiming to give a first awareness to entrepreneurship are not useful (existence of counter effect) for certain types of students. Further research along these lines could improve our understanding about these issues. In addition, we are far from a good knowledge about the influence of the main factors playing a role within an ETP. Further research would allow us to verify specific relations between pedagogical and educational variables and perceived behavioral control. Consequently, our research model could be therefore improved by including new independent variables influencing one or more of Ajzen' antecedents.

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**AN EXAMINATION OF ENTREPRENEURSHIP  
CENTERS IN THE UNITED STATES: A NATIONAL SURVEY**

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**ABSTRACT**

This study fills a gap in previous research by performing an in-depth analysis of 146 entrepreneurship centers in the United States. This two part study looks at the characteristics of the entire sample of entrepreneurship centers and then examines the differences between top ranked centers versus non-ranked centers. The findings indicate that top ranked centers have three times as many endowed chairs as non-ranked centers. Top ranked centers also offer more comprehensive graduate programs. Overall, top ranked centers have more resources and manpower. The findings of this study will assist students, faculty, staff, administrators, directors and other stakeholders of entrepreneurship centers.

## INTRODUCTION

We investigated entrepreneurship centers throughout the United States. Utilizing a sample of entrepreneurship centers in the U.S., this study thoroughly examines two basic research questions to assist students, faculty, staff, administrators, directors and stakeholders to understand the characteristics of entrepreneurship centers. The first research question is: What are the determining factors of established entrepreneurship centers (e.g., faculty, students, courses offered, finances, etc.)? Focusing on the same factors, the second research question asks: What are the differences between ranked versus non-ranked entrepreneurship centers? The rankings for the top ranked programs were taken from the *U.S. News and World Report* over the last five years.

## LITERATURE REVIEW

Few researchers have focused specifically on aspects relating to entrepreneurship centers. In 1991, Sandberg and Gatewood examined research orientation, budgets size, and constituents for entrepreneurship centers. The most comprehensive study of entrepreneurship centers was entitled, "Successful Experiences of Entrepreneurship Center Directors" by Upton (1997). Funded by the Kauffman Foundation, Upton performed an in-depth case analysis on only nine entrepreneurship centers. Based on her findings she developed a best practices list for starting, directing, funding, managing, and marketing each center. Other than these two studies there is little knowledge to be gained from the literature regarding entrepreneurship centers. Given the lack of research in this area and the importance of entrepreneurship centers play to a university, we surveyed 146 entrepreneurship centers in the United States. To date this is the largest sample of centers ever examined in the literature.

## METHODOLOGY

### Sample and Procedures

The sample consists of 146 entrepreneurship centers located in the United States. The list of centers was obtained from the National Consortium of Entrepreneurship Centers membership, the St. Louis University website on entrepreneurship centers, the Babson College research lists, and an in-depth search of web sites from the Internet.

We received responses from 94 program directors for a response rate of 64%—13 from nationally ranked centers and 81 from unranked centers. The high response rate is probably due to the collegiality among center directors in the entrepreneurship field and the study was endorsed by the National Consortium of Entrepreneurship Centers (NCEC). For this study, we define an entrepreneurship center as having a Center for Entrepreneurship (which may use titles such as Free Enterprise, Family Business, or Innovation Center), academic curriculum in entrepreneurship (having three or more for-credit courses aimed at an undergraduate degree or graduate degree), external outreach activities, and faculty that perform research in the field of entrepreneurship. The study did not include Small Business Development Centers.

In this descriptive study, we break down our sample into three categories: (1) mean for the entire sample, (2) mean for top ranked centers and (3) mean for non-ranked centers. Utilizing t-tests and chi-square analysis we examined the differences between the top ranked centers versus the non-ranked centers.

For the purpose of this study, an entrepreneurship center is considered nationally (top) ranked if it appeared as a Top 25-program in *U.S. News and World Report* at either the undergraduate or graduate levels. The *U.S. News and World Report* rankings are based on responses from the Deans and Directors of MBA Programs at over 350 Accredited Schools of Business who rank the top entrepreneurship programs in the country. Based on their responses, a list of the Top 25 schools in entrepreneurship is developed by *U.S. News and World Report* at both the undergraduate and graduate levels.

## **RESULTS/DISCUSSION**

### **Center Characteristics**

Table 1 illustrates that the average age of all centers in the study was 8.3 years old. There was a significant difference between top ranked centers at 11.9 years old versus non-ranked centers at 7.7 years old ( $p < .02$ ). Ranked programs are, on average, 4.2 years older, which may serve as an advantage by having more time to garner resources, build curricula, legitimacy and brand name recognition that are needed to attain national status. When asked about the primary emphasis in the College of Business, the percentage breakdown for the entire sample was 74% academic programs, outreach 26%, and fundraising 6%. There were no significant differences between top ranked and non-ranked centers. This demonstrates the fact that the academic component drives these centers.

When asked about the percentage breakdown that universities place on teaching, research, and service, the average for the entire sample was 49%, 33% and 18% with no significant differences between top ranked versus non-ranked centers. This demonstrates that teaching and research (82%) comprise the majority of center's activities. Fifty-three percent of the founders in the sample were still working at their respective centers, however there were no significant differences between top ranked versus non-ranked centers.

The average student population for a school in the sample of centers was 16,578. Sixty-one percent of the centers were located within public universities. There were no significant differences between top ranked and non-ranked centers in regards to their classification (public versus private university).

The average number of students in an entrepreneurship program associated with a center was 173 (112 graduate and 61 undergraduate). Top ranked programs were significantly more likely to have a larger number of graduate students ( $p < .04$ ).

The bottom of Table 1 indicates where the Center for Entrepreneurship is located: Department of Management, Department of Marketing, Mixed within the College of

Business Administration (CBA), Independent Unit/Area (not a Department) and Independent Unit/Area (associated within a Department). Results for the sample indicate that centers were most often mixed within the College of Business Administration (CBA) (24 centers), an independent unit/area (not a department—22), an independent unit/area (associated with a department—19), Department of Management (16) and an independent department (8). The results show a center was significantly more likely to be ranked if it was an independent unit/area (associated with a department—6) at  $p < .01$ .

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Insert Table 1 about here  
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### **Entrepreneurship Faculty and Staff**

Table 2 illustrates the differences in demographics among faculty in the study. The table shows that the average center had 5.4 faculty members teaching in the program (3.9 PhDs and 1.5 MBAs). The average number of tenure track and non tenure track faculty that teach is 3.0 and 2.2. The average number of adjunct faculty that teaches is 1.8 and the mean number of full-time and part-time entrepreneurship faculty that had started a business was 2.2 and 1.5. Each center had a mean of 2.8 and 1.3 full-time and part-time staff members. The average number of endowed chairs is one and the average amount of money that each position was endowed was \$982,041. An interesting finding is that 47% of the centers did not have an endowed chair.

Looking at individual differences between ranked and non-ranked centers we find that ranked programs fund more faculty positions in entrepreneurship. For example, ranked programs employed an average of 5.2 faculty members with doctorates while non-ranked centers employed 3.6. Even though this is not statistically significant, it demonstrates the serious commitment that universities with ranked centers place on resource allocation for entrepreneurship.

Ranked centers also reported 4.3 tenure track positions compared to 2.7 for non-ranked programs ( $p < .06$ ). The number of non-entrepreneurship tenure track faculty at top centers was also significantly higher than non-ranked centers, 3.2 versus 2.1.

Ranked centers also draw on the assistance of at more adjunct instructors 2.8 versus 1.7. The average full-time faculty member started 2.9 businesses versus 2.2 for non-ranked programs. The numbers are even more diverse when looking at adjunct faculty. Adjunct faculty at ranked centers started an average of 2.9 businesses while non-ranked adjuncts started 1.2 ( $p < .007$ ).

No significant differences exist between the employment of part-time and full-time staff members. Thus, daily duties and functions are perhaps equally met by both types of centers; however, in depth content delivery may be better in ranked centers due to the larger number of full time faculty. More full time faculty teaching in the concentration or the major better insures more topics covered, research undertaken, and collegial interaction in entrepreneurship areas—all factors that could partially account for higher national reputations.

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Insert Table 2 about here  
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Another significant finding in the study focuses on the number of endowed chairs. The average center in the study had 1 endowed chair, with top centers averaging 2.31 versus non-ranked programs at .73 ( $p < .000$ ). On average, ranked centers had three times as many endowed chairs as non-ranked centers.

Table 2 also shows the average and median amount of money that is endowed to each of these positions. For the entire sample the average and median amounts of money that is endowed to each of these positions was \$982,041 and \$0 respectively. Significant differences were found between the ranked versus non-ranked centers for both average and median endowments for a chair. At top schools, the average was \$2,416,667 versus \$825,536 at non-ranked schools ( $p < .02$ ). The difference between the medians was \$1,750,000 versus \$0 ( $p < .00$ ).

### **Financial Operations within Centers for Entrepreneurship**

As illustrated in Table 3, the average size of a center's endowment for the full sample was \$3,891,304. The results show that ranked centers, on average, had \$10,409,500 more endowment money than non-ranked centers ( $p < .005$ ). This is also indicative of the non-ranked centers funding more their budgets from grants and contracts. An interesting side note is that 47% of the full sample had an endowment less than \$500,000.

The mean amount of scholarship money available to students for the full sample was \$25,731. Ranked centers had more scholarship money available, \$38,000 versus \$22,708. There was no scholarship money available for students at 17 centers. All respondents in the survey from top ranked centers had scholarship money available for students.

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Insert Table 3 about here  
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### **Administration of an Entrepreneurship Center – Problems and Challenges**

An interesting aspect of the study was the inquiry into the major problems encountered by center directors in the administration of their programs. Table 4 outlines the various problems cited by the directors. It is important to make the distinction between those directors who started their center (founder) and those who were not the founder. We believe this distinction is necessary because certain problems are more inherent in the “founding” of a center versus those problems that arise afterwards.

For all of the centers in the study, the top five problems encountered for directors who started their program were time, funding, finding qualified faculty, legitimacy, and faculty jealousy. The major problems encountered for directors who did not start their program were funding, time, finding qualified faculty, and measures of success.

Among the ranked centers, the directors who founded their programs cited finding qualified faculty, funding, time, and legitimacy and as the most critical problems encountered. Those directors who did not start the center at a ranked school had the most problems with time, finding qualified faculty, the administration, and obsession with rankings.

Directors who started a center at non-ranked centers most pressing problems were time, funding, legitimacy, finding qualified faculty, and faculty jealousy. Directors who did not start the program at non-ranked centers programs cited funding, time, finding qualified faculty, legitimacy, recruiting students, and measures of success as the most pressing problems.

Two significant differences were found in each category of director. Founding directors from top ranked centers had significantly more problems in finding qualified faculty ( $p < .01$ ). Founding directors from non ranked centers had significantly more problems recruiting students ( $p < .047$ ). Non founding directors had significantly more problems in obtaining funding ( $p < .005$ ) and legitimacy ( $p < .01$ ).

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Insert Table 4 about here  
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### **Perceived Measures of Success**

The directors were surveyed about their perceptions of how the faculty and administrators measured the success of their entrepreneurship centers. The results are reported in Table 5.

For the entire sample of centers, the directors' perceptions of the faculty's top measures of success for a center are (in order of importance): (1) number of students in the program, (2) student evaluations, (3) number of graduates and (4) funding generated. The directors' perceptions of the administration's top measures of success for a center are: (1) number of students in the program, (2) recognition, (3) funding generated and (4) number of graduates.

For top ranked centers, the directors' perceptions of the faculty's top measures of success for a center are: (1) student evaluations, (2) recognition, (3) number of graduates and (4) number of students in the program and (5) research. The directors' perceptions of the administration's top measures of success for a top ranked center are: (1) recognition, (2) number of students in the program, (3) number of graduates and (4) student evaluations.

For non ranked centers, the directors' perceptions of the faculty's top measures of success for a center are: (1) number of students in the program, (2) student evaluations, (3) number of graduates and (4) funding generated. The directors' perceptions of the administration's top measures of success for a non ranked center are: (1) number of students in the program, (2) recognition, (3) funding generated and (4) student evaluations.

Two significant differences were found in the results. In the category, "directors' perception of faculty measures of success", non ranked centers ranked funding generated as a significantly more important measure of success than ranked centers ( $p < .04$ ). In the category, "directors' perception of administrators' measure of success", external programs was a significantly more important measure of success for non ranked centers ( $p < .01$ ). While not significant at the .05 level, recognition was moderately significant ( $p < .07$ ) for directors' perception of faculty measures of success. Recognition was more important to ranked schools than non ranked schools.

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Insert Table 5 about here  
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## **CONCLUSION & IMPLICATIONS**

This study fills a gap in entrepreneurship education research by surveying the largest sample of entrepreneurship centers in the U.S. ever attempted and obtaining in-depth information about the characteristics of these centers. This descriptive study breaks down the sample into three categories: the entire sample of entrepreneurship centers, top ranked centers and non-ranked centers.

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**Table 1: Characteristics of Entrepreneurship Centers (N=94)**

|  | <b>All Centers<br/>N=94<br/>Mean</b> | <b>Top Ranked<br/>Centers N=13<br/>Mean</b> | <b>Non Ranked<br/>Centers N=81<br/>Mean</b> | <b>P<br/>value</b> |
|--|--------------------------------------|---|---|--------------------|
| Age of Center (yrs)  | 8.3                                  | 11.9  | 7.7   | .02*               |
| Primary Emphasis in CBA (%)                                  |                                      |   |   |                    |
| Academic Programs  | .74                                  | .62   | .76   | .28                |
| Outreach   | .26                                  | .23   | .20   | .79                |
| Fundraising  | .06                                  | .15   | .04   | .10                |
| School's % Breakdown   |                                      |   |   |                    |
| Teaching   | 49                                   | 47  | 49  | .60                |
| Research   | 33                                   | 37  | 33  | .35                |
| Service  | 18                                   | 16  | 18  | .62                |
| Founder (%)  | 53                                   | 38  | 56  | .25                |
| Tenure of Founder (yrs)                                      | 5.42                                 | 7.4   | 5.1   | .15                |
| Size of School   | 16,578                               | 22,553                                      | 15,971                                      | .20                |
| Public University (%)  | 61                                   | 54  | 62  | .62                |
| Total # of Students in<br>Entrepreneurship Program           |                                      |   |   |                    |
| Graduate   | 112                                  | 115   | 51  | .04*               |
| Undergraduate  | 61                                   | 90  | 116   | .61                |
| Total Students   | 173                                  | 205   | 167   | .43                |
| Full Time ENT Faculty with<br>Ph.D.'s to Total Student Ratio | 44.4                                 | 39.4  | 46.4  | .34                |
| Location of Center<br>(# of Centers)                         |                                      |   |   |                    |
| Department of Management                                     | 16                                   | 3   | 13  | .40                |
| Department of Marketing                                      | 5                                    | 1   | 4   | .72                |
| Independent Department                                       | 8                                    | 0   | 8   | .23                |
| Mixed Within CBA   | 24                                   | 3   | 21  | .90                |
| Independent Unit/Area (Not<br>a Department)                  | 22                                   | 3   | 19  | .68                |
| Independent Unit/Area<br>(Associated with a<br>Department)   | 19                                   | 6   | 13  | .01*               |

\* p &lt; .05 .

\*\* p &lt; .01.

\*\*\* p &lt; .001.

**Table 2: Entrepreneurship Faculty and Staff**

|   | All Centers Mean | Top Ranked Centers Mean | Non Ranked Centers Mean | P value |
|---|------------------|-------------------------|-------------------------|---------|
| # Full-time ENT Faculty with Ph.D.s                       | 3.9              | 5.2                     | 3.6                     | .34     |
| # ENT Faculty with MBAs                                   | 1.5              | 1.8                     | 1.4                     | .62     |
| # TT ENT Faculty that Teach                               | 3.0              | 4.3                     | 2.7                     | .06     |
| # Non ENT TT Faculty Teach                                | 2.2              | 3.2                     | 2.1                     | .23     |
| # Adjunct Faculty that Teach                              | 1.8              | 2.8                     | 1.7                     | .26     |
| # Full-time ENT Faculty that Have Started Own Business    | 2.2              | 2.4                     | 2.2                     | .07     |
| # Adjunct Full ENT Faculty that Have Started Own Business | 1.5              | 2.9                     | 1.2                     | .007**  |
| # Full-time Staff Members                                 | 2.8              | 3.5                     | 2.7                     | .39     |
| # Part-time Staff Members                                 | 1.3              | 1.9                     | 1.3                     | .37     |
| # Endowed Chairs in ENT                                   | 1.0              | 2.31                    | .73                     | .000*** |
| Amount \$ Endowed to Chairs                               | 982,041          | 2,416,667               | 825,536                 | .02*    |
| <b><u>Mean</u></b>  |                  |                         |                         |         |
| <b><u>Median</u></b>                                      | 0.0              | 1,750,000               | 0                       | .00*    |

\* p < .05 .

\*\* p < .01.

\*\*\* p < .001.

**Table 3: Financial Operations within Centers for Entrepreneurship**

|  | <b>All Centers</b> | <b>Top Ranked Centers</b> | <b>Non Ranked Centers</b> | <b>P value</b> |
|--|--------------------|---------------------------|---------------------------|----------------|
|  | <b>Mean</b>        | <b>Mean</b>               | <b>Mean</b>               | <b>Mean</b>    |
| Annual Scholarship \$ Center has Discretion over | 25,731             | 38,000                    | 22,708                    | .29            |
| Size of Center's Endowment (\$)                  | 3,891,304          | 13,000,000                | 2,590,500                 | .005**         |
| Size of Center's Annual Budget (\$)              | 329,609            | 433,928                   | 319,021                   | .33            |
| <b><u>% Composition of the Budget:</u></b>       |                    |                           |                           |                |
| Endowment  | 32.78              | 46.1                      | 30.80                     | .20            |
| Grants & Contracts                               | 36.60              | 19.78                     | 39.17                     | .09            |
| Outreach Programs                                | 17.13              | 17.44                     | 17.08                     | .96            |
| Other  | 13.49              | 16.68                     | 12.95                     | .68            |

\* p < .05 .

\*\* p < .01.

\*\*\* p < .001.

**Table 4: Problems Encountered in the Administration of an Entrepreneurship Center**

|                                | All Centers Mean |               | Top Ranked Centers Mean |               | Non Ranked Centers Mean |               | P value |               |
|--------------------------------|------------------|---------------|-------------------------|---------------|-------------------------|---------------|---------|---------------|
|                                | Started          | Did Not Start | Started                 | Did Not Start | Started                 | Did Not Start | Started | Did Not Start |
|                                |                  |               |                         |               |                         |               |         |               |
| Time                           | 5.1              | 4.8           | 5.6                     | 4.6           | 5.0                     | 4.8           | .56     | .83           |
| Funding                        | 4.5              | 5.2           | 5.8                     | 3.0           | 4.3                     | 5.6           | .21     | .005**        |
| Finding Qualified Faculty      | 4.1              | 4.3           | 6.8                     | 4.0           | 3.8                     | 4.4           | .01*    | .72           |
| Legitimacy                     | 4.0              | 3.5           | 5.4                     | 1.4           | 3.8                     | 4.0           | .14     | .01*          |
| Rewards                        | 3.1              | 3.2           | 3.3                     | 1.3           | 3.0                     | 3.6           | .84     | .10           |
| Faculty Jealousy               | 3.6              | 3.3           | 3.5                     | 1.7           | 3.4                     | 3.5           | .23     | .19           |
| Administration                 | 3.1              | 3.8           | 2.8                     | 4.0           | 3.1                     | 3.8           | .72     | .84           |
| Lack of Focus                  | 2.9              | 3.8           | 3.0                     | 2.9           | 2.9                     | 4.0           | .93     | .30           |
| Recruiting students/Enrollment | 2.9              | 3.5           | 1.0                     | 2.0           | 3.1                     | 3.9           | .047*   | .06           |
| Measures of Success            | 2.9              | 3.9           | 2.8                     | 3.5           | 2.7                     | 4.0           | .18     | .64           |
| Control of Program             | 2.6              | 2.4           | 2.7                     | 2.8           | 2.4                     | 2.7           | .09     | .24           |
| Obsession with Ranking         | 2.5              | 3.2           | 2.5                     | 3.3           | 2.5                     | 3.2           | .99     | .97           |
| Faculty Burnout                | 2.3              | 2.5           | 1.0                     | 2.2           | 2.4                     | 2.6           | .22     | .65           |

\* p < .05 .

\*\* p < .01.

\*\*\* p < .001

Likert scale where 1 is the least problems and 7 the most problems.

**Table 5: Directors' Perceptions of How Their Faculty and Administration Measure the Success of Their Entrepreneurship Center**

|   | All Centers Mean |       | Top Ranked Centers Mean |       | Non Ranked Centers Mean |       | P value |       |
|---|------------------|-------|-------------------------|-------|-------------------------|-------|---------|-------|
|   | Faculty          | Admin | Faculty                 | Admin | Faculty                 | Admin | Faculty | Admin |
| # Students                              | 2.65             | 2.60  | 2.88                    | 2.78  | 2.62                    | 2.57  | .72     | .78   |
| Student Evaluations                     | 3.04             | 3.30  | 2.29                    | 3.43  | 3.14                    | 3.28  | .28     | .86   |
| # Graduates                             | 3.20             | 3.27  | 2.71                    | 3.20  | 3.28                    | 3.28  | .50     | .94   |
| Funding Generated                       | 3.52             | 2.94  | 5.00                    | 3.71  | 3.33                    | 2.81  | .04*    | .26   |
| Community Service                       | 3.64             | 3.95  | 4.00                    | 4.43  | 3.57                    | 3.86  | .32     | .52   |
| # Startups                              | 3.65             | 4.03  | 3.50                    | 4.80  | 3.67                    | 3.90  | .85     | .38   |
| Recognition                             | 3.75             | 2.90  | 2.43                    | 2.29  | 3.92                    | 3.00  | .07     | .37   |
| Size & Growth of Startups               | 3.81             | 4.03  | 3.67                    | 5.20  | 3.83                    | 3.80  | .85     | .24   |
| External Programs                       | 3.84             | 3.83  | 4.00                    | 5.25  | 3.81                    | 3.53  | .80     | .01*  |
| Placements in Entrepreneurial Companies | 3.85             | 3.96  | 3.40                    | 5.75  | 3.91                    | 3.67  | .61     | .06   |
| Placement at Competitions               | 4.05             | 4.00  | 3.57                    | 4.00  | 4.14                    | 4.00  | .53     | 1.0   |
| Research                                | 4.06             | 3.71  | 3.14                    | 3.22  | 4.20                    | 3.85  | .24     | .46   |

\* p < .05 .

\*\* p < .01.

\*\*\* p < .001

Likert scale where 1 is the most important and 7 is least important.

**ECONOMIC DEVELOPMENT THROUGH  
ENTREPRENEURSHIP IN TANZANIA'S AGRICULTURAL SECTOR**

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**ABSTRACT**

The African business environment is changing dramatically as a consequence of liberalization policies and exposure to free international flows of capital, services, and commodities (Kristiansen, 2002). The small-scale enterprise sector is an important driving force for economic development in Africa (Mead & Liedholm, 1998). The purpose of this paper is to identify obstacles and interests of agribusinesses in Tanzania, which is located on the eastern coast of the African continent. Agriculture is the foundation of the Tanzanian economy, yet there is limited research on entrepreneurship and agribusiness in sub-Saharan Africa. To advance Tanzanian economic development through entrepreneurship in agriculture, the Ohio State University (OSU) and Sokoine University of Agriculture (SUA) joined forces. With financing from USAID's Association Liaison Office (ALO), OSU and SUA surveyed 61 firms in 7 administrative regions in mainland Tanzania. Africa's challenges are numerous and complex, but there is also much potential and opportunity for growth and development. Together, OSU and SUA are addressing challenges and opportunities, building institutional capacities through linkages with the private sector, and developing an agribusiness management program at SUA. They are advancing entrepreneurship education and continuing to collaborate with stakeholders in the development of personal, institutional, and environmental factors for promoting entrepreneurship in a transitioning economy. It can be concluded from the findings of this survey, that there is demand for training on business planning, market management and other priorities. It can also be concluded that agribusinesses are willing to participate in a new Agribusiness Management Program (AMP) at SUA.

# **HIGH-TECH VENTURE START-UP BY CIVIL SERVANT RESEARCHERS: THE MANAGEMENT OF THE COUPLING-DECOUPLING QUESTION**

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## Abstract:

If many works concern exchanges between scientific and industrial communities, the French case shows an original situation with the Act of July 1999. French researchers working in public laboratories are also civil servants and most of the time not concerned by entrepreneurship question. The Act gives them authorisation to set up their own venture. The path used by researchers to become entrepreneur is full of questions. We will analyse this situation according to two theories: first the theory of social networks and second the orders of worth. These theories will help us to highlight the situation of researchers embedded between public and private stakeholders, and how the decoupling process could be managed by the researchers.

## Introduction:

The technology transfer of university research findings towards high-tech venture is the subject of numerous works, for example: the international study of Pirnay on the university spinoffs (2001, 2002) or the work of Shane about academic entrepreneurship (Shane, 2004). In France, since the end of the ninety's, high tech venture is in the heart of research and innovation public policies (Mustar and Penan, 2003). According to this logic, the Act of July 12th, 1999 focuses on university spinoffs as a way to transfer technology research, targeting researchers who are civil servants, even if most of them are not really attracted by this opportunity (Emin, 2003). A report on public incubators reveals, however, that nearly a hundred civil servant researchers used the 1999's Act. It demonstrates that the law answers a real demand from researchers. However, it does not explain how they use what is supplied by the law. This type of entrepreneurship concerns would-be entrepreneurs who work as civil servant researchers<sup>1</sup>, who are remove from the business community, and sometimes rebel against imperatives of the market. Moreover, their status forbids them to have another job. Now, the law of 1999, easing some the constraints: it authorizes the researchers to go out gradually from the public area to join the market world. How do they consider this passage? Which obstacles do they have to overcome? With what kind of aids? Are their own establishments and the incubators sufficient supports? What about the relations with stakeholders? Answers to these questions helps to understand the specific process of university spinoff by civil servant researcher.

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<sup>1</sup> In France, faculty and research staff are national civil servants and are divided in two categories: the first one works for the university, the second one works for specialised establishment such as CNRS, INSERM, INRA...

To consider this problem, we will use the theory of the social networks and the concept of embeddedness (Granovetter, 1985). The civil servant researcher has to go out of his initial networks and tie up links with actors in a trade perspective, what Granovetter calls the coupling-decoupling process. Therefore, we will combine this theory with the concept of orders of worth developed by Boltanski and Thévenot (1991, 1999) to understand the question of coordination among stakeholders.

The theoretical framework, combining the social networks theory and the concept of orders of worth allows to complete entrepreneurship theory on the university spinoffs. Our analysis is based on the study of seven projects of high-tech ventures. Results underline that the researcher lives, from the beginning, in an ambiguous embeddedness, followed by a partial decoupling from the non-profit area, even if tensions between various stakeholders require him to adopt a trade logic very early.

We shall present in the first section the theoretical frame of the analysis. The second section will clarify the Act of 1999 and the empirical study. Finally, the third section will expose obtained results.

## **THE THEORETICAL FRAMEWORK: A COMBINATION OF SOCIAL NETWORK THEORY AND ORDERS OF WORTH CONCEPT**

If literature in entrepreneurship allows understanding the spinoff process, the specificity of French case (the researcher's status) supposes to build a special theoretical framework to be understood. This one is based on social networks theory and completed with orders of worth concept.

### **University Spinoffs: Contributions of Social Networks Theory**

Literature in entrepreneurship operates on a distinction between pure creation and spinoff (Pirnay, 2001, 2002). The spinoff phenomenon corresponds to the creation of a company from an organization. The difference between push spinoffs and pull spinoffs underlines the importance of the context of the creation. Thus, a push spinoff has the explicit support of the organization. This is the case in the university spinoffs. Academic studies on this subject contribute to understand the process in which the researcher is at first a would-be entrepreneur.

The question of the process, central in entrepreneurship (Gartner and alii, 1992; Shane, 2004), can be enriched by the social networks theory. Many researches insist on the role of networks in the entrepreneurship process (Hoang and Antoncic, 2003). For the social networks theorists (Burt, 1992, 2000; Granovetter, 1985), companies are built by individuals whose action is at the same time facilitated and limited by the structure and the available resources of the social networks where they take place. The embeddedness gives confidence and resources to the entrepreneur (Granovetter, 1995). But the situation is paradoxical (Uzzi, 1997) because it could be considered in the same time as a constraint. Insertion in an interpersonal relations network could make the company dependent to his network such as satisfied some demands of its members, bad for the profitability of his project. Granovetter illustrates this danger through the example of the Chinese entrepreneurs (1995, p.142). To limit links with the domestic and friendly environment, the Chinese entrepreneur spends most of the time in his native region. The balance between "coupling" and "decoupling" constitutes the condition of its development. The process of decoupling followed by the entrepreneur is presented as necessary for his survival. The entrepreneur has to go outside (at least partially) of his initial network so that his entrepreneurial

project succeeds. It allows him to escape some of the non economic obligations which are demanded by the network into which he was inserted initially. Nevertheless, this decoupling is relative in itself, because it does not imply a total break with the initial network which has supplied useful resources for the launch of the project.

As underlined by Chabaud and al. (2003), the question of coupling-decoupling can become richer with the notion of structural hole developed by Burt (1992). The entrepreneur is located in the intersection of networks which have no (or few) links. Thus, he is able to add value by being go-between to various networks and building bridges between the various structural holes. Someone living at the intersection of two social worlds has more of a chance to have good ideas (Burt, 2000) and to be in a good position to innovate. For Hite and Hesterly (2001), it is towards this type of more «calculative» networks, i.e. characterized by economic relations and less socially embedded, that the creator has to turn. Jack and Anderson (2002) demonstrated how entrepreneurs recognize and treat some aspects of their social structure in order to exploit some of its opportunities.

The theory of the social networks, following the example of the literature in entrepreneurship, is interesting in regard to the process which one follows when he decides to set up a company. Moreover, it underlines the interest to lean on a network of relations, then to go out of it, to treat the various networks, to link them. However, in the very particular case of a university spinoff set up by a civil servant researcher, this theoretical frame is not sufficient to understand consequences of his new status. This change widely explains difficulties, conflicts, ambiguities met during the spinoff process as the researcher goes from a non-profit environment to a trade one. The orders of worth concept allows a better understanding of this process by explaining the specificity of framework in which researcher is or will be during the process, their different logics of action and the potential conflicts.

### **The Concept of Order of Worth**

According to the approach developed by Boltanski and Thévenot (1991, 1999), many situation in social life can be analysed by their requirement for the justification of action. The logic of action appears with the meeting of an actor and an action characterised by a historic and institutional context, symbolic and mythical references, structural constraints. Since a plurality of mutually incompatible modes of justification exists, disputes can be understood as disagreements either about whether the accepted rule of justification has not been violated or about which mode of justification to apply at all. The article develops a grammar of such modes of justification called orders of worth (*grandeur*). The actor does not exist in itself, independently of the situation in which he has to face. These situations of action are very numerous. In *De la justification* (1991), the authors focus on six worlds. In each of these, coherences are mobilized around persons, objects, representations, and relational designs which are so many faces allowing to recognize from which nature is the situation, as well on a person included in one of these worlds as on an observer point of view which tries to understand it. In each world, people value “states” and, in case of controversy, they agree in reference to a common superior principle. Disputes can appear among people belonging to two different worlds and “quarrel” (the confrontation of two worlds) finds a solution either in the exclusive reference to one of the two worlds, or in a local agreement (a temporary and not generalized deal between people staying in their world), or in a compromise (an agreement which exceeds the two worlds, stable because it builds with objects resulting from each of worlds). Thus, the concept of orders of worth not only demonstrates the way agreements

between people are built and realized, but also the coordination among people who work according to various.

The spinoff process by a civil servant's researcher implies two different situations of action, each of those having specific legal rules and different objectives. Indeed, the civil servant researcher evolves in a professional environment that we shall call the public or non-profit area, characterized by particular legal rules (the status of Public service, its rights and its obligations), within which the notions of public utility, the general interest is advanced. The entrepreneur evolves in a private area governed by his own legal rules, economic aims and mostly by the search for individual interest and for profit.

The specificities of these two areas are similar to two of the worlds described by Boltanski and Thévenot. The first one, called civic world, is defined through “greatnesses” such as the superiority of the collective interest, the embodiment of a general interest, the importance of the equality. The second, called market world, is described by the notions of competition, opportunism, profit. And among the two, exist “an inflexible opposition between public good and private interests” because “the definition of the public utilities is built on the critical opposition towards a definition of a trade service” (Boltanski and Thévenot, 1991 , p. 318-319).

The authors clarify, furthermore “that the same people are able to take into account many kinds of “greatnesses”, which is different from the hypothesis that links value systems or cultures to members of the same social group or the same institution” (ibidem, p. 189). Nevertheless, considering the strong specificities of each area of our cases, it seems possible to identify two archetypes of action: one corresponds to the civic world and the other to the market world.

Using the theoretical framework of the orders of worth underlines differences between stakeholders’ ways of coordination because the use of the 1999 Act lead the researcher from the non-profit area to the commercially oriented one. Embedded professionally in the first one of which he uses a whole set of resources, he escapes it by the game of the Act and of his own objective –to set up a company-. The path to the other area can be compared to a “decoupling” of the researcher. Then, he will face the market world with its proper logics. The “decoupling” implies a change about regulation and conflicts resolution among people, what does not indicate the theory of the social networks. By the use of the Act, the researcher remains in a structural hole (Burt, 1992). Even though universities and companies develop several types of collaborations (Shane, 2002), each remains centred on his own activities and links, and relations remain weak, especially in France. Will the researcher succeed in establishing bridges between these two areas, in facing “situations found in the different worlds, to know how to recognize them and be able to adapt himself (Boltanski and Thévenot, 1991 , p. 266)?”

To understand the mechanics in this kind of a spinoff and try to address the questions, it is necessary to put it through the context.

## **THE CONTEXTUALIZATION OF THE DECOUPLING AND THE EMPIRICAL STUDY**

The coupling-decoupling process studied here is strongly dependent on the very particular context set up by the Act of 1999. This Act about innovation will be clarified. Then we shall present the methodology used to lead empirical study.

### **The Contextualization and the Act about Innovation**

The French Act about innovation breaks the principle of the suspension for a civil servant to create a company. This exception is limited to the technology transfer of his research works. So, the object of the future company is defined in a restrictive way. The establishment (University, School, Establishment of research) where the researcher formerly worked must give an agreement and verify that this condition is effectively followed. The researcher will then benefit from a temporary status. Expressed in the article 25-1, it allows him to start a company while keeping the possibility, if he wishes, to go back to his first job. He has the choice between a “détachement”<sup>2</sup> or “mise à disposition”<sup>3</sup>.

The agreement given by the establishment is available for two years, renewable twice. Also, he must obtain a second agreement given by the Commission of deontology. This one looks at the possible incompatibilities between his researcher’s mission and his project, and must be informed about all the major evolutions of relationship between the company, the researcher and the establishment from which he comes.

At the end of this period, the entrepreneur can ask for a “mise en disponibilité”<sup>4</sup> (he is not civil servant any more), a dismissal or a reinstatement.

Relations with his establishment are not reduced to this agreement; it includes another very important contractual dimension. The entrepreneur will be able to use his research, but it owns to his establishment (university for example). That’s why an agreement will define exploitable works by the future company, as well as rights and obligations of the two parts of the relationship. During this contractual phase, are detailed financial modalities linking the two parts: 1. royalties due to the university or the School and 2. the possible coverage (temporary) of the entrepreneur’s salary if he uses the “mise à disposition” or “délégation”..

## **Empirical Study**

The aim of our work is to confirm by the theory the phenomenon of decoupling means of data collected for a previous study. These were already restored under the shape of an “intrinsic” case study according to Stake (1994), that means not having a theoretical validation. To reach it, the data must be converting in an “instrumental” case. From then on, case plays a role of support in the theoretical construction, facilitates the understanding of the phenomenon and advances reflections and perspectives of search. Confrontation with the theory allows the case to reach the external validity such as describes by Yin (1989).

Our empirical study aggregates several sorts of data allowing consideration of context and process. It was realized in two ways: In the first, Act, institutional environment, situation and role of the actors were studied from texts. The Second step, centred on the process of decoupling and its consequences for the researcher who wishes to create its company, was compiled on the basis of interviews.

In the first stage, Act itself, decrees and circulars relating to it were consulted as well as the various texts treating the status of public service and some of civil servants researchers. We also examined the speech of the Minister presenting the project to the Assemblée National<sup>5</sup>. This

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<sup>2</sup> Détachement : The civil servant keeps the advantage of is status (more particularly the rights for pension) and is allowed to go back to his previous function after 6 years. He is paid by the spinoff.

<sup>3</sup> Mise à disposition : The civil servant keeps the advantage of is status (more particularly the rights for pension) and is allowed to go back to his previous function after 6 years. He is paid by the university.

<sup>4</sup> Mise en disponibilité :The civil servant doesn’t keep the advantage of his status, excepted the opportunity to go back to his previous function after 6 years.

<sup>5</sup> French Parliament

documentary collection included studying the legal subtleties which the entrepreneur has to face. Additionally, the first stage contained an institutional dimension. The number of public actors implied with the implementation of the Act exceeds what exists usually within the framework of assistants to start-up. At this point, the question was to identify and to select people concerned with entrepreneurial venture as a tool of technology transfer, to understand their role, and then to proceed to interviews.

The Second stage concerned essentially the analysis of interviews framed with two different set of questions, one for institutions interested by the spinoff project, the other for the researchers-would-be entrepreneur. Conversations lasted one to two hours some of the concerned people having been interviewed repeatedly between 2001 and 2003.

The first set of questions was administered to fourteen people within eight institutions. It was structured by the following subjects: the role of the institution in the spinoff process engaged by researchers, the material and relational elements set up since the Act, and their attitude about the spinoff led by a researcher.

The second set of questions was administered to seven would-be entrepreneurs (cf. table of cases, appendix 1) from two French counties (Lille and Lyon). This set included five dimensions: the legal status of the company or the future company, the statutory choice of the entrepreneur, the relations with the establishment, the relationship with the other actors, especially investors, and the perception of the Act by the interrogated people.

Interviews were then coded by subject as the unit of analysis tackled issues by the interlocutors, their place in the speech and so the importance of these. So the coding was realized after. These subjects were also put in perspective with regard to the context, but also some toward the others. By revealing the importance of certain subjects in speeches, the analysis of contents suggests explanations of the behaviour of the people interviewed. These explanations, then, allow us to understand how the researchers manage their decoupling from the non-profit area.

## **THE COUPLING-DECOUPLING QUESTION MANAGED BY THE RESEARCHER**

The majority of the interrogated researchers assert that they would not have left their positions without the Act. It globally strengthened a certain number of situations by adding financial and fiscal supports for the benefit of entrepreneurial venture, thereby facilitating the entry to incubators or nurseries, enabling the young company to work with various networks. (Chabaud and al., 2003). It also helps researchers to start new companies and to commercialize university inventions, new mission led in parallel with the classic one of technology transfer, and by giving a legal frame to practices which would have been illegal. However, by using the Act, the researcher is in a problematic situation. If the original coupling in the non-profit area is maintained by the use of the Act, it is at the same time ambiguous: the decoupling remains relative. This process is differently administered by the researchers. The theoretical frame of the orders of worth reveals that some of them stayed in the civic world while the others went over to the market world.

### **An Ambiguous Original Coupling, but a Relative Decoupling**

The ambiguity of the original coupling shows through in three types of relations which the researcher maintains. Relations with on one hand the members of his laboratory, on the other hand the persons in charge of the implementation of the Act who are also responsible for technology transfer office, and finally the private investors whom he needs to develop his project.

Nevertheless, this ambiguity of the previous coupling does not lead to a total break with the non-profit area. Different links are maintained with it and give some proofs of a relative decoupling.

### An Ambiguous Embeddedness

Being a would-be entrepreneur, the researcher meets incomprehension, even distrust, from members of his laboratory: “Many people of my laboratory thought that it was not my profession to create a company”(case 1). “There was a definite hostility. Everything was made to block my project, a part of the lab was very hostile. Some thought that I pirated public service. It is rather hallucinating this French mentality” (case 3). “With regard to the search team, they had the impression that we wanted to make money with them... [ establishment of membership of the concerned researcher]; I left of this team” (case 4). Some conceive with difficulty that a researcher can become an entrepreneur and that he takes advantage materially and financially of works produced unselfishly by a team. There is a certain tension in working relations, strengthened when the would-be entrepreneur convinces some of his co-workers to follow him in the adventure (case 3 and 4). This incomprehension is strengthened by the ambiguity of their professional situation during the process of creation. Several researchers felt this embarrassment. “The difficulty is to be still in the organization chart and to defend the interests of the venture. We have a double role: with regard to the research team and with regard to the new business start-up” (case 4). “At the beginning, we were representing school. We overlapped because we also represented the venture” (case 3). On the road to becoming an entrepreneur, the researcher meets people from the technology transfer office within his establishment, entering another type of ambiguity. They are supposed to be competent to inform him about the Act, but they often suffer from a lack of mastery of his interlocutors. They are supposed to be the only ones in the establishment who know and implement the Act. “At the Beginning of 2001, I met the human resources manager and she said to me “your file did not leave” she did not know the new Act” (case 7). “The university was contacted [in October, 2001], but no reaction [in June, 2002], while we had made propositions” (case 6). “In the choice of status, we managed by ourselves, the [establishment] had no knowledge ... We waited for Act for quite a lot of time; we had met people who prepared it... we gave information to them [establishment]” (case 3). “There are unresolved questions at every level; participation in the capital for example, 15 % with or without the family? We received a vague answer, either yes or no (case 3). “We do not know if I can get a complement of salary, I hope because my grant is going to be killed” (case 5). This lack of mastery of the Act contrasts with the expertise in negotiation on rights and obligations relative to the exploitation of the transferred research. The conclusion of the agreement in which they are clarified reveals not only a legal reality which the researcher barely understood, but especially tensions which he did not suspect. “Negotiation about royalties was tightened... To defend my interests, I did not rely on my establishment” (case 1). “Negotiation was hard for consultancy’s contract between the School and the company” (case 2). “At the beginning, the [establishment] wanted 25 % in the capital of the company. We negotiated more than 18 months to have a license of our own works. My status is the “détachement”<sup>6</sup> from the [establishment] but it continues to pay me over the first 6 months, I do not pay off. We asked to continue that way during 2 years but I have no news since the end of May (6 months)”. “The [establishment] agrees but if I sign agreement on the license. It is tit for tat” (case 4). “The negotiation of royalties is one of the most important stages before starting a new company. Three

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<sup>6</sup> Détachement: see note n°2.

months of negotiation even if the transfer technology office is experienced in this domain” (case 2). “The licensing agreement is always in negotiation. Royalties go between 3 and 5 % of the turnover; it is huge because we still have many technical problems to solve before the production and the marketing step, what still supposes important investments. I have no experience in negotiating royalties, and no one will help me. The university tries to protect its interests, but I still belong to the university” (case 5).

Even though the researcher believes that his project belongs to his establishment as well (“it is the start-up of the university” (case 5), he discovers not only that he is going to have to pay for the right to use his research, but also another side of its establishment. The university is supposed to assist him with the project, but he must also negotiate the modalities of such exploitation. Thus, the public establishment looks at the same time for a return on realized investments and for sources of financing for its missions. This last objective appears implicitly in the Act of 1999 with the implementation of the SAIC (services of industrial and commercial activities), which allows the public establishments concerned to have a clear reading of all his activities and so to develop them more. Besides the direct return on investment, establishments also expect indirect consequences (recognition, fame). Such objectives give them a rather ambiguous role: they support the project of their researchers, advise it (with an often insufficient mastery of the Act), but in return wait for consequences which surprise the researcher and often appear as a supplementary constraint for the project.

Finally, in relations with the private investors (when one exists) one suspects that they do not appreciate the situation of the researchers who are still in the public area and not totally involved in their company. “The financiers do not like it; they would wish they are 100 % inside [i.e. means outside the frame of the Act]. The participation of the School in the capital, they can’t stand it... They are afraid that we are subsidized venture” (case 3). “The investors require that I am completely in the company. This total implication would indicate that the entrepreneur trusts his company” (case 2).

The “moving” status is perceived by these stakeholders as the expression of a lesser implication of the entrepreneur. How then to obtain his partner’s trust if he doesn’t seem to believe in his company? In a more general way, the subsidized character gives to the company is most of the time a bad point for it. So, the participations of universities or the other establishments in the capital of companies are considered unwanted, so as to reduce them to some insignificant percentages (notably in terms of control!): 5 % in the case 1 “not to frighten the investors” while the establishment wished between 20 and 25 %; 25 % in the case 3 but with a clause of exit in five years; nothing in the case 4 while the establishment wished 25 % of the capital.

In spite of the ambiguous of the original embeddedness found in many case, the process of decoupling remains relative.

### A Relative Decoupling

Links with the laboratory of the researcher are maintained in various ways: by the association, by get round the Act and by the agreement of cooperation.

-By the association. The would-be entrepreneur collaborates with the other researchers of the laboratory who lend their scientific help. This participation is made within the framework of the art. 25-2 of Act: the concerned researchers do not leave either their civil servant's status or their position within their institution and so within their laboratory. “We thought we were in the same situation and made everything together, but it is not possible because the idea is to

maintain a bridge between the company and the School” (case 3). “It is necessary to keep a link with the laboratory” (case 4). “We have other projects with the university” (case 5).

-By get round the Act. Art. 25-2 proposes a statutory organization not foreseen for spinoff and which forbids the researcher to exercise the functions of a leader and to possess more than a certain percentage in the capital of the company. It was, however, used with the agreement between the establishment of the researcher and the Deontology Commission: “We mentioned explicitly that my wife was at  $x$  level in the capital and my father at  $y$  level (case 3)”. Only one researcher involved in the project of case 2 declares him: “I am scientific consultant. I would have been able to ask for the 25-1, but I did not choose it for two reasons: professionally, I am responsible for a team and personally if I left in “détachement”, the level of wages would be the same. My wage as a professor is about the same as an engineer ... They proposed that I have a place in the board « (case 2).

-By the agreement of cooperation. It is about royalties, and also transfer of the other studies led with the laboratory, or the possible scientific collaborations. Case 5 is significant on this point: “The idea is to create a start-up able to do continuous technology transfer. We work on the long term. There will be several types of projects: to market the technology, to finance the university’s research or to simply subcontract”. Case 3 is based on exchange of services between the spinoff and the laboratory: “All developments made [by the spinoff] are in relation with the laboratory”.

The separation between the spinoff and the laboratory does not mean a total break. To maintain the links is the best way to help the development of the project. Maintaining the relation provides an evident benefit to the spinoff: its core is based on innovation; it has to keep in touch with the elements which will feed its growth. This is also why the article 25-2 presents an obvious interest because it allows the researcher to become an entrepreneur and the entrepreneur to remain a researcher.

The process of decoupling, as illustrated in the interviews, places the researcher in front of a whole series of difficulties: ambiguity of its interlocutors, ambiguity of the situation, tensions, and sometimes conflicts due to the researcher's status. The theoretical frame of the orders of worth gives elements to understand and interpret these stakes.

### **The Management of the Decoupling Highlighted by the Orders of Worth**

This concept gives an interesting clarification of the various types of tensions. As we analyzed these cases, the would-be entrepreneurs were subdivided into two groups: those that continued to be in a non-profit logic and those closer to the trade logic.

#### **The Preservation of a Strong Non-Profit Logic**

The researcher is embedded in a professional sphere (the laboratory, his colleagues) characterised by the non-profit system. They do adhere to their value system. The desire to create a company is not understood; it is even perceived as opposite to the public service, and against general interest. In one of the cases, the researcher resolves this type of tension by using a common superior principle specific to the civic world: “In my case, people understand. I have a good commercial contact, I can speak to political people, to journalists, so I can have a spinoff which will be the pride of the university. I leave a mission with the spinoff and then I go back to my establishment” (case 5). Few tensions exist here and they relate to the common superior principle of the community: every stakeholder works for it. On the other hand, in another case (case 4), the

researcher is in conflict with his establishment: continuing to take place in a non-profit area based on collective. He does not understand that his establishment does not give him all the means which he demands. The relation with the laboratory is strongly compromised: "I lost my power on the team, and at the same time no one takes over my job so that not easy for the laboratory". At the same time, his relations with the university technology transfer office are tightened. The researcher said: "They want to transfer but they are not sure what it is ... They are not efficient in the search for venture-capital... I asked for a research engineer, I got no answer, not even a negative one!". In case 4, the would-be entrepreneur remains in the non-profit field. He asks his establishment to get resources to achieve his project without any regard to their cost. That raises obvious tensions. The establishment has a cost versus profit approach of the technology transfer. They want gain on the investments they have made. Quarrels (conflicts between two worlds) are explained by the reference to each one exclusively to his own world, which does not help the development of the project

In these two cases, the private investors are not still present. In the case 4 however, they are integrated by giving funds to establishment: aside from royalties, they will have to pay cash to participate in the project (This entrance fee decided without their input shows a lack of consideration of the market world by the researcher). How can investors agree with a fee they did not negotiate?

Finally, in these two cases, the projects are still at the very beginning, which could explain why the researcher remain in the same "world" in the sense of the orders of worth.

### The Entrance to the Market World

The other would-be entrepreneurs who had a more developed project, became aware that they will have to change of "world". If their relations with the laboratory are strained similar to a quarrel, there are specific resolutions. Case 2 uses a "local classification" (temporary and not spreadable) with the choice of the 25-2 to spinoff: "In the Act, there are absurd constraints, and it was necessary to find parallel solutions". Others managed to establish a compromise between the two "world" with resolutions to each problem. Case 3 illustrates it well: "There was a search for balance. If two contracts concern software packages, the first one transfers the totality of the property to the company but with a right of free use for the laboratory. The other one grants an exclusive distribution but with an obligation to integrate developments realized with the laboratory and a right of free use of developments realized by the company for the benefit of the laboratory".

In relations with the university transfer technology office, the researchers understood that their establishment followed interests which did not always fit with their project. They were often aided by specialists in industrial property who were well-informed about legal questions on technology transfer. They knew how to sell licenses and patents at the best price. A significant example of this approach is in case 3 where every stakeholder of the negotiation agreed to be represented by lawyers (objects of the trade world) who act as referees taking into account the best interests of each. The presence of the researcher in the trade world to finalize the negotiation does not alleviate all the tensions, but it allows him to use examples of the trade logic and to solve controversies through the use of a common principle (e.g. the maximisation of the interests of each), with cases of the same nature (e.g. lawyers).

This appropriation of objects and logics of the trade world is made during the process of decoupling: the negotiation of rights about transferred research and contacts with actors of the private area, such as the lawyers, the management consultants, etc. set off this mechanism. In this

respect, entrepreneurs who follow courses in management were helped: “Following management courses helps to recognize the company’s problems” (case 1); “It is a guide” (case 3). This learning is important because the researcher is totally dependent on his references in the non-profit area. It gives him, more than a consciousness, a knowledge of another world in the sense of the orders of worth.

Moreover, relations with private investors participate in this evolution in the sense that entrepreneurs are not satisfied with their position in the civic world and ask for a real involvement in the market one. Any element which does not correspond to their world, represents for the investors an incompatible risk to the success of the project. That is why some researchers want to leave the Act before their time. “The investors require that I am completely in the company (case 3); it is the proof of my involvement (case 2)”. Being in relation with the market world seems to hasten the decoupling of the researcher.

## **Conclusion**

The theoretical framework, combining the social networks theory and the concept of orders of worth completes the entrepreneurship theory on the university spinoffs.

The results of our research show the specificity and complexity of the process of spinoff followed by the researcher, and can be abstracted in three points:

- On one hand, they clarify the notion of decoupling by explaining the nature of the link maintained with the civic world and the rise of new coordination systems that the entrepreneur has to articulate. He does not go from (Hite and Hesterly, 2001) a “cohesive” network to a more “calculative” network in the phase of development, but he changes his references. Legally, economically, statutorily, he develops other relations with the stakeholders of civic world.
  - On the other hand, they highlight the concept of structural hole. The researcher does not develop a strategy to position himself in the interface of independent networks. The Act places him that way: there is no intention in that case. At first, the researcher, if he wants to make a success of the project, has to connect the civic world and the trade one. It is more a necessity than an opportunity. Intermediation is not a wanted role, but a compulsory one. Also, this process is rather binding, if not delicate ... The concept of structural hole often presented as an advantage to be looked for by the entrepreneur is here more a source of embarrassment.
  - Finally, the results underline statutory contingency of the decoupling. This must be understood in a contextual way. The particular status of Public Service, implementation of the Act about technology transfer research, is a given element of the context of the decoupling.
- Naturally, our work calls for other research. We have at least two directions. The first should deepen investigate the reality of the structural holes in which the researcher is placed and estimate precisely the constraints and opportunities which he meets. A study more focused on the private stakeholders and their relationships with entrepreneurs could investigate the role played by maintaining links with certain actors or institutions from the public area for the profit of its relations with those of the private one. A second track of research should lead to an international comparison to identify the differences of context and impacts on the process of decoupling.

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## **AN ANALYSIS OF TRAINING AND DEVELOPMENT ISSUES AFFECTING SMALL AND MEDIUM ENTERPRISES IN THE UNITED STATES**

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### **ABSTRACT**

The development of a highly competitive, technology-based information society in the United States has caused an increased need for attracting and retaining skilled workers in small and medium enterprises. The very nature of business today requires these firms to compete on a global basis with, in some cases, less knowledgeable and skilled employees than larger firms. Success depends on such firms being able to produce a comparable product or service at a lower cost than competitors. Thus, small and medium enterprises often seek to use their human resources to create a competitive advantage. Employee training and development is one means to this end.

The purpose of this paper is fourfold. First, it provides a brief overview of why training and development is important in today's environment, paying particular attention to why employers do not train their employees as well as why they do. Second, the paper summarizes what the leading authorities say regarding employee training and development. Third, it reports the initial results of a pilot study of small and medium enterprises in West Texas in order to ascertain what types of training and development these owners and managers believe their employees need, what types of training methods are already in place for employees, and what types of training and development are needed by owners and managers. Ultimately, the paper concludes with a discussion of what this all means for small and medium enterprises.

### **INTRODUCTION**

Lack of skilled human resources as well as employee training and development has been blamed for American companies losing market share in the global marketplace (Lichtenstein, 1992; Senge, 1994; Cross & Funk, 1997; Yochelson, 2000; Carnevale, 2005). A growing illiteracy problem is also impacting employers' ability to find adequate workers. A survey conducted by the National Association of Manufacturers found that 60 percent of new jobs will require more than a high school diploma but 70 percent of new workers will not have it. Companies surveyed also stated that inadequately educated workers made it difficult to upgrade technology (Anonymous, 1992). Another study conducted by the United States government found that approximately 90 million adults do not have the literacy skills necessary to write a simple letter

(Anonymous, 1993). But, these studies were reported more than a decade ago. Hasn't this changed?

Interestingly, eight years later, *Winning the Skills Race*, a report issued by the Council on Competitiveness, concluded that there is an acute skills shortage in every part of the country that threatens the very foundation of American competitiveness (Yochelson, 2000). Additionally, a National Federation of Independent Business Small Business Poll entitled *The Changing Search for Employees* reported that 71 percent of small employers felt that qualified employees are "hard" to find, compared to 29 percent who said they "are not hard" to find (Dennis, 2001). Addis (2003) contends that small employers are still plagued by the lack of employees with basic reading and math skills. As an example, workers with inadequate reading skills are not able to interpret operating instructions for machinery properly and may not comprehend warning signs. A 2004 Administristaff survey of small and medium businesses in the United States found that the most significant problem facing these organizations was finding and retaining competent employees. Although respondents were somewhat optimistic about the future, they were concerned about providing adequate training and motivation for employees (Administristaff, 2005). Finally, the Bureau of Labor Statistics projects that during the next decade, 30 percent of new jobs will require some postsecondary education or vocational training (Carnevale, 2005). As might be suspected, employees with postsecondary education are more trainable.

Many perceive that a lack of skilled workers will affect an organization's ability to grow and prosper. This perception is particularly true for small and medium enterprises which continue to create the majority of new jobs in the United States. If current projections and research findings hold true, owners and managers will have to look for less qualified employees that will require more training and development in order to be productive as well as find ways to retain existing productive employees while continuing to train and develop them. Therefore, training and development of human resources has become the unspoken competitive advantage. Small and medium enterprises must consider employees as an investment much like new machines and apply the same effort to keep employees well maintained. To do this, they must overcome the barriers to training.

### **WHY DON'T EMPLOYERS TRAIN?**

There are five main reasons why owner and managers tend not to train and develop their employees (Tracey, 2001). First, they simply do not have the time. Managers are so busy doing more and more with less and less that they lose sight of their employees being an important competitive advantage. Second, they do not know how to give employees the training they need. More often than not, managers avoid the things they do not understand or know how to do. Third, they do not know what materials to use. There is an abundance of information in the marketplace, and the problem becomes choosing what is relevant to the individual necessitating the training. Fourth, the managers do not know how to follow up. A major concern is that managers do not know how to measure or evaluate whether the training is effective. Lastly, managers do not know how to get people to apply the new skills learned in training or to evaluate whether transfer of learning has occurred.

## **WHY DO EMPLOYERS TRAIN?**

Employers provide training and development for their employees for a variety of reasons. They may wish to orient new hires to the organization or teach them how to perform in their initial assignments. Some organizations also wish to improve the current performance of employees who may not be working as effectively as desired, or to prepare employees for future promotions or upcoming changes in design, processes, or technology in their present jobs (Fisher, Schoenfeldt, & Shaw, 1999).

Training may help an organization succeed in a number of ways. Traditionally, training facilitates the implementation of strategy by providing employees with the skills and knowledge needed to perform their jobs. Training also assists in solving immediate organizational problems. Finally, to stay abreast in a highly competitive and turbulent environment, it has been suggested that training and development must foster a continuous learning culture and stimulate managers to reinvent their corporations (Martocchio and Baldwin, 1997).

Over 21 million new jobs have been created since 1991, and most have been in small businesses (Dennis, 2001). Employers in these small organizations are increasingly sensitive to the need for flexible employees in the workplace. Ultimately, many small employers have learned the hard way that it is usually cheaper to retain and retrain workers than fire and rehire (Wells, 2001). As a result, ongoing training and development of employees in small and medium enterprises is essential to the success of the organizations. Education of current employees, whether by having them attend a seminar, conference, or a course at a local college, not only helps them work more effectively but can help with employee retention by making employees feel that the employer values their contributions to the organization enough to train them (Heathfield, 2002).

## **WHAT DO THE EXPERTS SAY ABOUT EMPLOYEE TRAINING?**

In 1990, 66 percent of German workers were involved in apprenticeship training programs, while only two-tenths of one percent of American workers were involved in similar programs (Carnevale, Gainer, & Meltzer, 1990). In addition, on average, American businesses only spend about one-third as much as Japanese companies on training per year (Noe, 1998). Some statistics also suggest that only 16 percent of American employees have ever received any training from their employers (Noe, 1998).

Approximately 70 percent of employers provide some formal training (Noe, 1998). The larger the organization, the more likely its employees have been trained. In one research study, 75 percent of respondents in firms with fewer than 500 employees received some training, compared with 82 percent in companies with more than 1,000 workers (Schaaf, 1998). According to Noe (1998), smaller to midsize firms, employing 100 to 499 people, averaged \$140,040 per company for training; these companies make up about 78 percent of the Dun & Bradstreet database of 146,837 organizations in the United States. Those businesses employing between 500 and 999

people, about 10 percent of the database, planned to spend about \$237,600 each on training. The largest companies, those with 10,000 or more employees (one percent of the database), had training budgets that averaged well over \$15 million. Of particular importance, small companies (50-99 employees) spend about one-third as much as large employers (500+ employees) (Noe, 1998). Most training and development, however, is provided to managerial, supervisory, white-collar, and salaried employees (Mincer, 1997). Yet, 80 percent of people at work today are hourly workers. Interestingly, people who in the past have received training are more apt to undergo further training in the future (Mincer, 1997).

Clearly, small businesses can raise productivity by training and developing their employees. Training ensures that the right people learn the right things at the right time and in the right priority order (O'Connor, Bronner, & Delaney, 1996). As a result, training and development is one of the primary ways to bring less-qualified employees up to acceptable standards of performance and to increase their productivity in a time of global competitiveness (Lichtenstein, 1992). In the long run, the only sustainable source of competitive advantage is an organization's ability to learn faster than its competition (Senge, 1994). Small businesses especially must train and develop their employees due to the size and quality of the labor market that has been projected for the next decade. According to Dennis (2001), 64 percent of small employers have elected to increase training in response to labor shortages. What types of training and development are small and medium enterprises utilizing? More importantly, what types of training and development are needed in small and medium enterprises?

## **SURVEY METHODOLOGY**

A mailed questionnaire paralleling questionnaires used by Solomon and Fernald (2000-2004) was sent to a stratified random sample of small business owners and managers who were members of one or more area chambers of commerce in West Texas. The survey requested a wide range of information pertaining to the areas in which the small business owners and managers and their employees need the most training and development, what methods they currently use to train and develop, and the delivery options used in the training and development process. Demographic data were also gathered. Various statistical analysis using SPSS PC+ 13 were employed on the data.

## **SURVEY RESULTS**

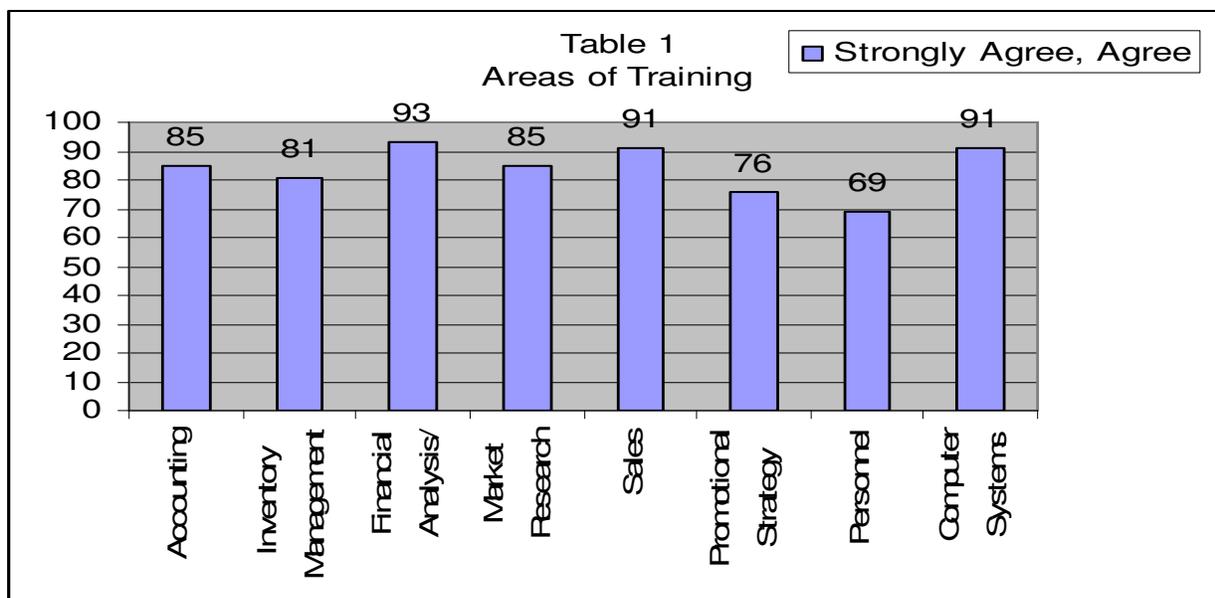
Fifty three businesses returned the mail surveys and their data were analyzed to form the basis for the pilot study. For the purpose of this paper, we will only examine three issues. First, which areas of training do employees need to better compete in today's marketplace? Second, which methods/tools does the business use to train employees? And, finally, which areas of training do the managers in the business need to better execute their responsibilities and duties? To begin, we will present a profile of the typical respondent.

### **Profile of Typical Respondent**

The typical respondent was male (71%), predominantly between 36-45 years of age (48%). Respondents had either a college education (34%) or had attended some college (30%). Their businesses were predominately professional (26%) or service (26%). The typical business has been in existence from one to 73 years with the mean being 20 years.

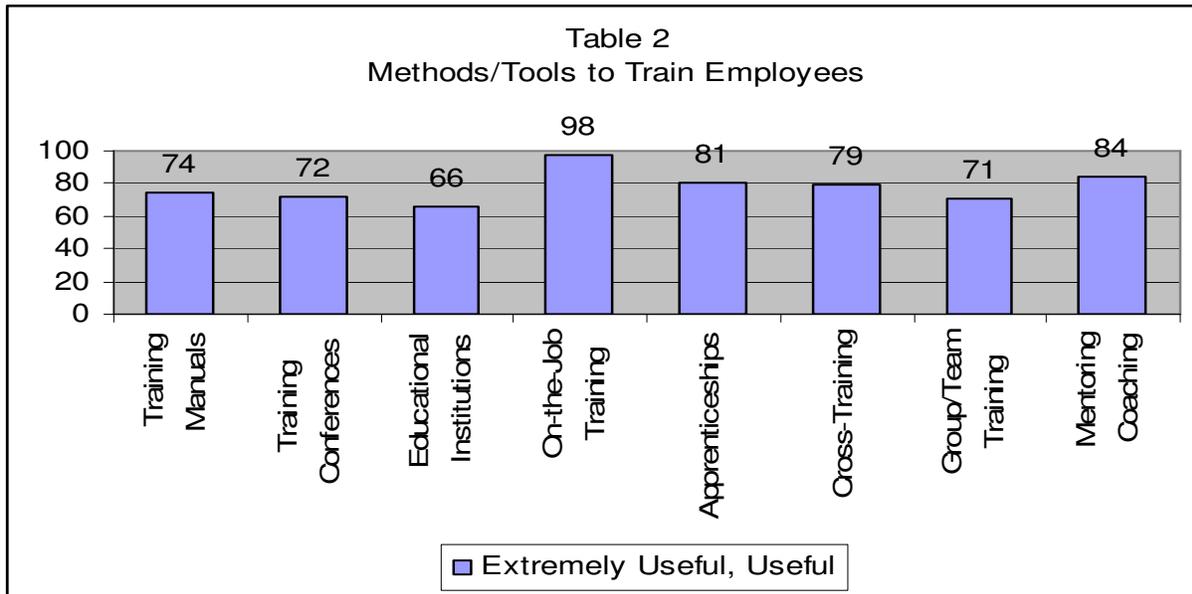
### Areas of Training Employees Need

Owners and managers were asked to indicate which areas of training their employees need to better compete in today's marketplace. Of the twelve possible choices, the responses to the top eight are displayed in Table 1. Respondents strongly agreed or agreed that the top training areas their employees need were financial analysis (93%), sales (91%), computer systems (91%), accounting (85%), market research (85%), and inventory management (81%). The data tends to indicate that those training areas dealing with the operational system of the business and the marketing of the business are the most needed in small and entrepreneurial businesses.



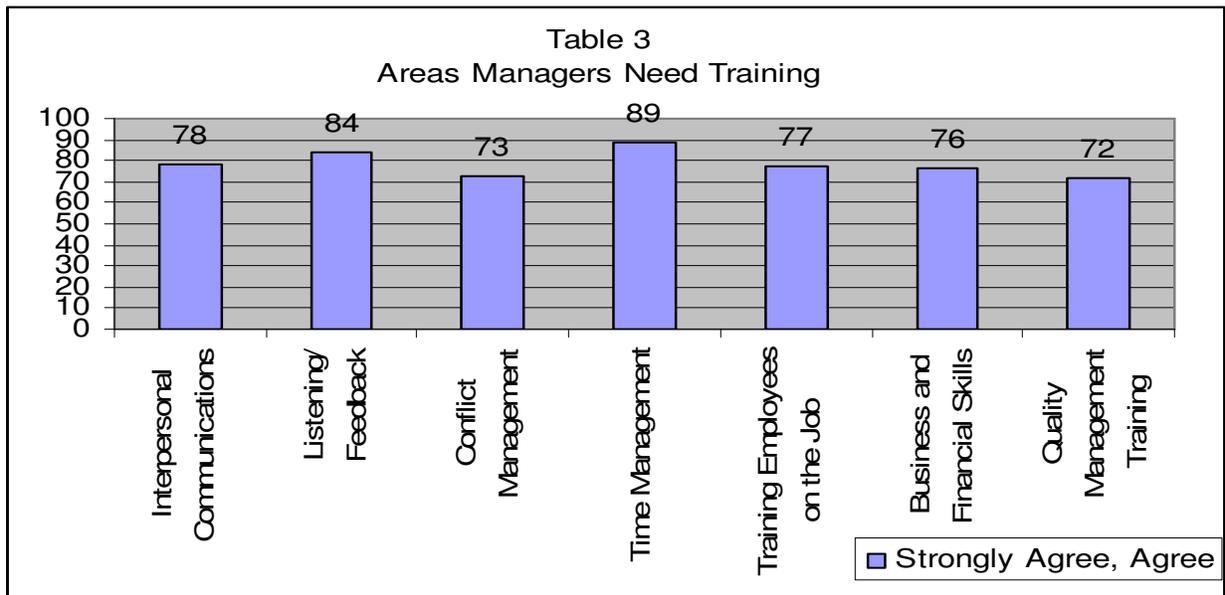
### Methods/Tools Used to Train Employees

Owners and managers of small and entrepreneurial firms were asked to indicate which methods/tools they use to train their employees. Of the 15 possible methods/tools, the top eight methods/tools are displayed in Table 2. Respondents indicated that the top training methods/tools that were extremely useful and useful were on-the-job training (98%), mentoring/coaching (84%), apprenticeships (81%), cross-training (79%), training manuals (74%), training conferences (72%), group/team training (71%), and educational institutions (66%). The data tends to indicate that most respondents believe that face-to-face training more likely done at the business is the most useful.



#### Areas of Training Owners and Managers Need

Respondents were asked to indicate which areas of training and development small and medium enterprise owners and managers need. The top eight areas of management training are displayed in Table 3. Respondents strongly agreed or agreed that training related to time management (89%) listening/feedback (84%), interpersonal communications (78%), training employees on the job (77%), business and financial skills (76%), conflict management (73%), and quality management (72%) were needed. They also perceived that owners and managers, by and large, need to have excellent people skills and also be able to handle specific operational problems such as financial and quality management. Respondents also indicated that training employees on the job is an essential factor in the success of their firms.



### CONCLUDING REMARKS

The literature indicates that today's small and medium enterprises are not providing enough training and development for their employees to be competitive. The pilot survey results provide information on the types of training that are needed for small and medium enterprise employees, methods/tools that are being used to train these employees, and the areas in which small and medium size business owners and managers need training. Generally, the data suggests that training dealing with the operational system and the marketing of the business is most needed by employees. Specifically, training in financial analysis, sales, computer systems, accounting, market research, and inventory management were reported as most important for small and medium enterprise employees.

The top training methods/tools used to train small and entrepreneurial firm employees were on-the-job training, mentoring/coaching, apprenticeships, cross-training, training manuals, training conferences, group/team training, and educational institutions. These responses are consistent with both the literature and anecdotal evidence showing that small entrepreneurs rely primarily on workplace training, or training conducted on site by the owners and managers and their employees.

Small and medium enterprise respondents reported that owners and managers, by and large, need to squeeze more productivity out of their workdays through better time management, be able to initiate, build, and maintain relationships, and also be able to handle specific operational problems such as financial and quality management. Respondents also realize that because training employees on the job is an essential factor in the success of their businesses, they themselves need training and development in order to supervise and conduct such training.

The results of this pilot study may be used to assist small and medium enterprise owners and managers as well as researchers to gain a better understanding of the training needs and methods used to conduct training, for both employees and owners and managers. It must be reiterated, however, that this is a pilot study which needs to be conducted with a larger sample size before we can be confident in generalizing the results

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# **CUBAN AMERICAN ENTREPRENEURS: CHAMPIONS OF ECONOMIC DEVELOPMENT IN FLORIDA<sup>1</sup>**

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Based on the old institutional theoretical approach of ethnic development, this paper presents a historical perspective of the role of Cuban American entrepreneurship in the economic development in Florida. The importance of ethnic small businesses in the economic progress of immigrant groups and the community is discussed. Specifically, the development of the Cuban American community in Tampa, Florida is examined. The factors that have contributed to the economic success of Cuban Americans are reviewed. Finally, future opportunities for Hispanic small businesses are discussed.

## **INTRODUCTION**

Entrepreneurship has played an important role in the economic progress of several ethnic minority groups in the United States, including African Americans, American Indians, Asians, and Hispanics. Hispanic-owned businesses account for the largest category of minority-owned firms in the United States. A report of the U.S. Small Business Administration indicates that there were 1.2 million Hispanic-owned firms in 1997, which represented a 30% increase from 1992 (U.S. Small Business Administration, 2001, March 22). Hispanic Business Inc., however, estimates that there are over two million Hispanic-owned businesses in the U.S. and this number is expected to increase to over three million by 2010 (HispanTelligence, 2004).

Although Cubans Americans only represent a small percentage of the Hispanic population (U.S. Census Bureau, March 2002), Cubans have achieved a remarkable success among Hispanic ethnic entrepreneurs (e.g. Peterson & Roquebert, 1993). In particular, the growth of ethnic entrepreneurship of Cubans in Miami, Florida has been most remarkable. The literature describes the central role of Cuban entrepreneurs in the transformation of Miami from a decaying and stagnant city to a booming economy (Rieff, 1987). While South Florida remains an ethnic enclave which has contributed to the entrepreneurial success of Cubans, few people are aware of the important role that Cuban entrepreneurs have historically played in the economic development of cities on the West coast of Florida, such as Tampa. In fact, the vision of Hispanic entrepreneurs was responsible for the birth of Ybor City which is now a part of Tampa. These entrepreneurs were instrumental in changing Tampa from a sleepy fishing village into the leading cigar manufacturing capital of the world by 1900 (Westfall, 1985).

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<sup>1</sup> The author would like to kindly thank Veatrice Farrell, Ana Beatriz Hale, Ken Hornung, Yanina Rosario, Sarah Sadd, and Frances A. Wimberley.

Based on the old institutional theoretical approach of ethnic development, this paper presents a historical perspective of the role of Cuban entrepreneurship in the economic development in Florida. First, the importance of ethnic small business in the economic progress of immigrant groups and the community is discussed. Specifically, the development of the Cuban community in Tampa, Florida is examined. The factors that have contributed the economic success of Cubans are reviewed. Finally, future opportunities for Hispanic small businesses are discussed.

## **THE IMPORTANCE OF ETHNIC SMALL BUSINESSES IN ECONOMIC PROGRESS**

When immigrant populations settle down, they are generally faced with a number of difficulties in finding entry-level jobs. Immigrants who find entry-level positions are often alienated from the main group of structured mobility with the labor market. Namely, language barriers and inadequate skills often prevent immigrants to enter positions that required some form of apprenticeship training or qualifying exams (Waldinger, Aldrich & Ward, 1990). In addition, the current economic situation may further reduce the likelihood of successful economic adaptation of these new immigrant groups (Waldinger et al., 1990). With the increased development of technology and global competition, the gap between the job requirements and immigrant skills often become a greater concern for these societies. In search of a solution, entrepreneurs begin to view the creation of ethnic small businesses as an alternative for increased economic mobility.

In the United States, small businesses have played a central role in the economic progress of several earlier immigrant groups, such as Chinese, Italians, Greeks, Hispanics, and Jews (Rajman & Tienda, 2000). By the 1980s, a substantial number of immigrants who moved to the United States chose self-employment. Statistics from the 1980 Census show that approximately 10% of male immigrants who arrived in the United States between 1965 and 1980 were self-employed (U.S. Department of Commerce, 1980). These trends have also been seen in other countries around the globe. For example, the percentage of Indian males in self-employment in England increased from 6% in 1971 to 18% in 1982 (Ward & Jenkins, 1984).

Despite the environmental obstacles faced by all immigrant groups, it became evident that success rates among various ethnic minorities groups differed. In the United States, for example, Cubans and Koreans have been more successful at establishing small businesses compared to Mexicans and Filipinos (Light & Rosenstein, 1995). Chinese and Cypriot immigrant small businesses dominated the fish and chip trade in England (Ward, Randall & Kremer, 1986). Although much of the literature has focused on the role of ethnic small businesses in the economic progress of the immigrant experiences, ethnic small businesses have also contributed to the economic development of communities. Cypriots and Asians were responsible for reviving London, England's weak East End clothing trade (Saifullah, 1979). Chinese small business owners who settled in France during 1975 also played a role in the development of a business sector in the 13<sup>th</sup> arrondissement (Guillon & Taboada-Leonetti, 1986). Cubans have also been central in the economic revival of cities in Florida, such as Miami and Tampa.

## **CUBANS ENTREPRENEURSHIP IN FLORIDA**

A little more than 30,000 people resided in the United States just before the Cuban revolution of 1959 (Portes & Bach, 1985). Political turmoil caused the first major exodus from Cuba to the

United States in the mid-1800s. Cuban political exiles plotting to overthrow Spanish rule took refuge in three U.S. cities -- New York, Key West, and Tampa (Boswell & Curtis, 1984). Several entrepreneurs in the cigar industry followed in the 1860s and 1870s by moving their operations from Havana to these three cities. The cigar companies provided additional employment opportunities for Cuban immigrants (Jaffe, Cullen, Boswell, 1980). By the 1930s, Miami, became the center of Cuban influence because it received huge numbers of exiles fleeing the effects of the revolution against Gerardo Machado. The growth and success of Cuban entrepreneurs in Miami has been well documented in the literature. The Cuban community in Miami has been accompanied by the development of an ethnic enclave (Peterson & Roquebert, 1993) and continues to be the center of a thriving entrepreneurial community. Few people realize that the pioneering Cubans living in New York and Tampa contributed to the success of Cuban entrepreneurs in Miami. Exiles who emigrated after the introduction of communism in Cuba greatly benefited from the experiences of earlier Cuban immigrants since their experiences and moving accounts of living conditions in the United States were captured in books, songs, folktales, and poetry.

Cuban Americans also played a central role in the economic development of Tampa, another city in Florida. In fact, Tampa's growth and prosperity was a result of the vision and efforts of Hispanic entrepreneurs. Ybor City, a section of Tampa, owes its birth to Cuban and Spanish-born entrepreneurs, such as Ignacio Haya and Vicente Martinez Ybor. These men were instrumental in making Tampa the cigar industry center by the 1900s. Ybor, a Spanish born native who immigrated to Cuba in his youth, became one of the early founders of the cigar industry in Havana, Cuba. He moved to Key West, Florida in 1869 after his life was threatened by Spanish agents for assisting the Cuban revolutionaries (Westfall, 1982). Ybor opened new production facilities in Key West and prospered there until 1885 when a strike convinced him to look elsewhere. Haya, another cigar manufacturer who lived in New York, shared Ybor's labour frustrations. Both entrepreneurs were searching for a new location.

After a visit to Tampa, Ybor and Haya were convinced that the environmental conditions were ideal for cigar production. The climate was warm and its location and its proximity to Cuba facilitated the importation of tobacco. A new railroad was under construction and it would further improve Tampa's strategic location for market distribution (Westfall, 1986). Although there were few local laborers available for cigar making, they did not consider it a major problem. Ybor and Haya hoped that the workers would be content in the new surroundings and there would be less labor organizations. Ybor and Haya chose land two miles northeast of Tampa for their factories (Westfall, 1985). The new industrial community, called Ybor City, was founded in 1885. Although Haya was one of the original founders of the cigar industry of Ybor City, the honor of naming the new business community went to Ybor (Westfall, 1985). Largely influenced by the trend of some American entrepreneurs to develop their own functional communities, Ybor began to plan a community to support the cigar factories by building homes for workers and commercial buildings. By the end of 1886, Ybor and his partners built 176 homes. These houses were considered superior to the worker dwellings in Key West or Havana and were used as an incentive for workers to move to Ybor City.

Ybor City was incorporated into the municipality of Tampa in 1887. The population of Tampa grew to 5,500 people in 1890 from 770 inhabitants in 1880 (National Park Service, 2004).

Although the majority of the residents in Ybor City were Cubans, the city also attracted immigrants from Spain and Italy (National Park Service, 2004). The inhabitants of Ybor City mainly made their living from cigar making and occupations related to the cigar trade. The growth of Ybor City also created a large demand for a range of commodities. Entrepreneurs quickly capitalized on the needs of the cigar workers by selling groceries, dry goods, pots and pans, and fabrics. Many Cuban entrepreneurs opened cafés, which eventually became the hub of daily social life in Ybor City. The Columbia Restaurant, currently Florida's oldest restaurant, was opened by Casimiro Hernandez who was born in Cuba. The Columbia Restaurant, now said to be the world's largest Spanish restaurant, started in 1905 as a small corner cafe serving authentic Cuban sandwiches and *café con leche* (coffee with milk) (Cavanaugh, 2003).

Eventually, Ybor City surpassed Havana as a manufacturing center of quality cigars and became the "Cigar Capital of the World" (National Park Service, 2004). Ybor City was also known as "Little Havana" as most of the residents preserved Cuban traditions and cultures. Ybor City continued to prosper through the 1920 and early 1930s, but by the end of the 1930s several factors contributed to its decline. These factors include increases in cigarette consumption, an economic depression, and improvements in technology that made machine-rolled cigars comparable in quality to hand-rolled cigars. In the 1960s, urban renewal and the U.S. embargo on Cuba finally ended Ybor City's long and prosperous reign as, "the cigar capital of the world" (Cavanaugh, 2003). As part of the urban renewal project, seventy acres and several hundred homes and buildings were demolished and leveled to make way for an interstate highway. These changes motivated civic organizations to band together to preserve the city's historic buildings and ethnic heritage (National Park Service, 2004). Protection turned to opportunity in the 1990s when Ybor City experienced an economic resurgence. Ybor City continues to grow and flourish in the present. Although Ybor City is no longer known as, "Little Havana", many people refer to the district as the "Latin Quarter".

Today, approximately 10% of Tampa's population is Latino and several of the nation's most successful Hispanic businesses are located in the Tampa Bay area (Gustafson, 2004). Recent statistics show that Hispanic immigrants in Tampa come from countries such as Colombia, Cuba, Mexico, and Puerto Rico. Cubans are now the third largest group according to the 2000 census (Steele, 2004). Currently, Puerto Ricans represent the largest Hispanic group in the Tampa area with 52,568 residents, followed by Mexicans with 35,321 residents and Cubans with 35,123 residents. Despite changes in immigration patterns, Cuban American entrepreneurs continue to succeed in Tampa. Cuban American entrepreneurs have opened new ventures, such as restaurants, tobacco import retail stores, law and accounting offices, real estate development companies, and advertising businesses. In addition, a number of Cuban American businesses are run by third- and fourth- generation family members.

### **FACTORS CONTRIBUTING TO THE ECONOMIC SUCCESS OF CUBANS**

A number of factors have facilitated the entrepreneurial activities among Cuban Americans in Florida. First, location contributed to the entrepreneurial growth in Tampa. Tampa's port is now Florida's largest and the most important economic engine in West Central Florida. It provides a direct route to Mexico, Latin America, and the Caribbean (Tampa Port Authority, 2005). Second, Cuban American entrepreneurs and workers in the cigar industry have shaped Tampa's traditions

and customs. Cuban consumer products are popular because Cuban heritage permeates Tampa's culture. Although these businesses initially targeted the Cuban immigrant community alone, many now serve broader markets. Third, strong ties within Cuban families have facilitated the growth in the entrepreneurial activities of Cuban Americans. Due to their collectivist culture (Romero, 2004), Cuban Americans entrepreneurs receive strong support from their kinship. Family members will often help to accumulate start-up capital and work in the family business. Finally, strong social networks within the Cuban American community facilitated entrepreneurial activities in Tampa. Because ethnic entrepreneurs have limited resources and less access to mainstream sources of credit and technical assistance compared to others, strong ties are important in the formation and maintenance of immigrant firms (Waldinger et al., 1990).

## **FUTURE OPPORTUNITIES FOR HISPANIC SMALL BUSINESSES**

A number of future opportunities exist for Hispanic entrepreneurs. Several resources are available to Hispanics planning to start a new venture. These resources provide future Hispanic entrepreneurs with valuable training and information to start a business. Organizations that can help future Hispanic entrepreneurs are discussed below.

### **Small Business Administration**

The U.S. SBA, specifically created by Congress to help America's entrepreneurs develop small enterprises, offers a variety of programs, such as federal contract procurement assistance and specialized outreach programs for women, minorities, and armed forces veterans (U.S. Small Business Administration, 2001, March 3). Government programs supporting minority-owned businesses include the 7(a) loan program and the 8(a) business development program (U.S. Small Business Administration Office of Advocacy, 2001). The U.S. SBA has helped thousands of aspiring entrepreneurs from various minority groups over the years; it is expected that these programs will continue to be an important program for future Hispanic entrepreneurs in the future.

### **Office of Supplier Diversity of the State of Florida**

The OSD of the State of Florida's function is to improve business and economic opportunities for Florida's women-owned and minority-owned businesses (Florida's Office of Supplier Diversity, 2005). In line with Governor Bush's One Florida Initiative to embrace diversity in the state of Florida, OSD's primary functions are the Minority Business Enterprise Certification, a program designed to increase the number of minority business enterprises throughout Florida; advocacy and outreach activities which support minority businesses and foster positive relationships; and, matchmaking activities which are designed to build relationships between minority businesses and the community. The OSD also works collaboratively with other organizations, such as Small Business Development Centers (SBDC), The Development Minority Business Development Agency (MBDA), The City of Tampa Minority Business Development Office

### **Tampa Bay Economic Development Corporation**

TEDCO, a U.S. SBA certified development company (CDC), provides funding for projects that expand small business operations and creates job in the community. TEDCO offers various programs, such as SBA's CDC/504 loan program. The CDC/504 loan program is a long-term

financing tool for economic development within a community, including the expansion of minority business development. The CDC/504 program provides growing businesses with long-term, fixed-rate financing for major fixed assets, such as land and buildings (U.S. Small Business Administration, 2005). The CDC/504 program is available to small business owners, regardless of minority status, and provides valuable assistance to all Americans, including Hispanics. Although TEDCO does not specialize in funding opportunities for Hispanic businesses alone, the Women/Minority Business Fund, a privately funded program, is designed to foster the economic development and financial growth of minority-owned businesses located within the incorporated City Limits of Tampa. Ken Hornung, President, explained that in order to be eligible for the program the business must be owned by a minority; that is a 51% or more of total ownership (personal communication, January 12, 2005). The Women/Minority Fund can provide prospective Cuban American entrepreneurs with funding opportunities.

### **Tampa Bay Black Business Investment Corporation**

The Tampa Bay BBIC, a nonprofit corporation, was incorporated as a public-private partnership between local government and the corporate community. The purpose of the Tampa Bay BBIC is to advance the economic well being of African-American-owned businesses in Hillsborough and Pinellas Counties (Tampa Bay Black Business Investment Corporation, 2005). Tampa Bay BBIC is also the loan intermediary for the U.S. SBA Pre-qualification Loan Program, a loan program available to any business that is at least 51% owned and operated by a racial or ethnic minority, woman or veteran. Frances A. Wimberly, President of the Tampa Bay BBIC, and Veatrice Farrell, Vice President of the Tampa Bay BBIC, explained that the program was originally restricted to women and minorities but the U.S. SBA recently expanded eligible borrowers to include veterans (personal communication, January 6, 2005). The Tampa Bay BBIC also is a loan intermediary for the U.S. SBA Small Office Home Office program, another loan program in which loan proceeds can be used for equipment and machinery, working capital, or business expansion. Although the programs offered by BBIC are more inclusive, prospective Cuban American entrepreneurs can certainly benefit.

### **Tampa Bay Hispanic Chamber of Commerce**

TBHCC, a private not for profit organization, is dedicated to building the community through business and creating a climate in which Hispanic businesses can flourish. Its mission is to serve the community while energizing Hispanic businesses and the economic growth of Tampa Bay (Tampa Bay Hispanic Chamber of Commerce, 2004).

### **Ybor City Chamber of Commerce**

The Ybor City Chamber of Commerce is a membership organization that represents and assists local businesses (Ybor City Chamber of Commerce, 2005). The Chamber is dedicated to the preservation, revitalization and growth of Tampa's National Historic Landmark District. Its mission is "building strength through members." While the Chamber strives to increase the diversity, Ana Beatriz Hale, Membership and Marketing Director, stated that a substantial proportion of its members are Hispanics. She noted, "I would say 50% of the members of the Chamber are ethnic entrepreneurs--either first, second, third or fourth generation or people who have recently immigrated to the United States." (personal communication, January 6, 2005). The Chamber provides prospective Cuban American entrepreneurs with a wide range of promotional and marketing opportunities which enable them to expand their potential client base. Prospective

Cuban American entrepreneurs also have access to a range of networking events, such as monthly membership luncheons and evening receptions.

### **Hispanic Business Initiative Fund**

The HBIF, a non-profit corporation registered in the state of Florida, provides technical assistance in English and Spanish for Hispanic entrepreneurs and Hispanic-owned businesses. It provides a variety of management training programs, professional services and specialized technical assistance for Hispanic entrepreneurs. For example, HBIF offers an orientation seminar for prospective entrepreneurs, which provides information on how to start a business. Yanina Rosario, Vice President HBIF, West Coast, noted, "This is a seminar that is provided to them (clients) free of charge. We walk them through the realities of stating a business. Licenses, permits, the financing process..." (personal communication, January 12, 2005). HBIF also counsels individuals who want to expand their businesses and assists with business certifications for entrepreneurs interested in participating in procurement programs. HBIF is able to provide these services free of charge because of support from grants and donations.

In conclusion, Cuban American entrepreneurs have played a central role in the economic development of Florida. Specifically, the vision of Hispanic entrepreneurs was responsible for the birth of Ybor City and the development of Tampa. Despite changes in Hispanic immigration patterns in Tampa, Cuban American entrepreneurs continue to succeed and partake in the development of the city. Given the numerous resources available to Hispanics interested in starting new businesses, it is expected that prospective Cuban-American entrepreneurs will experience greater success.

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**TOWARD A FRAMEWORK OF FINANCIAL PLANNING IN BUSINESS  
VENTURING – DEMONSTRATED BY A CASE STUDY**

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\* A preliminary draft of this paper titled “Financial Planning in New Venture Creation” was presented at the 27th ISBA National Entrepreneurship and SME Development Conference, held in Newcastle (U.K), in November 2004. The author would like to thank Klaas Dannen, Thomas Frank, Sina Heinemann, Alfred Luhmer, and Matthias Raith for critical comments and suggestions as well as Sandra Liebert for technical support. Financial support by the KfW Mittelstandsbank is gratefully acknowledged.

# **Toward a Framework of Financial Planning in Business Venturing – Demonstrated by a Case Study**

*Benjamin B. Gansel*

## **Abstract**

*We develop a coherent comprehensive framework for financial planning in business venturing. It is imperative to build a practical guideline that exhibits the financial assumptions, connections, and implications of business venturing which can be verified and tested. The whole framework can be interpreted as a linkage of decisions that provide a “sphere” within which entrepreneurial planning proceeds, strategies are quantified, decisions are made, and subsequent actions take place. This article demonstrates the applicability and employment of our financial planning framework based on a case study.*

*The foundation of the planning process comprises five interrelated financial planning elements: planning of sales, recurring expenditures, nonrecurring investments, capital requirements, and financing. This provides the groundwork for generating the financial statement. As a consequence of the decision analytic foundation, the robustness of the financial plan can be tested by employing sensitivity analysis, scenario analysis, and simulation. The implications are twofold: Firstly, our financial planning framework provides a practical guideline that aids entrepreneurs to obtain a deeper insight and thorough understanding of the financial magnitude of their present decisions. Secondly, We demonstrate that financial planning is a quantification of the corporate strategy and emerges from the action upon discovering an entrepreneurial opportunity. Thus, financial planning is strategically driven. Both are interrelated.*

## **1. INTRODUCTION AND REVIEW OF LITERATURE**

Financial planning is one of the most important but also difficult hurdles to overcome when planning a new venture. This topic has been discussed in several articles (Frankston, 1981; Gumpert & Stancill, 1986; Hayen, 1982; Hergert, 1987; McGrath & MacMillan, 1995). In addition, financial planning techniques for large-scale and international enterprises are not fully appropriate for dealing with start-up planning. Yet, there exists no generally accepted practical guideline for aligning financial planning with business venture creation. A coherent comprehensive framework which draws out interdependencies among the planning functions and financial items is still lacking (for notable exceptions see Gumpert & Stancill, 1986; McGrath & MacMillan, 1995). The importance of planning in business venturing is supported by recent research which has detected a positive correlation between planning intensity and the success of new ventures (Kugler, 2003; W. H. Stewart, Watson, Carland, & Carland, 1999). Several empirical studies highlight the positive signaling effect of a business plan (see, for example Delmar & Shane, 2003; W. H. Stewart et al., 1999; Zimmerman & Zeitz, 2002). Furthermore,

there is a significant positive relationship between formal planning by small firms and financial performance (see, for example Bracker & Pearson, 1986; Schwenk & Shrader, 1993).

Because of this gap we have developed a more appropriate framework for dealing with financial planning in business venturing. Our purpose is to conceptually aid entrepreneurs to obtain a deeper insight and thorough understanding of the financial magnitude of their present decisions. It is imperative to build a practical guideline that exhibits the financial assumptions, connections, and implications of business venturing which can be verified and tested. The framework also allows an analysis of “what if” questions. The purpose of this article is to demonstrate the applicability and employment of our financial planning framework based on the case of one real venture – “BioDup” – which is introduced in the following paragraph.

BioDup tries to enter the market of real-time thermocyclers which is dominated by big diversified biotechnology companies. While the product lifecycle for conventional thermocyclers is said to be in downturn, the market for real-time thermocyclers is expected to grow in subsequent years. Real-time thermocyclers duplicate DNA sequences in large numbers. The device developed by BioDup considerably shortens the process and can be produced at lower manufacturing costs. Both features are superior to competitor products. At the beginning, academic institutes and pharmaceutical company laboratories are the primary target market in Europe. In order to protect privacy we make the case anonymous.<sup>1</sup>

## 2. BACKGROUND

Our conceptual starting point of the financial planning framework is the entrepreneurial discovery approach, which, to a large extent, emerged in the Austrian school of economics, embedded in Kirzner's explanation of existing tendencies “... toward continual discovery and exploitation of pure profit opportunities thus tending to nudge the market in the equilibrative direction” (Kirzner, 1997, 67). The entrepreneurial discovery is characterized as “alertness” to available opportunities at which the entrepreneur takes advantage on such discoveries (Kirzner, 1973, 1997, 1999). The role of the entrepreneur can be described by taking innovative action upon discovering entrepreneurial opportunities, which nudges a dynamic process of changes whose tendency is equilibrative.<sup>2</sup> In doing so, entrepreneurs bear the risk of failure by financing themselves (Evans & Jovanovic, 1989). Kirzner (1997)<sup>3</sup> seems to suggest that perceptive entrepreneurs base their judgment on monetary calculations. Although, the pure discovery of an opportunity does not incur opportunity costs, taking action on an opportunity requires planning and calculation which is demonstrated by Minniti and Koppl (2003; 1999) using Kirzner's instantaneous arbitrage. In addition, the calculation strongly depends on the entrepreneurs' personal characteristics, due to the subjective perception of opportunities arising from personal access to information and experience as well as individual interpretation (Casson, 2003). Thus, entrepreneurs are facing different cost estimates when acting to exploit the discovered opportunity (Minniti & Bygrave, 1999).

As this perspective reveals, the profitable exploitation of opportunities is related to the task of systematic planning and the calculation of costs and revenues. So far, it is unexplained how the

potential entrepreneur conducts such calculations. There exists no generally accepted practical guideline for aligning financial planning with business venturing. Before discussing our framework, we define *financial planning* as the process of systematic and quantitative estimating of all cash in and outflows relevant for the exploitation of entrepreneurial opportunities, in order to deal with the futurity of present financial decisions (Drucker, 1959, 239). Thus, financial planning is the notional anticipation of future outcomes and the application of an appropriate decision making mechanism for dealing with uncertainties. As the project develops, the financial plan evolves and the real potential of the venture reveals (McGrath & MacMillan, 1995)<sup>4</sup>. Distinct from the definition of financial planning, the pro forma *financial plans* are the numerical results of the planning process.

Two sets of financial plans are necessary, one for internal planning purposes and one for banks, creditors, and stockholders, whereas the latter can be extracted from the internal planning process. The decision whether to act upon a discovery must not be fully based on generally accepted accounting standards (for an contrary point of view, refer to Gumpert & Stancill, 1986), as decisions in business venturing can be made independently from accounting practices. However, a framework of financial planning may be partly based on accounting standards. External addressees extensively see the financial plan, within the business plan, as a starting point for investment and financial decisions (for example Penman, 2001). Potential financiers expect to see and analyze specific details (Castrogiovanni, 1996). Hence, the official financial plan must conform to accounting practices of the government. As an internal planning instrument, financial planning primarily supports the decision making process. It should be viewed as a quantification of the specific corporate strategy emerging from the action upon discovering the opportunity. Thus, financial planning should have a strategic focus. Our framework can, thus, be interpreted as a linkage of decisions that provide a “sphere” within which entrepreneurial planning proceeds, strategies are quantified, decisions are made, and subsequent actions take place. In this sense, the financial plan for external purposes can be described as a “by-product” extracting from the internal planning process and conforming to accounting standards.

### 3. CONCEPTUAL FRAMEWORK

The financial planning process, regarded as a set of decision making instruments, requires the (monthly or periodically) planning of five related elements, defined as financial (planning) elements: (i) Planning of Sales; (ii) Planning of (recurring) Expenditures; (iii) Planning of (nonrecurring) Investments; (iv) Planning of Capital Requirements (both recurring expenditures and nonrecurring investments); (v) Planning of Financing. The production plan is derived from the planning of sales. A key instrument, defined as “Footnotes”, contains information on principles, assumptions, details, connections, schedules, and methods used to produce the financial planning elements (McGrath & MacMillan, 1995; Stancill, 2004). This provides the groundwork for the planning process. Financial planning elements are on a cash flow basis (Frankston, 1981). It is often the case that financial planning is heavily infected by accounting standards focusing on earnings and treating cash as a derivative rather than the center of attention (Howell, 2004). Figure 1 serves as a comprehensive overview for the following discussion. Planning of the financial elements provides the informational foundation to generate a pro forma

financial statement that includes the income statement, balance sheet, and cash flow statement (dotted lines).

Figure 1 about here

#### **4. PLANNING OF FINANCIAL ELEMENTS**

A crucial issue arising with any conceptual framework is the determination of the starting point. In contrast to existing enterprises, start-ups cannot take advantage of past financial data and an accounting information system. Because of the preceding market analysis, the planning of sales is a recommended starting point. Upon discovering the opportunity and analyzing the market, the entrepreneur continuously values the opportunity. The process results in the sales volume and price extracted from the preceding market analysis of estimated market needs and from a written justification of sales forecasting. Because sales volume and price is our starting point, this can be interpreted as an anchor for other planning elements, that is financial planning is driven by demand. The procedure described up to this point is demonstrated on the case study in the following paragraph.

The vision of BioDup entrepreneur's is to equip pharmaceutical researchers worldwide with a real-time thermocycler making their daily work more efficient and speed up the development process of pharmaceutical drugs. Within the first two years, academic institutes and pharmaceutical company laboratories are the primary target market in Europe. With more experience in the production and distribution process they pursue to expand geographically and in related industry markets. The key success factors of BioDup are twofold: First, the device developed by BioDup considerably shortens the process of DNA duplication and secondly, it can be produced at lower manufacturing costs. Both features are beneficial to customers and superior to competitor products. This competitive advantage is supported by a patented technology protecting the innovation because most parts of the device are delivered by vendors and, thus, leaving only the final assembling to BioDup. The technology has been developed in the university. However, a critical concern regarding the strategy reveals at this planning stage. Solely competing on the basis of a higher quality at lower costs than competitors can be an easy strategy to imitate.

An issue arising during the market analysis was related to the difficulty of obtaining sales volume. One market analysis from a consulting company provided only the number of academic institutes and pharmaceutical company laboratories using thermocyclers in Europe. From this analysis, the big three markets in Europe are Germany, United Kingdom, and France bringing together 930 companies and, thus, potential BioDup customers. Taking an average useful life of three years results in a market potential of 300 companies per year and a quantity of minimum replacement investments of 300 thermocyclers per year. Because of BioDup's superior device they pursue to capture at least ten percent of the market share in the first year and 20 percent in the second year resulting in more than 30 and 60 BioDup thermocyclers in sales volume respectively. The market of real-time thermocyclers is expected to grow on average 15 percent over the next two years, around ten percent in year three and afterwards adapting the growth rate of the biotechnology industry. With an average market price of 5.000 US-Dollars, BioDup enters

the market with an aggressive target price of 4.000 US-Dollars due to the fact of lower manufacturing costs.

At the end of year two, BioDup strategy is to expand geographically in the European market including an increase of a market potential of approximately 600 companies per year. With a stable market share of 20 percent, sales volume increases to at least 120 thermocyclers per year. Upon establishment in Europe, BioDup is planning to enter the US market in year three and four. Taking again a look at figure 1 shows that Footnotes are the foundation for generating the financial planning elements. Footnotes document the assumptions necessary to derive the financial plan, indicate the vulnerability of the venture and, thus, are always subject to review, testing, and revision. The key assumption for BioDup should be footnoted as well as reviewed and tested continuously.<sup>5</sup>

This demonstrates that sales volume and price have to be extracted and justified from the preceding market analysis of estimated market needs. Planning of sales determines the scale and scope of the new venture which also establishes the production plan that provides the foundation for planning of recurring expenditures and nonrecurring investments. The former starts with the calculation of production costs (labor, material, overhead, etc.; except depreciation). Secondly, the production plan specifies the required level of capacity of production which ascertains the needs of investments and working capital. This also influences the planning of recurring expenditures. Based on the production level, the entrepreneur calculates the remaining expenditures for administrative, selling, research and development, and other expenditures in order to complete the element planning of expenditures. This provides considerable information to construct partly the income statement.

## **5. FINANCIAL STATEMENT**

The financial statement consists of the income statement, balance sheet, and cash flow statement which could be expanded by statement of stockholders' equity. In this section we demonstrate how to generate each of these statements from the financial planning elements.

## **6. DECISION MAKING**

The issue that needs to be addressed is which approach should guide the entrepreneur in her present decisions. Besides factors such as intuition, feeling, and experience, other important methods include systematic planning and forecasting. Relying on intuition (Allinson, Chell, & Hayes, 2000; Bird, 1988; Bird & Jelinek, 1988) contradicts the fact that planning takes place before taking human action (Locke, Latham, Smith, & Wood, 1990). Simply speaking, the entrepreneur can examine her fundamental assumptions and estimations before investing in tangible or intangible assets. By estimating the timing of cash flows, the entrepreneur anticipates bottlenecks and financial slacks which enhance the allocation of scarce resources. For this, our framework can be interpreted as a linkage of decisions that provide a "sphere" within which entrepreneurial planning proceeds, strategies are quantified, decisions are made, and subsequent

actions take place. A decision made today creates a set of subsequent decisions and alternatives tomorrow (Hammond, Keeney, & Raiffa, 2002). The framework supports the entrepreneur to turn her vision and goals into concrete stepwise activities as well as to make decisions faster based on numerical values than with slower trial-and-error learning (Delmar & Shane, 2003). By knowing and understanding the associated uncertainty, the entrepreneur is able to rationally select among risk taking courses of action, instead relying on intuition, hearsay or experience (Drucker, 1959).

## 7. CONCLUSION

In this article, we develop a coherent comprehensive framework for financial planning in business venturing. The whole framework can be interpreted as a linkage of decisions that provide a “sphere” within which entrepreneurial planning proceeds, strategies are quantified, decisions are made, and subsequent actions take place. A decision made today creates a set of subsequent decisions and alternatives tomorrow. Our framework supports entrepreneurs in turning their vision and goals into concrete steps to be taken. The approach is value-driven meaning that the entrepreneur exploits only value adding opportunities based on her expectations and calculations. The foundation of the planning process comprises five interrelated financial planning elements: planning of sales, recurring expenditures, nonrecurring investments, capital requirements, and financing. This provides the groundwork for generating the financial statement. Finally, the robustness of the financial plan can be tested by employing sensitivity analysis, scenario analysis, and simulation.

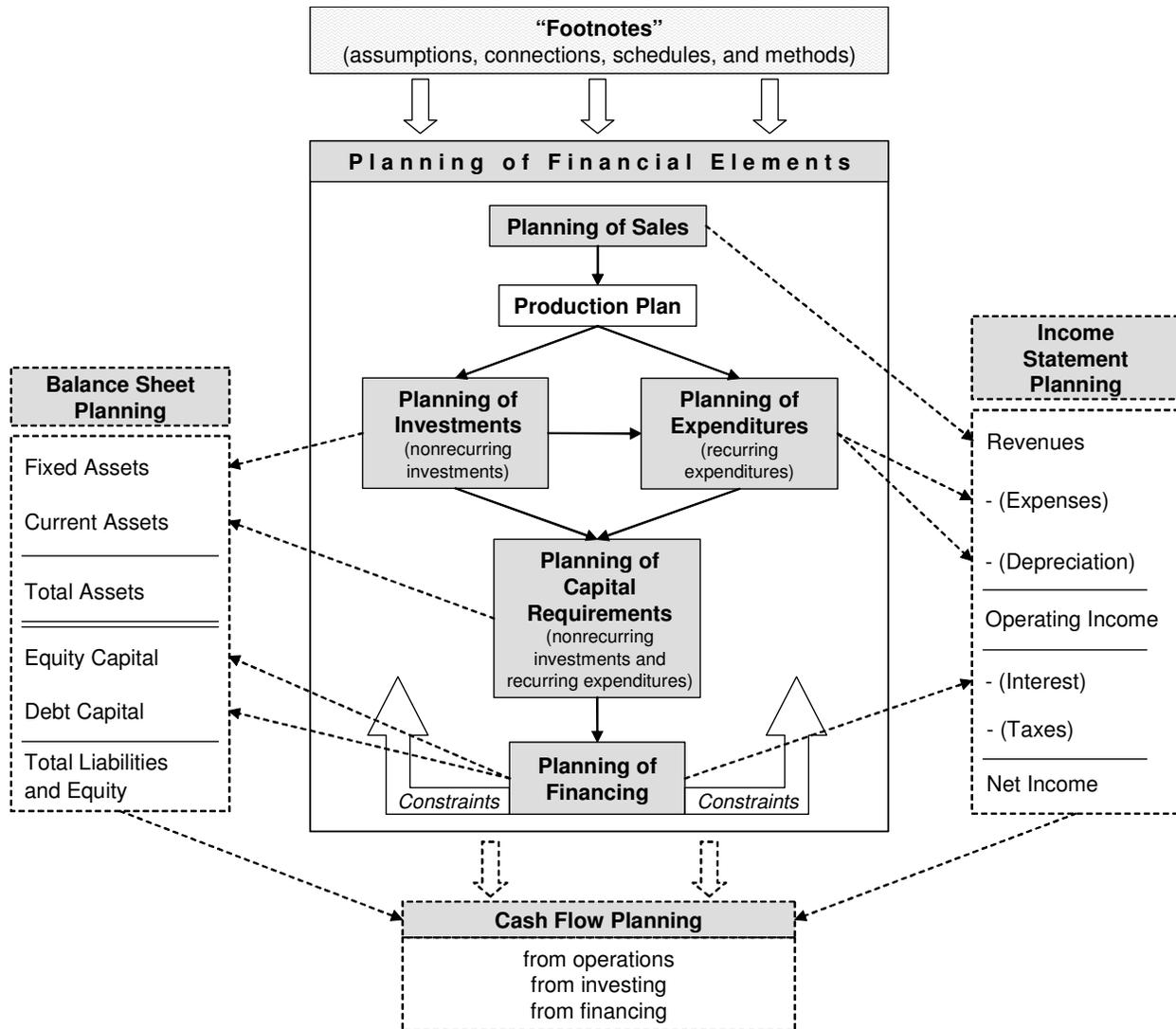
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**Figure 1: Conceptual Framework of Financial Planning in Business Venturing<sup>6</sup>**



## 9. ENDNOTES

<sup>1</sup> To make the case anonymous we have modified three things: The name of the venture, the industry, and the product. In this article, we are describing the real market structure, market volume and price, competitive advantages, cost structure, production plan, investments, and financing as it is in the real case, however, the biotechnology market and the real-time thermocycler is fictitious indicating that they are inconsistent with reality.

<sup>2</sup> There are other ways of understanding the term entrepreneurship (see, for example Baumol, 1993; Casson, 2003; Schumpeter, 1934; A. Stewart, 1991; Venkataraman, 1997).

<sup>3</sup> Kirzner (1997) refers to Rothbard (1994) and Salerno (1993; 1994).

<sup>4</sup> Because of this McGrath and MacMillan (1995) define planning as discovery-driven planning.

<sup>5</sup> Because of the reduced paper version, we neglecting the case study and focusing only on the general procedure from this point.

<sup>6</sup> Although the planning of balance sheet, income statement, and cash flow statement are simplifications, they are for the present purpose.

# USING INFLUENCE DIAGRAMS TO STRUCTURE THE PROCESS OF NEW VENTURE CREATION

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## Abstract

Influence diagrams and decision trees provide a convenient yet powerful approach for modeling, understanding, and evaluating multistage decision problems under uncertainty. Although both instruments are isomorphic, the size of decision trees becomes critical in situations with a high level of complexity. Influence diagrams offer a more compact approach in the structuring and planning phase. They incorporate the complex interdependencies and show the flow of information and decisions. By distinguishing between decision and chance nodes, they provide a precise description and structure of the entrepreneurial decision making process.

In this paper we demonstrate the application of decision making instruments to the financial planning process in new venture creation. The implications of a decision-analytical are twofold: Firstly, influence diagrams and decision trees are excellent methods to construct the scope of plausible future states, to show the flow of information and sequence of decisions, to structure the process of decision making in a more constant and precise way, and to identify critical decisions to be made. Influence diagrams are simple to understand, they are straight-forward to construct, and they provide an optimal basis for computer-aided decision support. Secondly, our approach helps entrepreneurs move beyond intuition. Relying on intuition contradicts the fact that planning takes place before taking human action. Hence, our approach provides entrepreneurs with a deeper insight and thorough understanding of the financial magnitude of their future decisions.

## **WOMEN'S BUSINESS CENTERS AS DRIVERS OF NASCENT ENTREPRENEURSHIP**

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### **Abstract**

According to the Global Entrepreneurship Monitor research project (GEM) women have lower nascent entrepreneurial activity rates than men. In the U.S., the passage of the Women's Business Ownership Act of 1988 (HR5050), provided seed funding for women's business centers through the Small Business Administration. Women's business centers were targeted to provide technical assistance to women for business formation, particularly women who were socially and economically disadvantaged. This study examined the accomplishments of women's business centers throughout the U.S. and found that women's business centers are drivers of nascent entrepreneurship by women. Centers consistently serve clients who are economically and socially disadvantaged. Two-thirds have household income below \$50,000, less than half have more than a high school education, and 42% are women of color. The study data indicates that approximately 40% of women's business center clients are nascent entrepreneurs, well above the national rate of 8.2% found in the 2003 GEM U.S. data. The success of women's business centers can be attributed to shared practices targeted specifically to women's situational needs. Programming tailored to women's interests and needs, a relationship-oriented approach, and networking activities that create a bridge to business culture are key practices consistently used by women's business centers nationwide. Increased funding and community support would enhance the impact of women's business centers and augment a powerful source of nascent entrepreneurship and economic development among disadvantaged women.

### **INTRODUCTION**

The Global Entrepreneurship Monitor research project has consistently shown that women have lower entrepreneurial activity rates than men. Although the United States has the highest level of entrepreneurial activity among G7 and First World countries, the gap in disparity of entrepreneurial activity persists by gender (Acs et. al, 2005). And while 2003 U.S. data shows a bounce back in nascent entrepreneurship to pre-2001 levels for men, the nascent entrepreneurship of women continued to lag (Minniti and Bygrave, 2004). Entrepreneurship is a means for economic development, as new venture creation contributes employment, income and many multiplier effects to an economy. Accordingly, policy implications of the entrepreneurial gender gap include a focus on

training and technical assistance in support of entrepreneurial activity by women. Gnyawali and Fogel (1994) define the “entrepreneurial environment” as a combination of factors influencing the development of entrepreneurship. One portion relates to the economic and socio-political factors that influence individuals’ proclivity and ability to undertake entrepreneurship. The other portion relates to the availability of technical assistance and support for entrepreneurial endeavors. Governments may influence all of these factors. Public policy targeted to the provision of technical assistance to aspiring entrepreneurs should therefore be expected to improve the entrepreneurial environment and new venture creation. Using the framework of expectancy theory, Gatewood (1993) posited various possibilities for the influence of public assistance organizations on new venture creation. This research study looks at the women’s business center movement in the United States, initiated by federal legislation, to ascertain the impact and effectiveness of targeted technical assistance and support for new business creation by women.

With the passage of the Women’s Business Ownership Act of 1988 (HR5050), seed funding for women’s business centers became available through an annual grant process administered by the U.S. Small Business Administration. Women’s business centers were targeted to provide technical assistance to women for business formation, particularly women who were socially and economically disadvantaged. While a few women’s business centers pre-date the 1988 act, most women’s business centers were founded in the early to mid-1990s when a confluence of positive entrepreneurial environment factors, including federal policy, provided a national platform and increased opportunities. Since these entrepreneurial programs targeting women were initially established, they have been steadily expanding their reach – both geographically and demographically; there are now approximately 100 known women’s business centers in the U.S. These community-based centers target education, training, and technical assistance to under-served and under-privileged women, precisely those who are the lagging group of nascent entrepreneurs.

This research study focused on assessing the impact and effectiveness of women’s business centers and includes data from centers in 33 states as well as the District of Columbia. More specifically, the research: 1) describes the diverse profile of existing centers; 2) examines key shared practices; and 3) assesses the opportunities and challenges that women’s business centers confront. This project helps us understand the impact women business centers have on our national economic landscape and the policy implications for how their work can be improved and extended. Our analysis shows that women’s business centers are effective developers of nascent women entrepreneurs through the woman-centered shared practices they bring to technical assistance and support. This paper is divided into the following sections: a) an overview of the methodology used in the research; b) a description of the demographic profile of women’s business centers; c) a discussion of the shared practices that contribute to center effectiveness; and d) the challenges and needs centers face as they seek to continue their work.

## **METHODOLOGY**

The research is based upon survey methods as well as focus groups. Fifty two center directors responded to the research survey. In addition, 34 center directors participated in focus groups. The survey responses, informed by the focus group discussions, form the basis of the data and conclusions in this study.

One-hundred institutions were pre-qualified as women's business centers through phone and e-mail interviews. To be considered a women's business center, organizations had to be: a) a 501(c) 3 non-profit entity; b) focused primarily on women clients starting businesses or, if part of a larger organization, have a dedicated staff focused on women clients; and c) provide short-term and long-term technical assistance, training and business counseling. After piloting the survey with 5 women's business centers, we distributed our 144-item survey. Over half of the identified women's business centers (n= 52) responded, providing a national sample of centers representing a diversity of age, locale, budget, and experience. The majority of centers (87%) have received SBA funding.

Three separate focus groups were conducted in conjunction with national conferences attended by center directors, with a total participation of 34 directors. The focus groups met for approximately one hour; the meetings were tape recorded and transcribed. In addition to participating in the discussion, focus group participants were asked to complete a written form identifying themselves and their center. They also had an opportunity to respond to focus group questions on this form. A written analysis was generated for each focus group based upon the transcription. The focus group discussion protocol concentrated on gender-specific needs of women entrepreneurs, the economic impact that women's business centers are able to make in women's lives and in the community, whether the training at women's business centers affects the way women run their businesses and successful practices at women's business centers.

## **DEMOGRAPHICS OF WOMEN'S BUSINESS CENTERS**

Women's Business Centers were created to assist socially and economically disadvantaged women in starting and building their own businesses, and the data shows that they are indeed accomplishing that mission. Centers range in age from less than a year to 28 years old, but nearly half of the centers are less than 5 years old. Approximately two-thirds of centers have one location only and just over half the centers share their location with another organization. Three-quarters of the centers responding to the survey are located in urban areas with a similar proportion of the less established (under 5 years of age) and more established centers located in urban areas. The majority of standalone centers are located in urban settings. Centers serve clients across a broad spectrum of the community.

In this study, centers reported an average of 79 clients visiting per month, with one center serving as many as 350 clients per month. (Actual activity at centers is no doubt higher as clients tend to visit multiple times per month and directors distinguish between clients served and contacts made. The survey asked only about the number of clients served per month.) There was a significant correlation between center age and the number of clients served per month, with the older centers serving clients at a higher rate. While older

centers on average have more employees, there is no significant correlation between the size of the center's staff and clients served per month. Thus, something besides staffing must account for the increased productivity among the more established centers—perhaps experience. No significant relationships emerged between location (urban vs. nonurban) or co-location and the number of clients served by centers per month. In addition, approximately three-quarters of the centers noted an increase in the average number of clients per month during the past year. The proportion of centers which reported a growth in client rate was consistent across location (urban vs. nonurban), age, and co-location.

Women's business centers serve a demographically diverse and disadvantaged clientele, and the majority of these clients are presently managing a start-up business. While the majority of clients served are women, the centers also serve men, who comprise an average 13% of clientele. Nearly one-half of all clients are considered a member of a minority group, the largest group being African Americans (23%), followed by Hispanics (10%) and Asian Americans (5%). Reflective of the general population, minority representation among clients is higher in the centers in urban areas. Centers consistently are reaching a diverse population regardless of how long they have been in operation and whether or not they are co-located with another organization. The average percentage of minority clients is 43% for all centers in the sample. This is consistent with the July 2004 National Women's Business Council study, which estimated that 46% of all women's business center clients in 2003 were minorities (Richtermeyer and Fife-Samyn, 2004).

Women's business centers also serve a modestly educated population of clients. Almost half of clients have only a high school diploma (49%), with 6% having less than a high school education. Centers in nonurban areas report a slightly lower proportion of clients with at least a college degree (41%) than those in urban areas (47%). In general, the educational distribution of the clients served by the centers is consistent regardless of age, location, or whether or not the center is co-located, with an average of 55% of the clients having at most a high school degree. (Sample size dropped to 28 center responses for these demographic questions due to non-response or the lack of tracking of this information by the centers.)

Centers that could estimate income level of their clients report that two-thirds of clients served have a household income less than \$50,000, and nearly all clients (94%) have a household income less than \$100,000. This income distribution of clients was consistent for older and newer centers, as well as for co-located and stand-alone centers. However, centers located in nonurban areas report a significantly greater proportion of clients with a household income less than \$50,000 (90% vs. 57%,  $p < .05$ ). (Again, sample size dropped to 29 center respondents for these demographic questions due to non-response or the lack of tracking of this information by the centers. These income categories represent those given to the respondents on the survey.) Thus in general women's business centers serve a population that can be considered predominantly economically disadvantaged.

With each center reaching an average of just under 1,000 clients per year, the level of nascent entrepreneurship is high. According to the Global Entrepreneurship Monitor (GEM) 2003 report (Minniti and Bygrave, 2003), total nascent entrepreneurial activity among women in the United States is 8.2% of the adult population. On average, the

centers in this research reported that more than 60% of their clients were managing a start-up business and 66% of those were nascent entrepreneurs, managing a start-up that is less than three years old. In other words, approximately 40% of women's business center clients are nascent entrepreneurs compared with the general rate among U.S. women of 8.2%. The proportion of women's business center clients who owned a business was similar in both urban and nonurban areas and it was also similar regardless of age of the center, and whether or not it was co-located. The conclusion is clear: women's business centers succeed in their mission. They are drivers of nascent entrepreneurship among women who are socially and economically disadvantaged.

## **SHARED PRACTICES CREATE EFFECTIVENESS**

Women's business centers exhibit shared practices that underlie their success and constitute the source of their uniqueness. These shared practices address many of the situational and cultural barriers of the women clients they serve (Brush, 1997). First, centers tailor programming to be relevant to the industry interests and time schedules of women clients. Second, centers use a relationship-oriented approach to attract targeted clients and to create a safe environment based upon trust and connection. Finally, women's business centers focus on network building to create a bridge to business culture for clientele. Through this activity, women's business centers create a community of support that enhances the success of both programs and clients. Networking, mentoring, role-modeling and peer-to-peer roundtable discussions are key shared practices that support this objective. This section provides an overview of key research findings identified as shared practices forming the foundation of success for women's business centers nationwide.

### **Tailored Programming**

The main objective of women's business centers is to provide technical assistance and support to aspiring women entrepreneurs. Through tailored programming, women's business centers pay close attention to clients' interests and the reality of their lives, customizing programming to best suit the needs of women. Programming is offered across a range of topics and formats, covering both business functional topics, as well as support services. The most frequently attended formats are one-hour seminars followed by one-day workshops. Clients typically prefer the morning or noontime periods, as opposed to the afternoons or evenings for programs. Center directors report that the most frequently attended sessions are on business planning, finance, and marketing, while the least attended sessions cover employment/origination and equity financing.

In addition to functional business training, women's business centers offer clients the opportunity to explore and learn about an array of industries. The industries that clients expressed the greatest interest in are retail (96%); accommodations/food (90%); other services, including child care and pet care (90%); and arts, entertainment, and recreation (76%). Clients express the lowest level of interest in manufacturing and biotechnology.

Women's business centers also tailor educational programs in order to "meet clients where they are," particularly with respect to low-income minority women. The consensus among directors at the women's business centers in this study is that women

entrepreneurs who seek assistance through the centers have a dimension of needs that are specific to their experience. According to the directors, these women's distinct needs often reflect a lack of experience in the business world, an inability to secure funding and a disproportionate amount of childcare responsibility. Directors confirm that these needs are particularly evident among the low-income minority women their centers serve. Specifically, women usually shoulder more time-consuming family responsibilities as caregivers and have less access to credit and lower financial or business literacy. Also, many women clients view their businesses as a way to provide for and spend more time with their families. Finally, in their efforts to start businesses, women clients may experience role incongruity, putting social gender expectations as caregivers in conflict with business leadership expectations as entrepreneurs. This is often particularly apparent among women of more traditional gender-role ethnic culture backgrounds, such that they receive less family support for their business endeavors (Native American, Hispanic, Iranian, rural Caucasian, and Taiwanese women were mentioned). Directors also perceive that ethnic and racial minority women often experience less respect from business community members as well due to stereotyping (bankers, educators and administrators were specifically mentioned).

Given the realities and experiences of women clients, directors report that center clients are often more anxious about the prospect of starting a business. In response, center programming is tailored to address the personal as well as business development issues that clients face as they seek to start businesses. Some specific programs mentioned were "Workshop on the Mindset of Women Business Owners," "Life Skills Seminar on Empowerment," "Balancing Life and Family," and "Women's Networking and Empowerment Series." A final area of tailoring reflects the educational and English language level of center clients. Because many women's business center clients are recent immigrants, for whom English may be a new language, adjustments are made. In some cases, bilingual education is provided while in others curricula are designed around a secondary school educational level and teachers are trained to speak slowly and without American idioms. The distinct needs of women's business center clients constitute the situational barriers they experience as a result of social and economic disadvantage. Tailored programming can help break down some of these barriers.

### **Relationship Orientation**

A second shared practice among women's business centers is a relationship orientation manifest in one-on-one outreach, counseling and long-term connection with clients. This relationship orientation creates a supportive learning community and is an important aspect of the services provided by women's business centers. Through this approach, centers are seen by the women clients they serve as "safe spaces" for learning and the pursuit of their entrepreneurial goals. Programming that prioritizes content common to and valued by women, and that is delivered primarily by women staff, sends a strong signal to clients that women's business centers are a safe and accessible educational space for women.

Directors noted that some women clients seek the help of a women's business center to start a business because they are experiencing a financial or personal crisis, such as divorce or job loss. Others, as noted earlier, may do so to overcome the gender role

constraints of their home environments. The relationship-orientation combined with the high percentage of female staff members, encourages clients to confide in center professionals about their position in their family hierarchy and how it may curtail their financial independence. The relationship orientation itself then becomes a support service tailored to women.

A focus by centers on connection and relationships does not negate the pedagogical focus on serious accomplishment of entrepreneurial goals. Many directors commented that clients often seek out the refuge of a women's business center after trying to attend business training classes offered by other organizations. Center directors are sensitive to the needs of women, both in terms of situational barriers and learning style preferences. Many directors talked about their observation that women have different "learning styles" from men. One center director noted, "Women have different learning styles from men. We try to establish a personal connection with women. Women are often intimidated by men." Directors perceive that women value learning through relationships rather than learning in an impersonal way, and that women respond better when taught in a holistic manner instead of being taught specific skills in a piecemeal fashion. As women's business centers adapt to these needs, they are nonetheless firm in their focus on inspiring and training women to establish businesses. In the words of a director, "We like to say, we hold hands, we give you hugs, and we kick you in the butt."

Center directors are acutely aware of the gender-role, race and class-specific obstacles to starting a business which their client population faces. Women's business centers provide entrepreneurial education and support programs targeted specifically for women, and delivered with an approach designed to build trust and connection. This programmatic tailoring and relationship oriented philosophy are unique features to women's business centers.

### **Network of Connection**

A third shared practice identified among women's business centers is the use of high-touch support services to build a network of community, provide access to opportunities, spotlight aspirational role models, and build professional and personal development. Through this network of connection, centers provide a bridge to business culture for their clients.

Mentoring, role modeling and networking opportunities are among the most important of support services that centers provide to their clients. More than 80% of the centers provide networking, mentoring and peer-to-peer learning opportunities. Other important personal development support services provided include time-management and leadership training. Many focus group participants noted that women clients often report a sense of profound loneliness that center programs can help quell, by providing role models and a network. One director described the importance of networking for her clients, "[Starting a business] feels very daunting. Some of that is reduced by seeing women who look like themselves and women who have had the same experience succeed."

Often, women's business center clients have not had the opportunity to participate in the mainstream educational and economic environment. At the centers, aspiring women business owners have the opportunity to learn about business culture from successful women entrepreneurs. Networking opportunities provide a sense of camaraderie and emotional support among women, and serve as a primer for how to navigate in a business setting, how to make contacts, how to make an entrepreneurial pitch, and how to follow up on a connection. Directors underscored the importance of this networking as a bridge to the business community. One spoke about how women often do not know what type of business they would like to start, and how women have various and complementary skills, "Not every woman can by themselves create a business, but some of them together can. We can get them together. Women like to share their business ideas." Women's business centers serve as a locus of connection to potential business partners, entrepreneurial role models, and business community contacts for their clients.

Through the shared practices of tailored programming, relationship orientation and network building, women's business centers create a positive environment for socially and economically disadvantaged women to take advantage of technical assistance and support for building businesses. The approach to entrepreneurial education shared among women's business centers creates effective results with respect to the number of clients who are nascent entrepreneurs.

## **CHALLENGES AND OPPORTUNITIES**

Despite the effectiveness of women's business centers, specific challenges and opportunities present themselves. The top three challenges center directors perceived are securing funding, center infrastructure, and working with the Small Business Administration (SBA). These challenges are interconnected. Funding levels affect a center's ability to develop its infrastructure through additions to staff or technological capability. And, because SBA funding plays a major role in most women's business centers' operating budgets, working with the SBA is intimately connected to the funding challenge. These challenges can also be seen as opportunities. Specifically, women's business centers can extend and enhance the impact of their work by diversifying their sources of funding and creating stronger connections with both the Small Business Administration and with other like-minded community and business organizations. This section summarizes the research findings with respect to the challenges and opportunities facing women's business centers.

### **Funding**

As non-profits, women's business centers operate on lean budgets as well as with lean organizations. Annual budgets range from a low of \$25,000 to a maximum of \$3.1 million, with an average budget of approximately \$745,000 per year. Location does not have a significant impact on the average budget of the centers in our sample. Not surprisingly, centers that are co-located and centers that are less established have significantly lower budgets—most likely because both have smaller staffs, on average.

A high percent of the centers (87%) have at some point in time received grants from the SBA. SBA funding plays a major role in sustaining women's business centers, accounting for an average 42% of center funding, but other major funding sources include private sources including fee income (18%), bank loans (5%), public and private grant foundations (16%), and non-SBA government sources (14%).

Funding is the single greatest challenge to sustaining the success of women's business centers. Funding is the most common concern of center directors—more than 70% of the centers list it among their top three challenges. A series of perceptual questions on funding reveals that while few directors are satisfied with the current financial state of their centers the majority have a financial plan and believe they have the skills required to raise funds. And, while 73% of directors report optimism about growing support for women's enterprise, a comparable proportion senses a more difficult funding climate.

### **Infrastructure**

Funding and staffing are closely connected. Women's Business Centers operate with fairly lean organization structures. The typical center has an average of five full-time and two part-time employees. Leadership of the centers is reasonably stable, with the tenure of a center director averaging four years. In addition to this daily leadership, nearly 90% of the centers in our sample have a board of directors. Many directors report that they do not have enough time to raise funds and develop relationships with financial institutions. Often, staffing to pursue financing is tight due to the one-on-one relationship approach with clients emblematic of the women's business center approach. The structure of grants also presents challenges to programming and staffing. Further, since grants are often given on one-to-three-year cycles, center directors report that they face running out of funds for existing projects and the challenge of providing consistent services. Further, funding is often available only for *new* initiatives, and directors complain that they do not have enough staff to service current programs, let alone invest in new ones. Finally, since grant funding generally may not be used for operating costs, having the resources to adequately support staffing is often a challenge. As one director commented, "Federal government funding is most available, but has to be matched with state money—none of it is for operating costs. [We need money] so that people can do the work."

Since funding directly affects the staffing level a center can afford, it, in turn, produces other challenges that center directors mentioned: the ability of the centers to follow-up with clients, to reach out to low-income minority women, to secure attendance at classes, and the ability to train existing staff members, especially in the areas of technology and grant writing. A lack of staff or high staff turnover feeds into the challenge of establishing leadership and maintaining the women's business center culture at centers. The challenge of adequate infrastructure is acutely felt by women's business centers.

### **Collaboration with the U.S. Small Business Administration**

Strong collaboration with the Small Business Administration poses another major challenge for women's business centers. Just over half (55%) of directors expressed satisfaction with the financial support received from the SBA but barely one third (31%)

are satisfied with the SBA grant process. Enhancing the disparity in satisfaction with the SBA would be beneficial to women's business centers. When asked what improvements center directors would like to see in the relationship between their centers and the SBA, the overwhelming answer was better communication (54%). Center directors were not sure that the SBA fully understood the work actually being done by the centers and admitted that they did not always clearly understand the SBA's procedures. Many directors would like to see better direction from the SBA on procedures and guidelines and stronger lines of communication. Further, many directors voiced the impression that the SBA did not seem to care about the work that women's business centers do. One wrote, "I would like for the district direct to acknowledge and appreciate the efforts and accomplishments of our center," while another commented that she longed for "a sense that SBA cares if we live or die." Other major concerns about the SBA were the amount of paperwork they needed to fill out for SBA funding (14%), the amount of time it took for the SBA to provide reimbursements (12%), and the desire for more funding (10%).

Overall, funding, infrastructure needs, and connection to the SBA pose serious challenges to the daily operations of Women's Business Centers. Despite these constraints, centers succeed in providing effective outreach and entrepreneurial education to socially and economically disadvantaged women.

### **Opportunities**

Given the effectiveness of women's business centers, it is worthwhile considering the opportunities for extending and enhancing their work. The evidence from this study suggests several possibilities. The first, and perhaps greatest, opportunity for enhancing center effectiveness relates to increased funding. Since women's business centers have an established track record of creating nascent entrepreneurs among a population of socially and economically disadvantaged women, increased funding for existing as well as new centers would likely extend that success. A second opportunity is available through the diversification of funding sources. Funding is a critical issue for centers as they are largely dependent on outside funds rather than fee or programmatic income for their operating budgets. Funding has become increasingly difficult in recent years and the Small Business Administration is providing less than sufficient support for women's business centers. The funding environment is extremely challenging for center directors serving a clientele that continues to grow with each year and who lack equal alternatives to turn toward for assistance. In a challenging funding environment, any opportunity to further diversify and enhance sources of funding for a center should be seriously considered. Third, improvements to both federal and local organization connections may benefit women's business centers. Certainly a revised operating approach on the part of the SBA would be welcomed by center directors. But given the status quo, directors might prioritize emphasis on improving local relations with business and community leaders. Capitalizing on local connections might yield the dual benefits of enhancing client networking opportunities and augmenting center fundraising sources and levels.

## **CONCLUSION**

This study examined the accomplishments of women's business centers throughout the United States and found that women's business centers are drivers of nascent entrepreneurship among women. This track record can be seen in the following findings:

- Women's business centers consistently serve clients nationwide who are economically and socially disadvantaged. Two-thirds have household income below \$50,000, less than half have more than a high school education, and 42% are women of color.
- On average, 60% of women's business center clients are actively managing a business venture and two-thirds of these clients have businesses less than three years old. Overall, this indicates that approximately 40% of women's business center clients are nascent entrepreneurs, well above the rate of 8.2% among U.S. women.
- The success of women's business centers can be attributed to shared practices targeted specifically to women's situational needs. Programming tailored to women's interests and needs, a relationship-oriented approach, and networking activities that create a bridge to business culture are key practices consistently used by women's business centers nationwide.

Women's business centers serve an important role as unique providers of business formation education to women clients who are socially and economically disadvantaged. Increased funding and community support would enhance the impact of women's business centers and augment a powerful source of nascent entrepreneurship and economic development among disadvantaged women.

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## **HELPING SMES SUCCESSFULLY TRANSFORM THEIR BUSINESSES THROUGH MANAGEMENT DEVELOPMENT**

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### **ABSTRACT**

Adding to the existing body of research on the strategic development of Irish SMEs, this paper proposes a model for a management development programme (TRANSFORM) for developing the skills of owners and managers in SMEs. In addition, this paper details the transfer of learning back to the workplace that occurred when applying this model in a practical SME context. It also highlights the effectiveness of developing management teams as opposed to developing a group of individuals.

This paper charts the progress of 20 managers from nine Irish companies in the print, industrial product and construction products sectors who attended the first programme over a 15 month period. It tracks their individual progress and the evolution of their businesses by providing pre and post programme analyses. Questionnaires and focus groups were used to elicit programme participants' business and individual needs, their views on the programme and the personal and organisational impact. Almost a year after completing the programme a subsequent follow-up focus group was held with participants, the results of which form a central element in this paper, identifying the key outcomes of the programme for SME businesses and managers.

In addition, this paper details the background, rationale, structure and content for the proposed model for a management development programme for SMEs and more importantly highlights the key benefits which the programme offered SME owners and managers in providing an effective and strategic approach to the management of their businesses. The findings are of potential interest to those involved in management development for SMEs.

### **INTRODUCTION**

In the context of rapid environment and industrial change in a landscape which is experiencing increased competition e.g. from low cost eastern economies, it is recognised that there is an increasing need for the development of strategic thinking and change leadership skills in SMEs. It is imperative that managers can generate strategic options for survival and growth. As a result, a model development programme structure –TRANSFORM - was created and refined through practice-oriented feedback.

#### **Background**

Before discussing the details of the TRANSFORM programme<sup>i</sup> and its impact on SMEs, it is important to outline the environment and standing of SMEs in Ireland. Since the foundation of the Irish Government, SME growth in Ireland has been moderate. The vast majority of businesses in Ireland are small and medium sized enterprises.<sup>ii</sup> These businesses employ over 80% of the workforce and make up at least 95% of all trading entities. In terms of sectoral

composition, the majority of businesses are engaged in service activities (O'Driscoll, 2004). Irish SMEs have traditionally struggled to gain a foothold in Irish industrial policy – economic objectives have been traditionally designed to attract foreign-owned industry. SMEs have therefore had to struggle to find sources of competitive advantage which would aid their survival in the increasingly changing competitive landscape. The issue is compounded by the fact that Ireland is a small and open economy on the periphery of Europe.

In 2004 the Irish Government appointed an Enterprise Strategy Group to prepare an enterprise strategy for growth and employment in Ireland up to the year 2015. They concluded that Ireland's industrial policy was in need of new strategic direction as Ireland moves from being an investment or production-based model to one that is market and knowledge-based. The Group highlighted the importance of developing indigenous Irish industry and enhancing management capability. Management capability was viewed as an essential condition which must exist in order to create sustainable indigenous enterprises (O'Driscoll, 2004). Therefore, the development of SME managers in Ireland is of enormous national importance.

Historically two government agencies, in particular, have helped to foster SME growth and development - Enterprise Ireland was founded in 1992 to grow Ireland's indigenous industry while FÁS, the national Training and Employment agency was founded in 1988. The Irish Management Institute, Ireland's national management development centre, has been instrumental in the development of SME owners and managers since 1952.

### **Structure and Size of SMEs**

The following European Union classifications (2005) of organisations by size currently exist in Ireland:

- Micro-businesses are those that employ less than 10 with a turnover of less than €2 millions
- Small businesses are those that employ between 10 and 50 people with a turnover of up to €10millions (formerly €7 millions)
- Medium-sized businesses are those that employ between 51 and 250 people with a turnover of up to €50m (formerly €40 millions)
- Large businesses are those that employ more than 250 people and have a turnover greater than €50millions. (formerly €40 millions)

### **Identifying the Need for Developing SME Owners and Managers**

Enterprise Ireland, the state agency with primary responsibility for the development of Irish-owned businesses in manufacturing and internationally-traded services, in consultation with their mid-size indigenous client base, recognised an ever increasing need for the development of strategic thinking and change leadership skills. This need emerged from sectoral reviews and awareness of the need to improve the competitiveness of Irish enterprise. A Print forum was formed in 2002 which prompted print business owners to address these needs in the Irish traditional paper, print and packaging industry. The Irish Management Institute, Ireland's national management development centre, therefore developed 'TRANSFORM', a strategic planning and change management programme to help develop the skills of managers and owners in SMEs. A focus on managers ability to manage the process of change within their companies and to generate options for survival and growth was critical to companies in this industry.

A group of 20 managers from 9 companies in the print, packaging and industrial product sectors formed the pilot programme participants. Sectorally the breakdown was 7 Print and packaging and 2 Industrial product companies. Three companies were in the Small category while the remainder were Medium size as per the 1996 EU classification. The companies average sales were €10 millions with an average employment of 111. While average net profitability was 7%, four companies described their profitability as breakeven. 30% of combined sales were exported.

## METHODOLOGY

A four-step approach was adopted in testing the TRANSFORM model for SME management development. It is important to note that the original TRANSFORM model was developed from extensive feedback from industry bodies, SMEs and State developmental agencies who identified a need for SMEs to employ structured strategy development processes during times of change. In order to test the model, a total of 4 questionnaires, as outlined below, were designed and administered at various stages of the programme delivery. An average response rate of over 80% was achieved.

### Research Stage 1

**Pre-Programme Business and Personal Needs Analysis:** Programme participants were asked to identify their business and personal needs – a questionnaire template was completed prior to commencing the programme.<sup>iii</sup>

### Research Stage 2

**Midyear-Evaluation:** Participants were asked to comment on the progress of the programme - a questionnaire was administered 'halfway' through the programme after 5 modules were completed.<sup>iv</sup>

### Research Stage 3

**End of Programme Evaluation:** After completing the programme, participants were asked to evaluate the programme on a number of criteria, including programme content, personal and business benefits, delivery and impact. This questionnaire was administered by an external consultant.

### Research Stage 4

**Post Programme Follow-up:** This stage consisted of two elements:

- Questionnaires which were completed by participants approximately 1 year after the programme concluded.
- Focus group also held 1 year after the programme concluded.

Questionnaire findings were complemented by the 'follow-up' focus group discussion which was held with participants. Participants were asked to discuss the progress of their companies since completing the programme and to explain whether any learning gained was actually transferred back to the workplace – the personal and business outcomes of the programme. Rich qualitative and quantitative data were captured from managers who identified the key personal and business benefits of the programme. A mid-year focus group was also held with participants of a subsequent programme to ascertain their views on how the programme was progressing.

In relation to sampling, this was not an issue in this study due to the fact that it was possible to study the whole population i.e. all participants on the programme.

## THE TRANSFORM MODEL

The model (see Figure 1) adopts a four-phased approach to development:

- (1) Identify needs
- (2) Develop strategy
- (3) Action
- (4) Review.<sup>v</sup>

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**Figure 1 here**

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### **(1) Identify needs**

The business and personal needs of the participating companies and individual managers were identified prior to commencing the programme through a pre-programme company visit and interview and the completion of self training needs questionnaires.

### **(2) Develop strategy**

A key focus for the programme was the development of a 5 year vision and strategy for each business. Workshops supported the generation of such a strategy. Businesses were required to devise a strategy and document this in the form of written strategic plan.

### **(3) Action**

The purpose of the action phase was to implement strategy and to manage the necessary change. In practice the action and review became a feedback loop with review informing further action. Businesses were required to implement learning from workshops consistent with their strategic direction.

### **(4) Review**

Reviews at workshops informed strategy and action and the process was iterative.

Key outcomes are identified after each phase including devising an impact statement, constructing a strategic plan and identifying results. The programme has a duration of one year and comprises residential workshops, overseas visits and business counselling. Recognising the time pressures that SMEs experience, two-day residential workshops are scheduled at monthly intervals for 1 year. Each of the workshops contains a mixture of subject matter integrated to optimise and support action learning across disciplines. The programme content includes modules on the following topics: strategic planning and growth, change management, export marketing and funding a marketing plan, financial dynamics, creativity and innovation, new product development, managing operations, resources and information, leadership and team building, personal effectiveness, communication skills and cultural awareness.

As part of the programme each business is given one-to-one support through business counselling. Following residential workshops companies receive a visit from their business counsellor who worked with the management team in progressing their strategic planning process. This facilitates a customised approach for each company, helping them to:

- objectively audit their business and their potential to expand
- guide managers in change and decision making for the growth of their business
- facilitate the application of learning from the workshops to on-the-job behaviours

Emphasis is placed in the programme on providing networking opportunities in addition to an action learning approach. The process is facilitated through a combination of the following: interactive workshops, relevant case studies, business related work programme assignments and exercises (particularly the development of a five year strategic plan for the business), experience of other participants, business counsellors, network dinners, expert panel presentations, discussion groups and overseas visits. The model was viewed as being iterative in nature with the review of proposals and strategic plans being part of a continuous process.

## FINDINGS

The overall findings from the study point to the positive impact of the TRANSFORM programme as a management development model for SME managers and owners. This section focuses on findings from the various stages of the study – from the pre-programme analysis, end of programme analysis to the follow-up study.

### **Research Stage 1: Pre-Programme Business and Personal Needs Analysis**

With regard to the pre-programme questionnaire, participants pinpointed potential future developments in their companies and identified the role of TRANSFORM in helping them to achieve their goals. The major challenges or ‘blockages’ identified by managers in their organisations in moving forward, included the following: marketplace challenges including the economy and increased competition, lack of international marketing/selling skills, financial issues (high gearing, cost base, low margins, cash flow), risk adversity, lack of salespeople, employee issues, time management issues, lack of an ability to change, absence of leadership ability and a low level of management capability.

In relation to how managers viewed their businesses moving forward or the improvements they desired, among the many goals mentioned included: the need to reduce costs, increase growth, improve systems, increase product development, divest some business units, increase research and adopt a more proactive approach to management. In addition, participants identified specific personal learning needs which included leadership, assertiveness, strategic thinking, communication skills, teambuilding, finance and people skills.

### **Research Stage 2: Midyear Evaluation**

For the purposes of this paper the midyear evaluation completed by the first group of programme participants is not referred to. The results from the mid-evaluation of the second programme group are referred to briefly at the end of the paper.

### **Research Stage 3: End of Programme Evaluation**

After completing the programme, participants completed an evaluation questionnaire. The overall results were very positive – over half of participants rated the course as being ‘excellent’ (55%) while the remainder (45%) rated it as being ‘very good’. In relation to the *impact of the programme on their business* over the period that they attended the programme, the majority of participants stated that the company had either changed ‘quite a lot’, or changed ‘somewhat’. In relation to the future impact of the programme, 25% of participants surmised that it would have a ‘great deal’ of impact, 50% stated ‘quite a lot’ while the remaining 25% stated ‘some’.<sup>vi</sup> As highlighted by one participant ‘*I am now able to look beyond our current business and assess the impact of new products or customers and identify the strengths and weaknesses within our business. I have a better understanding of the financial side of the business.*’

In relation to the *personal benefits* gained from attending the programme, the majority of participants stated that they had either changed ‘quite a lot’ or ‘somewhat’ after attending the programme, as stated by one participant *‘I am much more confident in my approach to change and feel stronger as a manager. I believe more than ever that my ability to help people change and develop has been increased enormously (new programmes are already implemented and are starting to show results). I have a better understanding of how to formulate a plan and how to get others to buy in. I can see the bigger picture than before.’*

#### **Research Stage 4: Post Programme Follow-up**

Almost a year after the first programme concluded participants (**9 out of 20**) attended a focus group discussion and completed the follow-up questionnaire. The participants shared the key business and personal outcomes that they had experienced and witnessed from attending the programme.

- **Business Impact**

Participants were of the view that their respective organisations had changed as a result of the programme – rating on a five-point likert scale with 1 being ‘no change’ and 5 being ‘a lot of change’, 22% of participants gave a rating of 5, 33% a rating of 4 and 45% a rating of 3. The business impact of the programme are listed in Table 1.

---

**Take in Table 1**

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- **Personal Impact**

All participants who attended the focus group were of the view that they had changed personally as a result of completing the programme – rating on a five-point likert scale with 1 being ‘no change’ and 5 being ‘a lot of change’, 22% of participants gave a rating of 5, 33% a rating of 4 and 45% a rating of 3. The key personal benefits from attending the programme are listed in Table 2.

---

**Take in Table 2**

---

The progression of the programme from the identification of business and training needs to the business and personal impacts of the programme is charted in Appendix A.

## **DISCUSSION**

From the analysis of data it can be observed that a positive business and personal impact of the programme on 9 SMEs (20 participants) occurred. A number of key points are worthy of further discussion.

#### **Developing a structured approach to strategy development**

Participants consistently identified key organisational benefits which the programme delivered, complimenting the overall ‘structured approach to strategy development’ that the programme promoted. They spoke highly of the ‘common direction to strategy’ and the ‘clear vision and goals focus’ which were being achieved in their organisations through the knowledge gained on the programme.

### **Learning as a management team**

A key benefit that was described was the management team-building aspect of the programme – some participants mentioned that the real benefits from the programme were being attained due to the participation of the management team as opposed to individuals. They mentioned that their organisations were devoting more time to strategic issues and appreciated the fact that the programme was forcing them to set deadlines for implementation. A number of organisations highlighted the human resource changes they implemented since commencing the programme, including the introduction of a performance management system etc.

### **Enhancing Skills**

On a personal impact level, participants valued the variety of management techniques learned on the programme which they were applying in their organisations. They increased their communication, listening and planning skills. Management and leadership modules were also valued.

### **Adopting a broader perspective**

Some participants mentioned the fact that they enhanced their ability to focus on strategic issues as opposed to issues of an operational nature. They were learning to view the organisation from a different perspective – ‘as a shareholder as opposed to an operator’. The programme provided participants with an ability to ‘see the wood from the trees’ and ‘think outside of the box’. This move from a ‘silo approach’ is encapsulated in the comment from a participant *‘I feel my outlook towards the business has changed considerably. I tended to confine myself to my designated role within the company. Now I feel I can relate to other areas of the business much more readily.’*

### **Learning from others**

Participants valued sharing experiences with other organisations in the group stating that it was beneficial to speak with other organisations experiencing similar challenges. Keynote speakers were complimented for sharing their experiences of change and how they managed to transform and adapt.

### **Transferring learning back to the workplace**

Participants complimented the knowledge content of the programme and were able to relate these modules back to the workplace e.g. finance and economics.

## **CASE STUDIES**

Examples of the impact of the programme on 4 sample companies are provided below.

### **Company A – Print packaging**

Before the programme Company A had a turnover of €10m and had breakeven profitability. Now the company reports turnover for its new products which it exports globally has grown 39%. Net profit has increased to 2 %.

#### **Outcomes**

- Increased sales globally - opened up markets in Denmark, Finland and Sweden and currently trying to enter the Croatian, German and the Benelux markets.
- Sold intellectual property to Australia, New Zealand and Africa
- Company is more focused on innovation and prepared for ongoing change
- Production / manufacturing processing time is down from 8.5days to 6.5 days

### **Company B - Print**

The print industry in Ireland has been experiencing increased changes and is in turmoil, with significant players dropping out. Company B completed a merger since the programme concluded. It consolidated operations to one location and achieved savings in labour and running costs. It successfully merged cultures through a single management team and constant communications. It commenced the merger process with trade unions and experienced no industrial relations issues.

#### **Outcomes:**

- Doubled market share
- Exceeded growth targets
- Doubled product sales
- 40% higher turnover
- Divested non-core activities

### **Company C – Industrial Products**

Before the programme commenced the company had sales of €4m and breakeven profitability. One year after completing the programme it had targeted sales of €6.5m and net profit of 7% was on track. One of the company's managers stated *'The company culture has changed to one of employee involvement throughout the organisation with planning at the forefront of everything we do'*.

Some of the initiatives implemented included the following:

- Appointed non executive director
- 'Pruned' and re-structured management team
- Established operation in London
- Increased employment by 50% (from 60 to 90)
- Has scheduled the establishment of a manufacturing site in Poland for Q1 2006.

Looking to the future the company is very positive *'We are well on the road to being a top class organisation with clear direction that is understood by everyone. The organisation no longer relies on the MD [Managing Director] for everything which was a substantial problem in the past.'*

### **Company D - Industrial Products**

The company increased productivity by 20% as a result of the introduction of new equipment. The justification for purchasing new equipment was made easier by the company being capable of applying the strategic plan developed during the programme. Financial justification was possible because of the training received through the programme and an improved ability to forecast results.

#### **Outcomes**

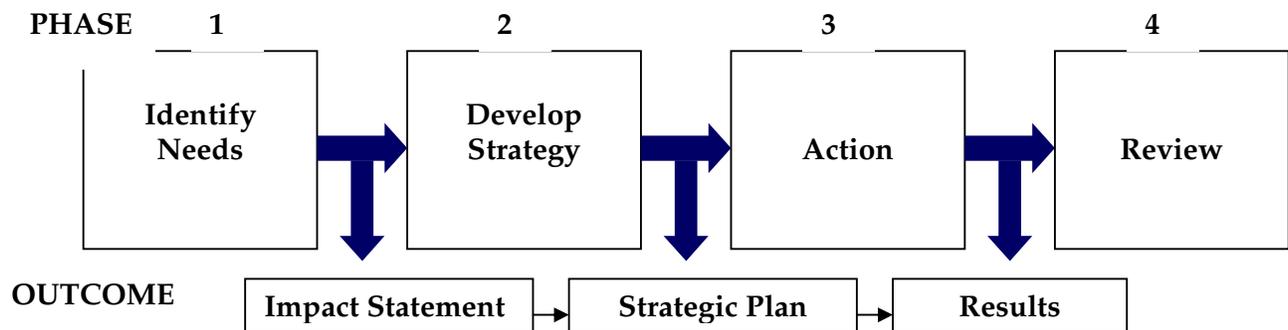
- 2004 was best financial year ever
- 20% increase in productivity
- Employee level remained constant
- Increased employee morale
- Sales and marketing - managed to get a 'top 5' customer (as identified in 5 year plan)
- Investment in IT and refurbishment of buildings to enhance customer image and profile

## **CONCLUSION**

This paper has detailed the background, rationale, structure, content and delivery for the proposed model for a management development programme for SMEs. It highlighted the key benefits which the programme offered SME owners and managers in providing an effective and strategic approach to the management of their businesses. The programme has aided managers in adopting a broader and more strategic focus to managing their companies, resulting in the transformation of their business models. Programme participants also experienced the key benefits that arise from learning as a management team. After completing the programme, it was remarkable to observe that companies operating in traditional industries which had become stagnant were beginning to experience growth rates associated with more vibrant industries. In addition, the programme helped managers to accept the need for change in their organisations, emphasizing the importance of adopting a structured approach to strategy development. It has taught managers to welcome change as opposed to shunning it, as stated by one participant *‘The programme reduced my personal fear of change. I believe the whole programme stimulated me personally and offered new avenues of thought for me. I am having great success in promoting the need for change throughout the organisation and I now have a cohesive management team working in harmony with each other who are committed to change. We are on the road to being a top class organisation with clear direction that is understood by everyone.’*

### EPILOGUE - AN EVOLVING PROCESS

A *second* TRANSFORM programme is in progress with 22 participants from 7 companies. Participants are following a revised programme model which focuses on early production of strategic plans and implementation of change in an action learning model. After completing five modules the majority of participants have already reported that they have experienced some personal benefits from attending the programme. In relation to the realisation of *immediate* business benefits to their companies, 89% of participants were of the view that these benefits had been ‘partly or fully realised’. Only 11% of participants believed that they had not been realised.



**Figure 1 TRANSFORM Programme Structure**

| <b>Business Benefits from attending the TRANSFORM Programme</b><br>(follow-up 1 year post programme) |   |
|--|---|
| ▪  | Financial measures  |
| -  | Increased profitability – e.g. one company’s profit increased from 0.3% to 2% |
| -  | Increased sales e.g. one company’s sales are 39% ahead of target              |
| -  | Increased sales from €4M to €6.5M, profit up from breakeven to 7%             |
| -  | Increased productivity by 20%   |
| -  | Rationalisation   |

|  |
|--|
| <ul style="list-style-type: none"> <li>▪ Management Processes <ul style="list-style-type: none"> <li>- Improved and faster decision making processes</li> <li>- Adopted more inclusive company culture of employee engagement</li> <li>- Employee empowerment throughout organisation</li> <li>- Staff levels up from 60 to 90.</li> </ul> </li> <li>▪ Operational Processes <ul style="list-style-type: none"> <li>- Introduced improved IT systems – inventory, stock control systems</li> <li>- Enhanced Flexibility</li> <li>- Adopted innovative processes</li> <li>- Increased productivity from investment in new production technology</li> </ul> </li> <li>▪ New Markets/ Products <ul style="list-style-type: none"> <li>- Entered new export markets e.g. Poland, Holland which were prompted after company visits undertaken as part of the programme. Other companies have developed marketing plans for new markets</li> <li>- Introduced new products</li> </ul> </li> <li>▪ Customers <ul style="list-style-type: none"> <li>- Gained new customers and improving customer service e.g. one company got a ‘top 5 customer’</li> </ul> </li> <li>▪ Industry level benefit – Merger and Consolidation of the sector <ul style="list-style-type: none"> <li>- 1 company <i>successfully</i> merged with another company in its industry, thus doubling its market share.</li> </ul> </li> </ul> |
|--|

**Table 1 Business Benefits from attending the TRANSFORM Programme**

|   |
|---|
| <b>Personal Benefits from attending the TRANSFORM Programme</b><br>(follow-up 1 year post programme)  |
| 1. Management skills in the following areas were enhanced: <ul style="list-style-type: none"> <li>▪ Delegation</li> <li>▪ Time management</li> <li>▪ Stress management</li> <li>▪ People management</li> <li>▪ Financial analysis</li> <li>▪ Change management</li> <li>▪ Conflict management</li> <li>▪ Communications</li> </ul> 2. Managers improved levels of self-confidence<br>3. Developed broader and more strategic insights into the business |

**Table 2 Personal Benefits from attending the TRANSFORM Programme**

**References**

O’Driscoll, A. (2004) Enterprise Strategy Group – *Ahead of the Curve. Ireland’s Place in the Global Economy*, Forfás.

Enterprise Ireland and FÁS (2005) *A Developing Future- A Study of the Paper, Print and Packaging Industry*.

<sup>i</sup> The TRANSFORM programme, will be referred to as ‘the programme’ hereafter

<sup>ii</sup> Enterprises with fewer than 250 employees

<sup>iii</sup> The needs analysis was accomplished through a face-to-face meeting with participants on an individual basis where a questionnaire template was completed.

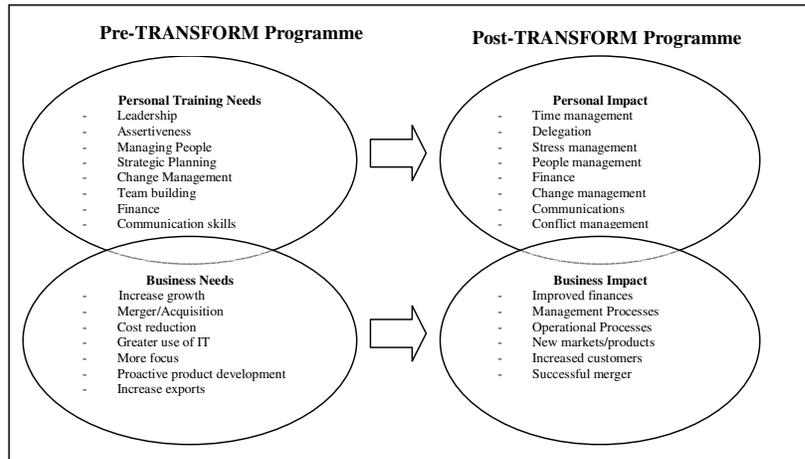
<sup>iv</sup> For the purposes of this study we do not refer to the mid-evaluation questionnaire completed by the first TRANSFORM group. However, the results from the mid-evaluation of the second TRANSFORM group are referred to briefly.

<sup>v</sup> This model is presented in revised format which presents an integrated approach working on strategy development and change simultaneously.

<sup>vi</sup> It should be noted that 3 participants did not complete questionnaires as they were absent

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## Appendix Personal and Business Impact of TRANSFORM programme



Making Technology Transfer More Effective At Public Universities In  
Rural States With Federal Labs

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Extended Abstract

The purpose of this pilot study is to research the stages of technology transfer – and related literature on the environment for corporate entrepreneurship – as they might best be applied to the public universities in a smaller state with a Federal lab. The general research question is whether or not the critical institutions of the State of Idaho have developed the entrepreneurial climate and the processes required to stimulate the technology transfer proposed in the State’s science and technology plan.

To examine the technology transfer process, as it exists today, the authors devised a survey instrument based on a technology commercialization model created for the Department of Energy by Randall Goldschmitt. Phases, stages, and steps organize the model. The survey incorporates measures of perceived entrepreneurial climate as well as items asking respondent to rate their resources, research activities, incentives, and the leadership in their units. Many of the items take the form of open-ended questions.

The survey was administered - by email and in person – to a small sample of faculty in defined research areas at the three institutions of higher learning in the State of Idaho: the University of Idaho, Boise State University, and Idaho State University; and to staff at the Idaho National Laboratory (INL). Qualitative results reveal first that some faculty members do not identify technology transfer as an integral part of their research efforts. Second, some faculty members have a strong interest in taking part (with their research inventions) in the process, but lack the understanding and the administrative support to enter the process. Third, only a very few, mostly with experience outside Idaho institutions, have actively engaged in the process of technology transfer at their institutions. In this pilot study, those few are located at INL and the University of Idaho. Fourth, those faculty and laboratory staff members with strong interest have

been, in this small sample, newer faculty in engineering and biotechnology-related disciplines or research areas where an environment has encouraged participation.

In general, the pilot study pointed out more weaknesses than strengths with the process of technology transfer, as it exists today. A follow-up study will be aimed at clarifying the results, measuring them more precisely, and making process recommendations to stimulate technology transfer in the State of Idaho.

**ABSORPTIVE CAPACITY AS A GROWTH CONSTRAINT IN SMALL  
ENTREPRENEURIAL FIRMS**

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**Abstract:** There are strong pressures on small and medium enterprises (SMEs) to embrace a new *knowledge economy*. Information and communication technologies (ICT) are impacting on virtually all SMEs. However, local development and policy reports reveal a picture of poor management and lack of ICT skills prevailing among many SMEs. There are a growing number of policy initiatives, at regional, national and EU levels, to improve innovation and management capabilities among SMEs and to increase innovation and the development and sharing of knowledge within SMEs through encouraging lifelong learning. Yet, SME participation is very low, particularly among the microfirms with fewer than 10 employees. The most common reasons given by SME owners include lack of time, inconvenience and low relevance but lack of skills and knowledge have been identified as endemic by the national Learning and Skills Development Agency (LSDA). This suggests a lack of ‘absorptive capacity’ – having the prior knowledge and the ability to assimilate new knowledge and to share it effectively within the firm – may better explain low SME participation and high failure rates. Over the past 20 years, OUBS-based Small Enterprise Research Team (SERT) has been engaged in a number of longitudinal and cross-sectional surveys of management development, use of ICT and knowledge management in SMEs. Drawing on the findings from these regular surveys this paper examines SME learning needs, educational and development levels, and the effects of increased ICT-adoption on the acquisition of knowledge necessary for survival, growth and success in the new economy

## INTRODUCTION

There is tremendous pressure at UK and European Union (EU) level to encourage greater participation in the information society by small and medium enterprises (SMEs). The participation of SMEs (in Europe this refers to firms with fewer than 250 employees) is seen as crucial not only because of the size of the sector (99 per cent of Britain's 4 million firms and 55 per cent of its 25 million workforce) but also because of the role that SMEs can play in innovation and in promoting the diffusion of new technologies. The capacity of small entrepreneurial firms to make effective use of technology transfer, research and development, networking, and knowledge sharing are now recognised by policy makers and strongly supported. This is reflected at policy level in pushing the role that SMEs can play in innovation, in improving the functioning and competitiveness of supply chains and in the wider adoption of e-commerce. Two main related policy drivers are:

- increasing EU competitiveness in the face of global competition (especially from the US and east Asia);
- boosting sustainable local development in order to reduce social exclusion and to build a knowledge economy in Europe.

Although global competition and knowledge management tend to be the province of large national firms and multinational corporations, the business effects impact on SMEs. As well as facing tougher resource constraints in marketing their products abroad, SMEs face tougher competition for necessary competences and skills in local labour markets due partly to a poor supply of such skills and partly to intensified competition from larger firms. In its 2002 report on work-based learning in SMEs, Britain's Learning Skills Development Agency (Hughes et al, 2002) has identified a number of critical skills shortages among SMEs, summarised the policy challenges as:

'In a fast-changing world of work, the ability to adapt and develop new learning and skills is a crucial ingredient in a successful economy. Globalisation and the knowledge-driven economy require the UK to develop a more highly-skilled workforce in order to compete within high-value-added sectors of the world economy,' (page, 14)

In spite of the strong pressures, however, the report also acknowledged that SME participation is very poor and that most staff training and development (including that of the owners and managers) is informal. The average knowledge base in the SME sector, especially among microfirms, is low compared with larger organisations. The report concluded that workforce learning is very important in developing knowledge in the firm necessary to its survival and growth but that 'there are other ways in which the workforce may be developed and a wide range of methods may be used.' Increased use and commercial applications by SMEs of more advanced information and communication technologies (ICT) and related services are seen by policymakers as the key to improved competitiveness and a knowledge economy. There is little doubt that the increased diffusion of ICT applications and pressures from global competition are already having an effect on capabilities required for managing a successful SME. For instance, Freel (1999) identified the major skills gaps that impede successful innovation in SMEs as:

- technical skills in the workforce;
- managerial competency;
- poor marketing skills.

The focus of this paper is on the effects of these knowledge, capabilities and skills gaps in relation to SME growth and their effective participation in the emerging knowledge economy.

## ABSORPTIVE CAPACITY

Some 15 years ago, Cohen and Levinthal (1990) identified the problems suffered by firms with capabilities and knowledge gaps in effectively managing inwards technology transfer and R&D programmes. In their words, an organisation 'needs prior related knowledge to assimilate and use new knowledge'. They termed this the firm's 'absorptive capacity', a concept that has subsequently been broadened to include a firm's overall capacity for learning, implementing new knowledge, disseminating new knowledge internally and making use of new resources, including new technologies. Absorptive capacity is a function of the organisation's existing resources, existing tacit and explicit knowledge, internal routines, management competences and culture. In entrepreneurial SMEs, it is likely that this will be largely reflected the development, experience and motivation of the owner/manager and key staff members. Zahra and George (2002) further developed the concept of absorptive capacity to include the organisational routines and processes by which firms operate and manage knowledge. They identified four distinct areas where knowledge needed to be managed in successful firms:

- Acquisition;
- Assimilation;
- Transformation;
- Exploitation..

Acquisition and assimilation of knowledge were seen as *potential* absorptive capacity while transformation and exploitation of knowledge represent *realized* absorptive capacity ( Zahra and George, 2003). Liao et al, (2003) conclude that SMEs with higher levels of absorptive capacity would tend to be more proactive whilst those with modest absorptive capacity will tend to be more reactive and that 'reactive and proactive modes of SMEs' behavior should remain rather stable over time'. Another distinction, which is very relevant to SMEs, is that absorptive capacity involves external knowledge acquisition and internal knowledge dissemination within the firm (Heeley, 1997). According to Liao et al, (2003), 'potential absorptive capacity has received disproportionately less empirical scrutiny when compared to realized absorptive capacity'. This means that less attention has been paid to how firms acquire and use external knowledge and this where SMEs seem to be at a disadvantage and is a focus of this paper. Thus the management of knowledge acquisition and use is crucial. With respect to SMEs, the focus is on two main crucial areas of knowledge –

- the functional areas of the business, which relate to the people in the firm;
- strategy and the need to remain competitive, or at least viable, which relate to the firm itself as an organisation.

The degree of functional knowledge in a firm is related to the level and relevance of formal training, experience and the response by firms to their perceived need for capability in the functional areas. In turn, this seems to be related to levels of education, source of knowledge acquisition (college, university, consultant, etc.) and experience. In Britain, some 16 per cent of the workforce are university graduates but the proportion is higher among younger SME owners and those in manufacturing and business services (which includes consultants and the professions). On the firm related knowledge, earlier work on organisational learning (Argyris and Schoen, 1978) has re-emerged in concepts such as the learning organisation (Senge, 1990) and knowledge management (Amidon and Skyrme, 1997). Essentially, the model is one based upon knowledge sharing and, through constant and open communication, the making explicit of often buried or tacit knowledge held by all employees. The drawing together of experiential knowledge of key employees (including the owner/manager) and the making explicit the effective routines developed within the firm in order to share, combine knowledge and create new knowledge is the innovative process that lies at the heart of

knowledge management. Zahra and George (2003) view such routines as a prime element of absorptive capacity..

The acquisition of new knowledge raises issues concerning the source of information, the internal absorptive capacity for interpreting and absorbing the new information as applicable knowledge and the use of the new knowledge. The third area, the creation of new knowledge, raises issues concerning innovation, creativity, and strategy. In all areas, ICT is increasingly seen as providing support for these processes internally and in relations externally with other firms. The development of ICT-mediated formal and informal links between SMEs and the growth of virtual clusters or industrial districts fits the knowledge management approach. In its final report, the UK National Skills Task Force (2000) saw networks and clusters as the way for SMEs to overcome their skills and knowledge gaps. It recommended the 'development of new sectoral and local learning networks to support the training and development needs of clusters of small and medium sized businesses'.

Although there are few direct studies on knowledge management and SMEs, a 1995 survey conducted by OUBS among some 2,500 SME owners revealed that growth-oriented owners were more likely to be participative in their management styles and more likely to network (Gray, 1998). During 2001-2002, OUBS led an in-depth cross European study of SME networking and the effects of ICT on existing networks. The study confirmed that most SMEs belong to at least one network and that the main drivers are the exchange of business and technical knowledge, as well as social interactions ( Gray, 2003 ). Later OUBS research, as part of a pan-European study into the determinants of management development, revealed high growth entrepreneurial firms to be more systematic and strategic in their management development policies, including having higher commitment to development from the top of the firm (Thomson and Gray, 1999; Thomson et al, 2001; Gray, 2004). However, SMEs were found to engage in fewer management development activities than larger firms. Managers in SMEs are much less likely to have formal appraisals or discussions on their training needs (41 per cent of SMEs reported no appraisal system compared with 27 per cent of large firms). These systems are clearly an important part in building absorptive capacity and were largely absent in non-growth SMEs. However, it appears that a strategic orientation towards growth is a much stronger determinant than size of firm of the proactive development of absorptive capacity. Table 1 summarizes the mean score differences on formal management development activities (5-point Likert scales, with 1 representing little or no activity and 5 very frequent activity).

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Table 1 about here

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Large firms provide a lot more management development than SMEs and the development of competences, an essential element of absorptive capacity, is more often linked to the firm's strategy. Interestingly, the preferred method by the entrepreneurial growth firms involved the introduction of knowledge from outside the firm in the form of external courses and having an internal culture that makes more use of mentoring. However, most evidence suggests that the managers of Britain's smallest firms are resistant not only to training but also to other forms of wider participation. The human resource practices in many SMEs are not conducive to the creation and exchange of knowledge. This is also an area where the increased connectivity of ICT might be expected to help. Increasingly, the Internet helps SMEs to participate in useful networks or to pursue commercial and industrial linkages without a

strong need for spatial proximity. In general, ICT adoption and use appears to be related to the size of the firm, with larger and growth SMEs using far more ICT applications and functions than other firms (Eursostat, 2001; Gray, 2003). This suggests that absorptive capacity is also strongly linked to access to resources inside the firm (which appears to be one of the main effects of size). The key role played by ICT in the management of knowledge in SMEs was specifically addressed by Corso and colleagues (2003) who state that ICT applications can ‘play a key role in this process. By providing quick and easy access to external sources of knowledge and new and more intense communication channels with partner organizations, ICT can erase traditional constraints on SMEs innovation ability, while leveraging their flexibility and responsiveness.’ This paper now examines the characteristics of the smaller firms that also adopt similar approaches.

## **METHODOLOGY**

The findings reported below are from national UK surveys were conducted by the independent non-profit Small Enterprise Research Team (SERT), which is based at OUBS and has been conducting, publishing and disseminating research on SMEs regularly for the past 20 years. Drawing on the findings from recent SERT national surveys on ICT adoption and use (final quarter of 2003; 687 respondents); business objectives, personal motivations, growth orientation and innovation (first quarter of 2004; 808 respondents) and on educational levels of owners plus training and development (second quarter of 2004; 739 respondents) , this paper examines the effects of high and low absorptive capacity on actual growth over time among some 2,000 UK SMEs. The samples were drawn from a wider SERT database which has been recruited and periodically replenished through a random selection of firms nationally (with findings in SERT’s regular reports weighted to reflect the distribution of SMEs across industries in the UK). Because of an overlap of common respondents, it was possible to analyse responses across surveys. The paper uses these surveys to explore whether high absorptive capacity are more proactive in innovation and more entrepreneurial.

## **FINDINGS**

First, it is important to establish key differences between entrepreneurial and non-entrepreneurial SMEs. Generally, the strongest motivation among SME owners for managing their own business is to be independent but entrepreneurial SMEs tend to be more business-oriented and set themselves financial goals (Gray, 1998). SERT surveys confirm this picture as a stable feature of SME motivation as Table 2 shows.

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Table 2 about here

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The need for independence motive dominates. Further analysis of all the SERT surveys reveals strong age and size effects with the older SME owners of the microfirms feeling this need particularly strongly and the self-employed microfirm owners even more. In contrast, younger SME owners seem less concerned about the need to preserve independence which implies a stronger propensity to work with other firms. This has enormous implications for the absorptive capacity of those firms and attitudes towards innovation and networking. The most determining feature of entrepreneurial SMEs is a stronger desire than most SMEs to grow and compete Table 3 summarises these broad trends from 1991 to 2004.

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Table 3 about here

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The effects of prevailing endogenous economic conditions are clear. During 1991 the British economy was still in recession but by 1995 it was peaking in a boom. This serves to highlight the uncertainty under which most SMEs operate. It is this uncertainty that is often the biggest barrier to SME participation in networks and longer term collaborative ventures that could boost their absorptive capacity. There is, however, less uncertainty among the growth-oriented entrepreneurial SMEs where strategic intent does lead to actual growth. Each survey asks respondents to indicate whether sales over the past year have been up, down or remained at the same levels and, similarly, their expectation for sales in the coming quarter. In this case the reporting period covers two quarters which enable respondents to be classified according to whether their sales and expectations were consistently positive (high growers) through to those who were consistently negative (strugglers), with three intermediate categories. The growth-orientation variable is split between the growth-oriented who are keen to grow (some to a target, others indefinitely). Those who have a strategy to sell or merge their firm and the non-growers who report having no growth strategy or a desire to reduce the size of the firm. Table 4 is a cross-tabulation of growth orientation with the constructed measure of growth that spans some 18 months.

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Table 4 about here

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It is clear that growth intention is related to performance. Some 45 per cent of proactive growth-oriented SME owners reported consistent or variable growth compared with just 27 per cent of the reactive or static non-growth strategy firms. Perhaps more significantly, nearly three-quarters of SMEs without growth objectives are weak, struggling or static. In this context, it seems reasonable to conclude that they have very low absorptive capacity which appears to be more related to educational levels and learning capabilities rather than to resource factors such as a lack of technology *per se*. Regular surveys conducted by SERT over time reveal that only a handful of microfirms report that they do not own or use a computer. The patterns of ICT adoption by SMEs in Britain are shown in Table 5, which is based on the findings of the SERT quarterly surveys conducted over the past 20 years.

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Table 5 about here

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There has been a steady increase in the use of computers by SMEs, reaching effective saturation. However, the more proactive SMEs demonstrate their higher absorptive capacity in moving on from stand alone computers to internal and external networks that facilitate the exchange of knowledge. The penetration the Internet and the use of websites is expanding rapidly though there are still important firm-size differences. Microfirms are far less likely to

network their computers and or to adopt broadband but both these rates are up significantly since 2001 and look set to increase. Thus, most SMEs already have, or will soon have, the right infrastructure to support knowledge acquisition online. Whatever barriers there are to potential absorptive capacity among SMEs, they are likely to be due to factors other than technical. It may be that background levels of educational attainment of SME owners are important influences on a firm's absorptive capacity. In 2004, SERT surveyed 739 SMEs on their highest formal qualifications. There was a strong recognition of their own development needs by SME owners and owners with degrees or professional qualifications were much more likely to provide staff development than those with only school or no qualifications. With respect to their functional areas of knowledge need, ICT and marketing dominate overall with finance in third place. First degree graduates had a stronger preference for marketing skills, which is quite entrepreneurial. SME owners with technical qualifications, in comparison with holders of all other qualifications, did not have such a strong need for developing more effective use of ICT (this group would include those with ICT-related qualifications) but they do feel a need to improve their marketing and financial management skills. It is interesting that people who only have school-level qualifications were more likely to report that they have no development needs. This suggests that there may be a lack of awareness among less qualified people on their knowledge gaps. This lack of awareness, plus the wide lack of ICT skills, poses real barriers to the development of knowledge from external sources and through sharing with peers. In a very real sense, this low absorptive capacity appears to be linked to low learning abilities and to impede SMEs in shifting from reactive to proactive strategies and behaviours.

A key element of absorptive capacity is the propensity to innovate. Based on a frequency count of the number of different areas of innovation they mentioned, respondents were classified into two categories, single activity and multi-activity innovators. There was a larger category of those who reported doing no innovation at all. Multi-activity innovators were significantly more likely to be consistent growers than single-activity innovators who in turn were more likely to be consistent growers than non-innovators. And at the opposite end, non-innovators were significantly more likely to have weak or struggling firms with very low absorptive capacity. Looking to the strategy implications of this, Table 6 cross-tabulates the growth-orientation strategy variable against the propensity for innovation with similarly significant effects.

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Table 6 about here

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The significant links between innovation and growth strategy are very clear as is the converse. Lack of innovation in a firm is clearly linked to its lack of a growth strategy, though then causal directions are perhaps not quite so clear. Lack of strategy suggests that the structures and culture to support innovation will also be absent though it is also likely in some cases that the lack of innovative capacity in the firm means that growth objectives are unrealistic. Also, while the innovative firms do have more growth related objectives, it is the single-activity innovators who appear to be more focused on those types of objective.

### **FUTURE IMPLICATIONS FOR SMES**

Despite the resistance of some very small microfirms, it is already clear that the vast majority of SMEs, whatever their driving motivations and business expectations, have become part of the wider ICT revolution to the business environment. This has increased their need to have up-to-date knowledge of ICT applications and of how to manage and use the massive

increase in connectivity that ICT supports both within firms and between them. The Internet also offers significant opportunities for improving competence, skills and understanding through rapid access to relevant and timely information.. More advanced ICT adoption seems to be linked to size, industry, and the growth-orientation of the owners. However, it is also clear that the implementation of ICT is also dependent on the type of owner manager and their attitude, the more proactive owners adopting ICTs to a higher extent, thus further developing their absorptive capacity. The process seems to be an iterative virtuous circle. However, the common SME impediments to innovation and knowledge creation have not gone away. This lack of competences and skills of many SMEs, especially the microfirms, adversely affect not only managers and staff, but also the firm's capacity to absorb new knowledge, communicate and sell its own knowledge effectively. The most important constraint on SME growth and networking lies in the career motivations and personal expectations of individual small firm owner and manager, and the reactive or static strategies that flow from this. If an owner wants to earn no more than a living as an individual or as a household then growth past a certain point, or even any real growth at all, is not on the agenda. Furthermore, if the mode of earning a living is also bound up with a certain lifestyle (informal, anti-bureaucratic, alternative, loose, individualistic, etc.), many decisions will be based on non-business criteria. This is not a milieu conducive to the establishment of good management or systematic innovation and can induce a vicious spiral. It is estimated in Britain that some 50 per cent of new firms fail within 4 years.

On the positive side, the findings above indicate a strong response to development initiatives from proactive SMEs with their strategic approach to growth (as opposed to tactical or reactive approaches). The implication is that strategic planning skills will also be in stronger demand among successful SMEs in the future. This conclusion is supported by OUBS studies in management development which have linked formal management development policies and a learning supportive environment with SMEs that have a growth strategy. However, these more strategic and structured firms (the ones most likely to develop a properly integrated strategy that embraces a planned use of ICT, e-learning and knowledge management practices) remain in the minority (Thomson et al, 2001; Gray, 2004). More research is needed into the defining characteristics of these firms and the personal development of their founders to determine whether educational histories and cultural effects influence expectations and strategy setting styles in ways that can be taught.

After a survey of 1,000 firms in the north-west US state of Washington, Liao and colleagues (2003) concluded that 'without certain prior knowledge, organizational responsiveness of growth-oriented SMEs will be curtailed'. The findings from the SERT surveys in Britain strongly support this conclusion. The challenge is how to provide that prior knowledge in more SMEs. For the small firms that do wish to be more proactive, the existence of a formal policy concerning management development and ICT strategy seems likely to be one requirement (Pettigrew, 1997; Thomson and Gray, 1999). Formal policies are more in evidence in organisations which give high priority to management and staff development and to the development of the firm as a learning organisation. The forces that seem to impel innovative SMEs towards this more formal approach reflect clear links between competitive pressures and the need to manage and generate knowledge effectively. The successful SMEs of the future are likely to be those that the development of absorptive capacity seriously. To help them, more research is needed on the nature and genesis of a firm's capacity to absorb and use knowledge effectively.

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## TABLES

**Table 1. Management development practices (mean scores; n = 701)**

| <u>Activities</u>       | SMEs  | Large firms | Non-growth | Growth |
|-------------------------|---|-------------|------------|--------|
| Link to competency      | 3.61**  | 3.83**      | 3.64*      | 3.85*  |
| Use internal programmes | 3.41**  | 3.85**      | 3.68       | 3.55   |
| Use external courses    | 3.32**  | 3.58**      | 3.34**     | 3.66** |
| Use mentoring           | 2.82  | 2.96        | 2.79**     | 3.06** |
| Use qualifications      | 2.61**  | 2.94**      | 2.74       | 2.84   |
| Use job rotation        | 2.22**  | 2.68**      | 2.41       | 2.54   |
| Use e-learning          | 1.88  | 1.88        | 1.81*      | 2.01*  |
| Use external placements | 1.77**  | 1.97**      | 1.85       | 1.93   |
|                         | Significance of t-tests: * = p <0.05; ** = p<0.01 |             |            |        |

Source: European Management Development Leonardo project. Gray (2004)

**Table 2. SME main personal career motivation 1990-2004 (column percentages)**

|                                   | 1990 | 1996 | 1999 | 2004 |
|-----------------------------------|------|------|------|------|
| Independence/be own boss          | 50   | 52   | 46   | 42   |
| Make money                        | 19   | 16   | 17   | 15   |
| Security for future               | 9    | 10   | 14   | 13   |
| No alternative/avoid unemployment | 6    | 11   | 8    | 6    |
| Family tradition                  | 5    | 5    | 5    | 6    |
| Other                             | 11   | 8    | 10   | 9    |
| Sample size                       | 1349 | 753  | 1121 | 808  |

Source: Small Enterprise Research Team – NatWest Quarterly Survey of Small Business in Britain, 20:1.

**Table 3. SME growth intentions 1991 – 2004 (column percentages)**

|                     | 1991 | 1995 | 1996 | 1999 | 2004 |
|---------------------|------|------|------|------|------|
| Growth-oriented     | 37   | 62   | 33   | 41   | 48   |
| Exit/merge strategy | 25   | 9    | 30   | 36   | 23   |
| Growth averse       | 38   | 30   | 37   | 23   | 29   |
| Sample              | 1719 | 2517 | 753  | 1121 | 808  |

Source: Small Enterprise Research Team - NatWest Quarterly Surveys of Small Business in Britain 20:4.

**Table 4. Growth orientation and performance (column percent)**

|                   | Growth-oriented                          | Exit/merge strategy | Growth-averse | All |
|-------------------|--|---------------------|---------------|-----|
| Consistent growth | 21                                       | 17                  | 9             | 16  |
| Variable growth   | 24                                       | 19                  | 18            | 21  |
| Static            | 33                                       | 40                  | 43            | 38  |
| Weak              | 9  | 15                  | 12            | 11  |
| Struggling        | 13                                       | 10                  | 18            | 14  |
| Total (n)         | 312                                      | 121                 | 244           | 677 |
|                   | <i>Chi2 = 24.866; df = 8; p&lt;0.002</i> |                     |               |     |

Source: Small Enterprise Research Team - NatWest Quarterly Surveys of Small Business in Britain 19:4; 20:1

**Table 5. SME use of computers 1985 – 2003 (percentages of annual total)**

| Size (staff) | 1985 | 1991 | 1996 | 1999 | 2001 | 2003 |
|--------------|------|------|------|------|------|------|
| 1-4          | 20   | 56   | 73   | 72   | 82   | 87   |
| 5-9          | 29   | 71   | 86   | 82   | 86   | 91   |
| 10-14        | 38   | 79   | 88   | 88   | 97   | 100  |
| 15-49        | 61   | 82   | 94   | 94   | 97   | 100  |
| 50+          | 72   | 97   | 95   | 96   | 100  | 100  |
| All          | 36   | 68   | 81   | 81   | 88   | 92   |
| Total (n)    | 1090 | 984  | 1099 | 601  | 720  | 687  |

Source: Small Enterprise Research Team - *NatWest Quarterly Surveys of Small Business in Britain* 1:3;7:2;12:2;15:1;17:3;19:4

**Table 6. SME growth strategy by innovation propensity (column percent)**

|  | Multi-activity | Single-activity | Non-innovator | All |
|--|----------------|-----------------|---------------|-----|
| Growth-oriented                            | 60             | 62              | 29            | 46  |
| Exit/merge strategy                        | 19             | 17              | 18            | 18  |
| Growth averse                              | 21             | 21              | 53            | 36  |
| Total (n)                                  | 168            | 187             | 314           | 679 |
| <i>Chi2 = 83.248; df = 4; p &lt; 0.000</i> |                |                 |               |     |

Source: Small Enterprise Research Team - NatWest Quarterly Surveys of Small Business in Britain 20:4

# **EXPERIMENTAL DIAGNOSE OF WOULD-BE ENTREPRENEURS IN DIFFERENT CULTURAL SETTINGS**

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## **ABSTRACT**

This paper presents a model of entrepreneurial risk-taking behavior in two different cultural settings. Young entrepreneurs and entrepreneurship students in Germany and the United States were researched to evaluate the model and to identify cultural differences in the decision to start a company. The central research question was: How does the cultural context influence the decision-making and risk-taking behavior of entrepreneurs? The overall results of this comparative study indicate that significant differences between entrepreneurs and non-entrepreneurs in risk-taking behavior are culturally driven. These results confirm earlier U.S. studies that distinguish between risk propensity and risk perception with respect to entrepreneurs' risk behavior and extended these results to an international, intercultural sample. The results of this study identify cultural context as a key factor for the differences in entrepreneurial risk behavior. Also, these results allow potential entrepreneurs to use the conducted experiment as an individual diagnostic instrument; this makes it possible to identify individual anomalies in risk and decision-making behavior contributing to a better understanding of suitable entrepreneurial behavior as well as to reveal discrepancies between self-assessment and actual behavior. These results also present a set of instruments, techniques and a framework for an improved understanding of potentially attractive, but risky, start-up opportunities.

## **INTRODUCTION**

The crux of the following thoughts is that it cannot be unambiguously proven that entrepreneurs' propensity towards risk-taking is significantly higher than that of other financial decision-makers such as, for example, managers (Brockhaus 1980). Nevertheless, rational start-up considerations seem to confirm that entrepreneurs tend to accept higher risks in the step towards self-employment than those who decide to remain in dependent employment (Bird 1989). A reason is the young entrepreneurs' specific view of risks in comparison to other economic actors' risk perception (Palich/Bagby 1995). Supportive empirical evidence is, however, uncommon: Whereas there is research on the risk aspects of young venture financiers' investment decisions (Zacharakis/Shepherd 2001), there are to date only a few studies that analyze risk-taking behavior from entrepreneurs' point of view (Palich/Bagby 1995; Forlani/Mullins 2000). It is,

however, undeniable that the willingness for risk-taking is central to the decision to be entrepreneurially self-employed and to deal with the associated entrepreneurial risk (Busenitz/Barney 1997). The key elements of the founder's entrepreneurial risk-taking behavior, risk perception and risk propensity (Sitkin/Pablo 1992) influence whether a venture is realized and, if so, which kind and/or level of entrepreneurial risk will be accepted (Forlani/Mullins 2000).

If you assume with Simon, Houghton and Aquino (1999) that risk perception influences the decision to start-up a company and risk the step towards self-employment, the question arises: what influences individual risk perception and the associated risk-taking behavior? A few studies confirm that the decision-making process, in particular the decision-maker's receptiveness of cognitive biases, can reduce his perception of risk (Busenitz/Barney 1997; Palich/Bagby 1995). Cognitive biases are subjective or predisposed opinions that can originate from specific decision-making heuristics. As a result of their cognitively limited information processing capacity, individuals neither search comprehensively for relevant decision-making information, nor do they assess it completely accurately. To handle these restrictions, they apply decision-making heuristics in the form of rules of thumb and simplify the perceived decision-making situation, which can lead to cognitive biases (Simon/Houghton/Aquino 1999). Although the application of decision-making heuristics can lead to quite good results and can be particularly efficient (Tversky/Kahneman 1974), the heuristically impacted start-up decision is highly risky.

Particularly individuals facing the decision to establish a company and to change from an alternative application of their working time to self-employment are confronted with a decision-making problem which tends to exceed their cognitive information-processing capacity and which is inevitably produced by a high degree of uncertainty, modernity, emotions and time pressure (Baron 1998). In their U.S. study, Simon, Houghton and Aquino (1999) identify overconfidence, the illusion of control and the belief in the "law of small numbers" as the three central biases of the risk-taking decision within the start-up decision's framework. On the other hand, international comparisons of differing entrepreneurship cultures confirm, besides overconfidence, the influence of worry about risk-taking in German entrepreneurs' start-up considerations (Frederick et al. 2002). Except for the risk propensity (Schade/Steul/Schroeder 2002) that is central to risk perception (Weber/Milliman 1997), the cognitive biases of overconfidence (Cooper/Woo/Dunkelberg 1988) and worry (Schade/Kunreuther 2002) should be included as influencing factors in the start-up considerations.

In an international comparison it must be taken into account that the start-up decision's selected cognitive goal factors are, in turn, influenced by the social and cultural background of the entrepreneurs' country of origin (Hunt/Levie 2003, George/Zahra 2002; Hofstede 2001; Busenitz/Lau 1996). According to intercultural entrepreneurship research studies (Hayton/George/Zahra 2002), behavioristic phenomena like attitudes and perceptions are culture-specific so that cross-cultural comparisons are either aimed at inter-culturally valid phenomena, or require a context-dependent result interpretation at the risk of culture-specific constructs.

## **MODEL AND HYPOTHESES**

To research actual risk-taking behavior in respect of entrepreneurs' personal and context-applicable characteristics, the determinants of risk-taking behavior have to be understood.

Whereas the normative theory of decision making makes no differentiation here, and to some extent equates risk-taking behavior and risk propensity, the descriptive theory of decision making identifies risk-taking behavior's key influencing factors. Consequently, the decision-making behavior under risk results from the combination of risk propensity and perceived risk (Weber/Milliman 1997).

Here a risk propensity should be understood as the decision-maker's personal trait that influences the risk-taking behavior, but does not determine it. This attitude concept does not correspond to the psychological attitude concept: Fishbein/Ajzen (1975, 6) summarize the posture's character in three constituting characteristics: "... the notion that attitude is learned, that it predisposes action, and that such actions are consistently favorable or unfavorable toward the object". Risk propensity, as the employed term, does not here possess this reference to object. On the contrary, a risk propensity is here object-independent and thus a relative constant personality trait that is only transformed by exceptional events in the decision-maker's environment (Weber/Milliman 1997).

Conversely, the perceived risk is essentially determined by the situational factors – in the research context to some extent by the venture's characteristics. The objectively presented and/or natural risk is transformed by the (risk) perception process. The result is the perceived risk. Consequently, in respect of the start-up consideration, it can be deduced that the decision-maker's personality traits, the venture's characteristics and the context factors influence the start-up decision more than the risk perception's transformation processes. A decision-maker's worry can to some extent be regarded as a personality trait that is molded by financial context factors, such as the economic situation, and by cultural context factors, such as national mentalities and fundamental moods, and thus lead to differences in risk perception.

Based on the insights of research into success factors, one can distinguish between a micro- and a macro-level in respect of context factors. To some extent the individual's financial status at the time of the start-up decision influences the assessment of the venture's perceived risk on the micro-level. Conversely, from the economic macro-context, the state's financial promotion programs are influenced by start-up considerations. The social and cultural norms have a corresponding effect as macro-factors, whereas the entrepreneurs' direct social environment influences the micro-level. In addition, note that the influence factors are interdependent: cultural context factors (2003, Hunt/Levie 2003, George/Zahra 2002, Hayton/George/Zahra 2002, Hofstede 2001) shape personality traits such as risk propensity and risk perception and consequently decision-making behavior.

To summarize, the three following hypotheses can be derived for the empirical test:

*Hypothesis 1: The choice between the ventures is determined by the entrepreneur's different perceptions of these venture-related risks and by his individual risk propensity, overconfidence and worry (Schade/Kunreuther 2002, Forlani/Mullins 2000, Simon/Houghton/Aquino 1999, Palich/Bagby 1995).*

*Hypothesis 2: The differences in the entrepreneurs' risk-taking behavior are largely shaped by the cultural context (Hunt/Levie 2003, George/Zahra 2002, Hayton/George/Zahra 2002, Hofstede 2001).*

*Hypothesis 3: Risk perception functions as the central mediator for the cultural influence on the entrepreneurs' risk-taking behavior (Hunt/Levie 2003, George/Zahra 2002, Hayton/George/Zahra 2002, Hofstede 2001).*

For the empirical testing of these hypotheses, the following structural model in respect of risk-taking behavior during the start-up decision (see Figure 1), should be examined.

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Figure 1 about here  
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In the centre of the model is the entrepreneur who makes his start-up decision through the choice of a venture and reveals a certain risk-taking behavior. How the entrepreneur assesses the chances and risks of a specific start-up intention depends, in turn, on his personal dispositions. Risk propensity (risk-avoider vs. risk-seeker) and perception of a specific risk (risk perception) play a decisive role. Personality characteristics, such as a tendency toward overconfidence (overconfident versus non-overconfident) and the expression of worry (worrier versus non-worrier) have a particular influence on the start-up decision. The decision manifests itself during the choice of one of the presented start-up alternatives which are distinguished from one another in respect of the risk profile. Risk is therefore defined as the positive and negative (standard) deviation of a target value and consequently also includes chance (Forlani/Mullins 2000). The particular risk associated with the venture is determined by the extent and probability (positive or negative) of deviation from the profit target (risk 1-4). The four ventures (white, purple, yellow, and pink) can be positioned in an unambiguous sequence (risk scoring) according to the specific degree of risk. As a control, the micro-context is revealed in the fundamental personality traits, the personal risk history and the individual risk perspectives. The macro-context flows into the analysis as a cultural context through the combination and comparison of the samples from the United States and Germany.

## FINDINGS

To empirically test the theoretically assumed dependencies between decision and risk-taking behavior's fundamental influencing factors during a start-up, two examples from various cultural contexts are required. For the model and hypotheses test a similar test design was developed and applied in Germany and the United States. The total sample is comprised of 254 (young) entrepreneurs and graduate entrepreneurship students in Germany (University of Cologne, University of Wuppertal, Business Plan Competition Cologne; n=124) and in the United States (Case Western Reserve University, Cleveland/Ohio; n=130); a group of 51 entrepreneurs (20%) versus a group of 201 non-entrepreneurs (80%). On average the participants were 29 years old within a range from 20 to 59 years old. The total sample consisted of 177 male and 74 female test participants.

Consistent with previous research on entrepreneurial risk-taking behavior (e.g., Forlani and Mullins 2000, Simon, Houghton and Aquino 1999, Palich and Bagby 1995), this study examines entrepreneurs and students' responses to a research design to measure behavior and personal dispositions. Entrepreneurs and entrepreneurship students were asked about their perception of risk and choice among a series of hypothetical new ventures with the choice being influenced by: the pattern of outcomes anticipated in each venture; the differing perceptions of those risks; and the differences in the personal propensities to take risks. A 2x2 full factorial within subjects experimental design was applied to manipulate the variability and hazard associated with the

outcomes of the new ventures. All four ventures had equal expected values, but different standard deviations of the predicted outcomes. In the non-experimental part of the research, the interviewees were classified into risk avoider and risk seeker measuring risk propensity indirectly by testing the choice of lotteries. Overconfident and non-overconfident individuals are differentiated by the perceived survival odds of the new venture in comparison to the survival rate of a competitive venture (Cooper, Woo and Dunkelberg 1988). Applying the established worry domains questionnaire (Tallis, Eysenck and Mathews 1992) worriers and non-worriers could be distinguished by an overall worry score based on five different worry domains. We controlled for individual differences such as age, gender, occupation and risk experience (entrepreneurial experience, family entrepreneurs, investment experience). The findings are:

*Hypothesis 1 appears to be confirmed and cannot be rejected:* in respect of the international sample of entrepreneurs it proves that the start-up decision, in the form of the tested risk-taking behavior, is sufficiently determined by the risk propensity, risk perception, worry, overconfidence and the cultural context ( $R=0.7$ ;  $R^2=0.49$ ) and that the tested decision-making model is significant ( $p<0.001$  through both the multi-linear as well as the logistic regression, see Table 1 and Table 2):

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Table 1 about here  
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The overconfidence and risk perception parameters (risk 2, risk 4) in the overall model make a significant behavior prediction possible. Because a substantial precondition of the model was not fulfilled with the assumption of variance homogeneity (see Table 1 Point 5), the analysis of the logistical regression is expanded. This method has the advantage of being essentially free of assumptions. As the sole precondition, the predicting characteristic must be applied in a binary manner, which provides the solution that the dependent risk-taking behavior variable is dichotomized. The results of the logistical regression (Table 2) show that the model is significant and can essentially be attributed to overconfidence and risk perception.

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Table 2 about here  
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*Hypothesis 2 appears to be confirmed and cannot be rejected:* the difference between entrepreneurs and non-entrepreneurs in respect of risk behavior varies significantly between the total sample's cultural contexts. The difference in the risk-taking behavior between entrepreneurs and non-entrepreneurs is significantly higher in the German context than in the U.S.-American context. Contrary to a widely accepted stereotype, the German entrepreneurs – in the control of the mentioned variables from the micro-context – choose for more risky ventures than their U.S.-American counterparts (see the variance analysis's results in Table 3):

As shown by Table 3, the interaction from being an entrepreneur and cultural context becomes significant ( $p=0.02$ ), German entrepreneurs exhibit less risk value, in other words, they take higher risks with a purchase than the U.S.-American entrepreneurs. With the non-entrepreneurs in both the cultural contexts, the opposite occurs.

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Table 3 about here  
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*Hypothesis 3 appears to be confirmed and cannot be rejected:* the dominant properties of risk-taking behavior are risk perception and overconfidence. The more pronounced the overconfidence and risk perception, the higher the risks that are taken. The influence of the cultural context on entrepreneurs' risk-taking behavior is conveyed through the risk perception, as these variables' interaction analysis shows (see the results of the variance analysis in Table 4):

As shown in Table 4, the interaction from being an entrepreneur and cultural context and risk perception is significant at a 10% level of significance ( $p=0.09$ ). Furthermore, a principal effect is indicated in the risk perception (here exemplary for the venture purple). Persons with supramedian risk perception (here: risk perception of the venture purple) exhibit less risk value, in other words, they take higher risks when venturing. German entrepreneurs exhibit less risk value, in other words, they take higher risks. This effect is more strongly pronounced by U.S. entrepreneurs than by German entrepreneurs. The opposite is true of non-entrepreneurs in both cultural contexts.

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Table 4 about here  
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The results of the model and hypotheses test imply that the model has been sufficiently well determined by the analyzed predictors and that none of the 3 hypotheses can be rejected.

## IMPLICATIONS

The results imply that the cultural context had a significant influence on the risk-taking behavior and that the risk perception functioned as a mediator. This insight helps to refine the understanding of entrepreneurial decision behavior in that, contrary to the normative theory of decision making, it postulates to inter-culturally distinguish between the risk propensity of and the risk perception for entrepreneurs' risk behavior. To sum up, one can state that:

1. The results confirm earlier U.S. studies to distinguish between risk propensity and risk perception in respect of entrepreneurs' risk behavior.
2. This is proved in respect of an international, intercultural sample.
3. The cultural context has been identified as a key factor for the differences in entrepreneurial risk behavior.
4. From the second and the third conclusion it can be deduced that the external validity of national start-up studies can be decreased in an international context.

Nevertheless, the limits of the employed methods are clear: the experimental base has advantages for the internal validity, but the experiment is not real and not linked to real cash flows, through which a question regarding the external validity arises: For which populations, context, treatment and measure variables can the measured effect be generalized? It can thus be established that the

experiment's laboratory situation was moderated to such a degree that the interviewees were presented with an individual risk profile as a feedback from their test result to provide the most authentic – realistic – answers. The majority of the interviewees made use of the feedback possibility.

A further possible problem could be that the measurement of the risk propensity is not accurate. An attempt was made to solve this problem by also asking the interviewees about the risk propensity of the self-assessment and only adding this information afterwards. On the other hand, the risk propensity was analyzed and evaluated indirectly by a lottery test.

Moreover, it can be noted that with the manipulation of the risk, the profit is also manipulated to keep the predicted cash-flows' expected values in the four ventures equal. In reality this is unlikely, and consequently reduces the results' external validity.

Furthermore, the study is limited to the start-up decision's key personal, and a few context-applicable, influence factors. Other factors such as team-decision processes and competencies remain unconsidered. Nevertheless, with the presented properties, the tested models reveal a sufficient degree of decisiveness in respect of psychological constructs.

The essential implications for entrepreneurship research can be summarized. The experimental project had the advantage that the internal validity was the purpose of theoretical test: risk-taking behavior has been shown to be a function of the risk perception and of other personal factors. Contrary to the assumptions of the normative theory of decision making, the risk-taking behavior, as a fundamental component of the start-up decision, is not exclusively based on the risk propensity and, as a result, supports the application of the descriptive theory of decision making in entrepreneurship research. However, with regard to the external validity of the hypothetical stimuli and of the group of test persons, it is possible to critically assess the experiment's initial analyses. A solution to this dilemma of the limited possibility to generalize the gained results could consist of using individual entrepreneurs' case as a behaviorist diagnostic initiative. Although this may contradict the strict economic principle in respect of the non-individual case examination, there is no contradiction here with regard to fundamental interdisciplinary, or behavioristically formed, entrepreneurship research.

This simultaneously facilitates the implications of entrepreneurship education. It is thus possible for "would-be entrepreneurs" to be used as an individual diagnostic instrument, making it possible to, on the one hand, identify individual anomalies in risk and decision-making behaviors and, consequently, contribute to a better understanding of suitable entrepreneurial behavior as well as to reveal discrepancies between self-assessment and actual behavior. On the other hand, this project offers a set of instruments, techniques and a framework for an improved understanding of potentially attractive, but risky, start-up opportunities. In ideal circumstances, a perfect fit between the personal start-up dispositions and the characteristic of the market opportunity as an entrepreneurial action field would be aspired to (Shane/Venkataraman 2000).

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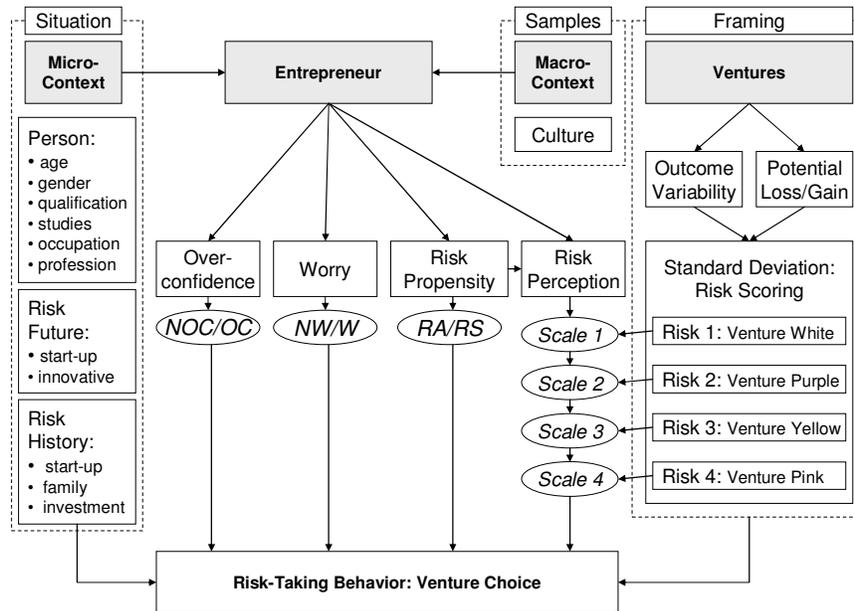
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**FIGURE 1**  
**Model structure of risk-taking behavior during the start-up decision**



**TABLE 1**  
**Prediction of risk-taking behavior (multi-linear regression)**

|                         | regression coefficient | t-value      | p-value      |
|-------------------------|------------------------|--------------|--------------|
| <b>(Constant)</b>       | <b>2.90</b>            | <b>3.03</b>  | <b>0.004</b> |
| <b>overconfidence</b>   | <b>-0.71</b>           | <b>-2.73</b> | <b>0.009</b> |
| worry                   | -0.15                  | -0.50        | 0.619        |
| risk propensity         | 0.07                   | 0.26         | 0.798        |
| risk1                   | -0.17                  | -1.84        | 0.073        |
| <b>risk2</b>            | <b>-0.28</b>           | <b>-3.01</b> | <b>0.004</b> |
| risk3                   | 0.12                   | 1.42         | 0.162        |
| <b>risk4</b>            | <b>0.28</b>            | <b>2.89</b>  | <b>0.006</b> |
| <b>cultural context</b> | <b>0.65</b>            | <b>2.35</b>  | <b>0.024</b> |

model:  $p < 0.001$ ,  $F = 4.88$   
goodness:  $R = 0.7$ ,  $R^2 = 0.49$ ,  $Adj R^2 = 0.39$ ,  $SE = 0.85$   
1. resid. mean = 0.00, sd = 0.80, n = 50  
2. resid. normality  $p = 0.20$ , df = 50  
3. zerocorr. resid. & pred.:  $p = 1.00$ ,  $F = 0.01$   
4. resid. zerocorr.: Durbin = 2.11  
5. homosked.:  $F = 42.5$   $p < 0.001$

**TABLE 2**  
**Logistical regression with regard to prediction of dichotomized risk-taking behavior**

|                         | regression coefficient | p-value      | change of risk | lower 95%-confidence | upper 95%-confidence |
|-------------------------|------------------------|--------------|----------------|----------------------|----------------------|
| <b>overconfidence</b>   | <b>-2.734</b>          | <b>0.018</b> | <b>0.065</b>   | <b>0.007</b>         | <b>0.629</b>         |
| worry                   | -1.152                 | 0.277        | 0.316          | 0.040                | 2.521                |
| risk propensity         | 0.327                  | 0.757        | 1.387          | 0.175                | 10.970               |
| risk1                   | -0.797                 | 0.073        | 0.451          | 0.189                | 1.077                |
| <b>risk2</b>            | <b>-1.403</b>          | <b>0.006</b> | <b>0.246</b>   | <b>0.091</b>         | <b>0.665</b>         |
| <b>risk3</b>            | <b>0.764</b>           | <b>0.030</b> | <b>2.146</b>   | <b>1.078</b>         | <b>4.271</b>         |
| risk4                   | 0.729                  | 0.154        | 2.072          | 0.760                | 5.648                |
| <b>cultural context</b> | <b>2.582</b>           | <b>0.032</b> | <b>13.227</b>  | <b>1.241</b>         | <b>&gt;15</b>        |
| Constant                | 4.024                  | 0.338        | >15            |                      |                      |

N=50, % correctly classified=80%, Chi<sup>2</sup>=29.8, df=8, p<0.001

**TABLE 3**  
**Variance analysis results of the 2x2 table**  
**(general linear model, SPSS procedure GLM)**

| ANOVA tested effect                    | test statistic (F-value) | degrees of freedom | p-value     |
|--|--------------------------|--------------------|-------------|
| entrepreneur                           | 1.08                     | 1.00               | 0.30        |
| cultural context                       | 1.74                     | 1.00               | 0.19        |
| <b>entrepreneur x cultural context</b> | <b>5.28</b>              | <b>1.00</b>        | <b>0.02</b> |

**TABLE 4**  
**Variance analysis's results 3x3 table**  
**(general linear model, SPSS procedure GLM)**

| ANOVA tested effect   | test statistic (F-value) | degrees of freedom | p-value     |
|---|--------------------------|--------------------|-------------|
| cultural context  | 1.82                     | 1.00               | 0.18        |
| <b>risk perception local purple</b>                                   | <b>16.44</b>             | <b>1.00</b>        | <b>0.00</b> |
| entrepreneur  | 0.75                     | 1.00               | 0.39        |
| cultural context x risk perception local purple                       | 0.02                     | 1.00               | 0.89        |
| cultural context x entrepreneur                                       | 3.18                     | 1.00               | 0.08        |
| risk perception local purple x entrepreneur                           | 0.00                     | 1.00               | 0.96        |
| <b>cultural context x risk perception local purple x entrepreneur</b> | <b>2.89</b>              | <b>1.00</b>        | <b>0.09</b> |

**DRIVERS OF EFFICIENCY IN SMALL SERVICE FIRMS:  
A DATA ENVELOPMENT APPROACH**

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## **Abstract**

We explore the drivers of efficiency in very small service firms. Efficiency of the firms is established through a Data Envelopment Analysis (DEA). DEA uses input and output relationships to derive a relative efficiency measure for the individual firm. This relative efficiency measure reflects the potential increase in output of a firm, given a level of inputs. The average level of efficiency in this sample, given the input and output categories specified, is 50%. The empirical results are robust against different model specifications.

The study, based on 2125 data points, suggests that efficiency of firms is higher for larger firms, providing a broad set of services. In addition, the average efficiency of firms varies with region: firms in urban areas are more efficient than in rural areas. Soft franchising appears to have a positive impact on efficiency, whereas hard franchise has not. When firms grow older, they become less efficient.

Firms can only marginally increase their efficiency by adjusting their size towards an optimal size. This reinforces the argument that very small firms are not able to react on temporary changes in the market. These firms are just too small to adjust inputs downwards, in times of recession. Surprisingly, small firms may be not as flexible as they are usually assumed to be.

## I. INTRODUCTION

In this paper we explore structural factors that explain variance in efficiency of real estate brokerages. Brokerages firms in the Netherlands are typically very small and therefore can hardly adjust their resources downwards. In addition, because of their limited size, they also have little influence on their outputs. Their level of output is highly dependent on the residential homes market. Together this makes firms vulnerable to large fluctuations in performance from year to year. Therefore we expect a high variation in efficiency of the firms.

In the first section of the paper, we derive a performance measure of the firms. A performance measure such as shareholder value is not available for small firms; therefore we use an efficiency measure. Data Envelopment Analysis (DEA) provides a *relative* efficiency measure of individual firms, based on the input and output relationships of each firm. Being a non-parametric method, DEA can deal with multiple inputs and outputs categories without specifying a production function up front. In the second step, we regress this efficiency measure on a number of firm characteristics and market variables.

The paper is structured as follows. Section 2 describes efficiency of brokerage firms, factors that explain differences in efficiency, and residential brokerage firms in the Netherlands. Section 3 explains the background of efficiency analysis with the emphasis on Data Envelopment Analysis. An overview of the collected data, variable measurement and used methods is reported in section 4. Section 5 provides the empirical results of the study. We end with a summary and conclusion in section 6.

## II. LITERATURE REVIEW

### *Efficiency of brokerage*

The long lasting stream of literature provides contagious results about the efficiency of real estate brokerage firms. Earlier studies mainly stressed the inefficient nature of the industry. Different explanations for this inefficiency that are provided are the level of excess capacity (Yinger, 1981), monopolistic nature of the industry (Miller and Shedd, 1979; Crockett, 1982), the commission structure for services provided and the existence of entry barriers (Wachter, 1985). Opposing views about the efficiency of these firms are hold by Schroeter (1987) and Knoll (1988). From a DEA analysis on brokerage firms in the US, Anderson et al. (1998) find an average efficiency score of 50%. This score implies that the average firm can increase the level of output with 50%, given the same input level.

### *Drivers of efficiency in residential brokerage*

#### *Scale*

Zumpano et al. (1993) suggest that most residential brokerages are too small to take advantages of economies of scale. They derive this conclusion from the shape of average costs as a function of firm size. A larger scale makes it possible to specialize employees in particular service types and therefore leads to a higher efficiency.

#### *Franchise*

The impact of membership of a franchise chain might be two-fold. Franchise membership has advantages in raising capital at lower costs, in pooling advertising activities, and in making knowledge and expertise accessible to affiliates. However, members of franchises can also shirk effort, because the franchise reputation gives them enough transactions, and therefore they might

engage in free-rider behavior (Anderson et al. 1998). Empirical evidence from Anderson et al. (1998) suggests that franchise membership has a negative impact on efficiency. However, in their setting they explore the impact of being a member of any franchise, without providing information about the terms and conditions of different franchise formulas.

### *Limited liability (BV)*

Limited liability may insure firms against personal negative implications of being inefficient. Therefore, having limited liability, for example, by using the fiscal entity private limited company, is expected to have a negative impact on efficiency. However, Anderson et al. (1998) failed to find empirical evidence for the impact of this limited liability on efficiency.

### *Economies of Scope*

The service proposition of real estate brokers in The Netherlands consists of four main services: (1) advising households selling property, (2) advising households buying property, (3) the valuation of houses and (4) selling new built houses on behalf of developers. On top of that they provide services as mortgage and insurance brokers, rental services, consulting services etc. Dutch real estate brokers are not allowed to advise both the selling and the buying party, the traditional position of the middleman.

Zumpano and Elder (1994) report significant economies of scope in the real estate brokerage industry. Brokers that offer different services can for example share the (fixed) costs of the back office function. However, different services need different expertise and therefore, employees within a brokerage firm probably need to specialize. Therefore, to be economically feasible, the different service categories should be large enough to make the investments worthwhile. Recent trends in brokerage services suggest that firms focus on a narrow range of services, for example

only advising buying households, or only act as a valuator. This trend is partly explained as a result of niche marketing, and partly (especially in the case of valuation) as an efficiency-driven strategy.

### *Firm age*

The impact of firm age on efficiency is two-fold. Longer operating firms have a more extensive network (and reputation) and therefore might attract more customers. In contrast, the extensive network might lead to overconfidence because firms believe customers will be attracted based on their reputation only (Anderson et al., 1998). Next to reputation effects, Jovanovic (2001) positions that older firms have more problems to adjust themselves to a changing environment. In the context of brokerage firms, the major change is the introduction of the internet as a substitute for traditional multiple listing services.

### *Market density*

When markets are more dense, i.e., in urban areas, there will be more properties for sale and therefore a higher level of transactions. This increases the proximity of the brokerages to the properties for sale and therefore reduces travel time. In addition, in dense markets, there will be more competition between brokerage firms. Together, a greater market density is expected to lead to a higher efficiency.

## **Residential brokerage in the Netherlands**

Almost 80% of existing housing transactions (180.000 per annum) in the Netherlands are undertaken through three Multi Listing Services (MLS). The largest of the three, run by the leading trade association, has a 65% market share in residential sales. Only members of the trade association (about 2000 agency firms) have direct access to this MLS.

Selling houses is the most important service provided by agents, followed by buying agency services and valuations. Recently, buyers less commonly use buying agents to look for properties and to negotiate purchases. There is no sharing of fees between selling and buying agents. Only a minority of real estate offices sells new houses. They tend to do such work for low fees, relying on mortgage commissions and the hope of organizing the sale of the existing home of new house purchasers, when they are previous owner occupiers.

Compared to the US situation, real estate brokerage in the Netherlands is an extremely small-scaled business. The average agency sells about 100 houses a year and helps around 20 buyers. The median number of houses sold yearly is about 60. Studies have shown that there are few scale or scope economies in agency work and that the most profitable firms in relation to turnover are relatively small ones, employing about 10 people, with an annual turnover of 150 house sales and 25-30 house buyers. The profitability of larger firms is less volatile than that of smaller ones, making risk-weighted returns fairly similar (Ball, 2004). Few agencies fail.

Between 1987 and 2000, there were only an handful of bankruptcies. Firms, instead, tend to disappear as their proprietors tire of the business or retire from it.

There is some evidence of consolidation amongst estate agents themselves. The impetus towards consolidation is related to broader economies of scale associated with branding, etc. Scale and scope results are influenced by the fact that firms operate in larger networks (e.g., franchise chains or multiple outlet firms) that provide considerable scale benefits.

### III. EFFICIENCY ANALYSIS AND DEA

Early, mainly regression based techniques, used for assessing (in)efficiency of decision making units, have the common limitation in that they can handle only one dependent variable, i.e., only one output category. In addition, these techniques do not provide specific information about the causes of inefficiency (Bardhan, et al., 1998). To be able to include multiple input and outputs in regression based techniques an often subjective, a priori weighting scheme of the inputs and outputs, is needed.

Data envelopment analysis (DEA) is a non-parametric technique that establishes the relative efficiency of firms or individual decision making units (DMU's). The fact that DEA is a non-parametric type of efficiency analysis implies that no functional form a priori is needed to specify input–output relationships, although it is possible to suppress or enlarge the impact of an individual input or output in the efficiency scores (see for an example, Thanassoulis et al., 1995). DEA is also able to explore inefficiencies in all input or output category used for each observation (Bardhan et al., 1998).

The relative technical efficiency of a firm is calculated by forming the ratio of a weighted sum of outputs and inputs to be selected in a manner that calculates the Pareto efficiency measure of each firm subject to the constraints that an efficiency of 100% is the maximum achievable (Charnes et al, 1994, p. 6). The efficiency measure is the radial distance from the optimal production frontier. This frontier is based on the levels of each output category that is produced by the most efficient firms.

DEA scores produce *relative efficiency measures* and therefore the average efficiency in the population should be interpreted with some caution. The average efficiency, for example,

depends on the sample size in combination with the number of input and output categories. To control the impact of a large set of inputs and outputs on the efficiency measure Cooper et al. (2000) suggest to start with a small set of input and output and gradually enlarge this set to study its impact on efficiency.

Firms operating in a niche, producing only a limited number of output categories, can receive the same efficiency measure in comparison to firms that produces the whole range of output categories. Therefore, the benchmark for each firm, used to compute its relative efficiency, is the set of firms in the sample that have exactly the same input and output mix, be it in different proportions. The observation that the average efficiency from a DEA analysis is dependent on the sample size implies that levels of average inefficiency can not be compared between different samples. Thus, for example comparing the average efficiencies of firms in one industry in different countries provides biased results due to the unequal sample size of the studies (Zhang and Bartels, 1998).

There are two models most frequently associated with the DEA methodology: the CCR (“Charnes-Cooper-Rhodes”)-model measures efficiency under constant returns of scale (Charnes, Cooper, & Rhodes, 1978) and produces an “overall efficiency” rating. In contrast, the BCC (“Banker-Charnes-Cooper”)-model measures efficiency on the assumption of variable returns to scale leading to a “pure technical efficiency” rating (Banker, Charnes, & Cooper, 1984). When variable returns to scale are assumed, the relative benchmark of a firm are the firms that operate with a similar scale. With constant returns to scale, the relative benchmark of a firm are all other firms in the sample.

Since 1978, DEA is applied in an almost unlimited number of different settings, represented by the list of a bibliography of 472 published papers and dissertations between 1978 and 1992 by Seinfeld in Cooper et al. (1994). Examples of applications are efficiency analysis of non-profit firms that receive financial support from governments (e.g., Hollingsworth, 2003), the impact of non-controllable inputs and external conditions on efficiency of schools (e.g., Ray 1991), the impact of technological change on trends in efficiency of the textile industry in China (Wei, et al. 1995), and efficiency gains of making use of economies of scale in software maintenance (Banker and Slaughter, 1997).

#### **IV. DATA, VARIABLES AND METHODS**

##### ***Data***

Data was collected from an ongoing annual benchmark study among brokerage firms commissioned by the main Dutch trade organization of estate brokers. The annual survey covers input (personnel, costs) and output (volume and revenues), as well as demographic information as firm age, region, franchise affiliation, etc. To enhanced data comparability, we limit the analysis to firms that receive at least 75% of their revenues from residential transactions. A benefit of this restriction, is that it leads to less input and output categories for the Data Envelopment Analysis.

Three years of data were pooled in the database from 2000, 2001 and 2002. The total sample size is 2125 data points, 959 from 2000, 563 from 2001, and 603 from 2002. For 296 firms we have a complete panel, with data on all three of the consecutive years.

##### ***Data envelop analysis***

The dependent variable efficiency is computed through Data Envelopment Analysis (DEA). DEA estimates efficiency of units by assessing input-output relationships. Firms that produce more outputs are considered to be more efficient than firms that produce less output given the same values of inputs.

Labor is the dominant asset in services, and the division of labor within the firm is the main instrument brokers can use as an instrument to enhance efficiency. To compute the input-output relationships in this setting, we use four labor-related input measures. These are the number of brokers, assistant brokers, mortgage brokers and support staff, all measured in full time equivalencies. Output categories are the number of transactions in sold existing homes, bought homes, sold new homes, rented houses, mortgages, and number of valuations. Descriptives of the inputs and outputs are reported in Table 1.

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Insert Table 1 about here  
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The descriptives indicate that the average brokerage is very small, with less than two brokers, 1.18 assistant brokers, 0.2 mortgage brokers and two supporting staff. To compute efficiency we focus on the constant return to scale DEA model (CCR). The variable return to scale DEA model (BCC) yields similar results.

### ***Variable measurement***

Firm age is measured in years since foundation of the firm (*Age*). The variable *Limited* measures whether the brokerage has limited liability. This is an indicator variable that is activated if the brokerage is a private limited company and is zero otherwise. The impact of franchise membership is measured by two dummy variables (*Franchise1*, *Franchise2*). Indicator variable

*Franchise1* is activated if the brokerage is a member of franchise 1 and 0 otherwise. *Franchise2* is activated when the firm is a member of franchise 2 and 0 otherwise. These two franchises are the largest in the Netherlands. The franchises have a different regime. *Franchise1* is an US based franchise that recommends strict enforcement of using the franchise name, and procedures. In contrast, *Franchise2* is a Dutch based franchise that leaves more individual freedom to the firm. In other words, it leaves more room for entrepreneurial behavior.

Three indicator variables are used to assess the impact of operating in four different regions within the Netherlands. (*Area1*, *Area2*, and *Area3*). The regions are the result of a cluster procedure based on the size of the market (number of sold house per annum), average prices of houses and scarcity of houses. *Area1* are the 4 largest cities of the Netherlands, markets with a large number of transactions, an average price level of properties and a scarce market. *Area2* is characterized by an average volume, high prices of the properties and a scarce market. *Area3* is a small market, with average prices of properties, and no scarcity. The fourth area, the reference group, are mainly rural areas. This is an area with low transaction volumes, low prices, and no scarcity.

Two competition measures are used. The first competition variable (*Share*) measures the pressure from firms outside the trade association. The second variable (*Entropy*) measures the concentration within the population of members of this association, as a proxy for competitive pressure. The correlation coefficient of the two competition variables is 0.04 (not significant), making it clear that two different dimensions of competition are measured.

The firm's economies of scope are measured by the number of different services a firm provides (*Scope*). These services are the output categories used for the DEA analysis. The range of this

variable is from one to six. Finally, firm size is measured by the number of full time equivalent employees (*Size*).

Using observations from more than one year in a DEA analysis might lead to a biased efficiency parameter, if for example new technologies lead to a higher efficiency in later years. A second factor that could impact the efficiency of brokerage in each year is changes in the residential properties market. To control for changing conditions in time we use indicator variables for two years, *Year2001* and *Year2002*.

### ***Methods***

The dependent variable efficiency is a bounded score, between 0 and 100 and often skewed with a bimodal distribution (Knox Lovell, et al., 1994). Therefore, ordinary least squares provide inaccurate estimates of coefficients. To overcome these problems we estimate a Tobit regression. To explain the variance in relative efficiency measure by the variance in the set of independent variables we estimate the following equation:

$$\begin{aligned} Eff_{it} = & \alpha + \beta_1 * Entropy_{it} + \beta_2 * Share_{it} + \beta_3 * Age_{it} + \beta_4 * Limited_{it} + \beta_5 * Franchise1_{it} \\ & + \beta_6 * Franchise2_{it} + \beta_7 * Area1_{it} + \beta_8 * Area2_{it} + \beta_9 * Area3_{it} + \beta_{10} * Size_{it} + \beta_{11} * Scope_{it} \\ & + \beta_{12} * year2000_{it} + \beta_{13} * year2001_{it} \end{aligned}$$

In which *i* is the firm and *t* is a period index. Using a panel dataset implies that the benchmark of an observation in the DEA is the same observation in another year or a different observation.

This assumes that the technology is constant in time. This is a reasonable assumption in this setting, even though the breakthrough of internet took place somewhere in the research period.

Next to using the panel dataset we also execute a cross-sectional analysis for firms that have three years of observations.

## **IV. EMPIRICAL RESULTS**

The results section incorporates four stages of analysis. First, we compute the efficiency of firms. Second, we explain variation in efficiency through a set of independent variables, which are related to market characteristics and firm characteristics. Third, we explore how much firms can increase their profits when they are able to increase their efficiency level. Finally, we check whether results are robust when we average the input and output categories over the three years in the sample. The motivation for this analysis is that firms have little influence on the level of output in one year.

### *Efficiency*

The DEA analysis is based on four input categories and six output categories. The descriptives for three different DEA efficiency measures are reported in table 2.

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Insert Table 2 about here  
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Average efficiency with constant return to scale ( $Eff_{CCR}$ ) based on the pooled three year data is 50.78. This implies that on average brokerages firm can realize 49% more transactions with the inputs used. Only a small part of this inefficiency is due to scale inefficiency, i.e. firms have the “wrong” scale. Since the efficiency scores from the BCC-model are by definition equal or larger than the efficiency score of the CCR-model, scale efficiency can be computed by  $\Theta = \sum(Eff_{CCR} / Eff_{BCC})$  (Cooper et al., 2000). In this industry, scale efficiency is 95,68. Therefore adjusting the scale of operations will not lead to major efficiency improvements. This result contrasts the finding of Anderson et al. (1998) who find that the largest part of inefficiency is due to having a sub-optimal scale. 48% of the firms in the sample have increasing returns to scale and therefore should increase size, whereas 43% have decreasing returns to scale, and therefore are too large.

To assess the stability of the efficiency measure, we also computed efficiency of brokerage in each year ( $eff_{year}$ ). Correlation between  $eff_{year}$  and  $eff_{CCR}$  is 0.934 ( $p < 0.01$ ). This means that it makes no (large) difference whether the benchmark is derived from firms in the same year or in the complete time-series. However, an artifact of DEA analysis is that a higher number of observations lead to a lower average efficiency. The reason for this mechanism is that with many observations each individual observation has more reference units increasing the probability that other reference units will be more efficient (Zhang and Bartels, 1998; Staat, 2001).

The DEA technique provides insights in the output categories where the highest efficiency gains are possible. Of the six output categories three have an inefficiency level of more than 10%. These are the number of mortgages (18%), the number of sold new houses (51%), and the number of valuations (13%). In the case of mortgages and new houses, the explanation lies in the structure of compensation: the financial reward for both services is high. In the case of valuations, the inefficiency is not compensated.

The efficiency measure from the DEA technique is dependent on the input and output relationships specified. Therefore, to explore the stability of the efficiency numbers we specify different input and output combinations. For example, 86% of the sample has no financial advisors; this input category might therefore have a large impact on the efficiency score. In addition, revenues for valuing homes are much lower than for brokerage services. This suggests that being efficient on this output category is less important for firms. Correlation coefficients between efficiency measures of these different input-output specifications are reported in Table 3.

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Insert Table 3 about here

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Based on the correlation coefficients of the alternative efficiency measures the efficiency number is robust against different input-output specifications. The lowest correlation coefficient is 0.8. In sum, we find that based on the specified input and output relationships there is considerable room for efficiency improvements in the firms. The relative differences in efficiency between firms however seem to be robust against different input-output specifications as indicated by the high correlation coefficients of the different efficiency results. Most of the inefficiencies are found complementary services provided such as valuation of homes and the number of mortgages. Only 5% of inefficiency can be gained by adjusting the firms to the optimal scale.

### ***Drivers of efficiency***

In this section, we explain the differences in efficiency from firm related factors, such as its size, membership of a franchise, and age, and market related factors such as degree of competition, and the impact of regions. A description of all variables used in the analysis is reported in Table 4. Correlations between all metric variables are reported in table 5.

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Insert Table 4 & 5 about here  
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The impact of the independent variables on the efficiency measures are reported in Table 6.

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Insert Table 6 about here  
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The  $R^2$ -adjusted of the analysis is 0.103. The two competition variables (*Entropy* and *Share*) are not significant. Firms that have a private limited company as legal identity (*Limited<sub>it</sub>*) are on average 3.447 points more efficient than firms without a private limited company ( $z=3.140$ ,

$p < 0.01$ ). This difference is significant (t-value is 5.302,  $p < 0.01$ ). A possible explanation is that Private limited firms are on average 2.3 FTE larger.

The area-dummies have an impact on the efficiency score. Firms with affiliations in *area1* are on average 8.403 ( $z = 5.188$ ,  $p < 0.01$ ) more efficient than firms from area 4 (the reference group).

Firms with affiliations in *area2* and *area3* are on average respectively  $-6.123$  ( $z = -3.190$ ,  $p < 0.01$ ) and  $-2,514$  ( $z = -1.787$ ,  $p < 0.08$ ) less efficient than area 4. Operating in a metropolitan area (*area1*), with a dense market, in a highly competitive environment, appears to have a beneficiary influence on firms' efficiency.

Firms that are a member of *Franchise2* are on average 7.258 more efficient ( $z = 2.669$ ,  $p < 0.01$ ) than firms that are not a member of a franchise chain. Being a member of *Franchise1* has no significant impact on efficiency ( $b = -2.543$ ,  $z = -1.347$ , ns). This suggests that the impact of franchise membership on the efficiency of brokerage is dependent on the type of franchise. Soft franchising, with room for entrepreneurship in the individual firm, enhances efficiency, hard franchising does not.

The number of services the firm provides (*Mix*) is also significantly associated with efficiency. Firms with a broad portfolio of services are more efficient than firms focusing on a narrow range ( $\beta = 1.847$ ,  $z = 3.719$ ,  $p < 0.01$ ). A (not tabulated) analysis of variance analysis (ANOVA) with efficiency as the test variables and *Mix* as the treatment variable indicates that this effect is linear. The average efficiency in the six product groups increases monotonically. Age has a marginal significant negative impact on efficiency. Older firms become less efficient ( $b = -0.501$ ,  $t = -1.824$ ,  $p < 0.07$ ).

The average efficiency of the brokerages differs significantly in the 3 years of the sample. Observations from the year 2000 are on average 7.771% more efficient than observations from 2002, being the reference group ( $t=6.315$ ,  $p<0.01$ ). A possible explanation is that after 2000, the residential property market became worse and therefore it was more difficult for brokers to close transactions efficiently.

Based on a comparison of the standardized regression coefficients, regional effects and the impact of observations from the year 2000 have the largest impact on efficiency. These factors can be considered as exogenous variables to the firms. From the more endogenous variables, size of the brokerage, the number of services supplied, and being a limited liable company has the largest impact on efficiency.

Finally, we use the efficiency score with variable return to scale as dependent variable ( $Eff_{bcc}$ ) (column 3 in table 6). The coefficients and significant levels are similar to the coefficients and significant levels of the model with  $Eff_{crr}$ . However, the  $R^2$ -adjusted increases from 0.103 to 0.150, indicating that the correction for non-linear volume effects, in the DEA measure, improves the model's explanatory power.

### ***Efficiency and profit***

DEA efficiency measure only reports whether firms use the available resources efficiently. To shed some light on the impact of efficiency on profitability, we regressed brokers' profits on the DEA efficiency measure. Profit is measured as the revenues of the brokerage minus operational costs. The results are reported in table 7.

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Insert Table 7 about here  
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The regression results indicate that variance in efficiency can explain 14% of variance in profit and 17% in variance of profit per full time equivalent. A higher efficiency level of 1% is associated with a higher profit level of €2547 and €478 per FTE in a year.

### *Averaging efficiency over three years*

The descriptives of the input categories in table 1 indicate that the average brokerage is very small, with less than five full time equivalents. Such a small size implies a lack of flexibility in input resources. This implies that the labor force can only be adjusted upwards. Downsizing, as a reaction to a bad year, is hardly possible. Therefore, we also explored the efficiency on a longer time horizon. We averaged the input and output and drivers over the three years. For drivers that are indicator variables we averaged the variables and then adjusted them to 0 or 1. For example, if the firm was a limited liability company in two of the three years we gave it a 1 and zero otherwise. Results of this analysis are reported in Table 8.

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Insert Table 8 about here  
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$R^2$  ( $R^2$ -adj) of the model is 14% (11%) which is somewhat higher than the model that uses time-series. This might be explained by the fact that the efficiency measure is more stable when it is computed over three years and therefore incorporates less noise. The set of coefficients has a similar sign compared to the signs of the time series model. However, due to the strongly decreased sample size and therefore the power of the test only some variables are significant. The significant variables that are associated with efficiency are *Franchise2* ( $\beta=28.191$ ,  $t=2.478$ ,  $p<0.05$ ), *Size* ( $\beta=0.978$ ,  $t=2.443$ ,  $p<0.02$ ) and *Mix* ( $\beta=4.870$ ,  $t=3.234$ ,  $p<0.01$ ). These three variables also had high standardized coefficients in the analysis from the time-series.

## VII. SUMMARY AND CONCLUSION

In this paper we explore drivers of efficiency in small service firms. Efficiency of the firms is established through a DEA analysis. DEA uses input and output relationships to derive a relative efficiency measure. This relative efficiency measure reflects the potential increase in output categories of a firm with a given level of input in comparison to efficient firms. Average inefficiency in this sample, given the input and output categories specified is 50%. Firms can only marginally increase their efficiency by adjusting their size to the optimal size.

The results from the empirical study suggest that efficiency of firms is higher for larger firms, firms that provide a broad set of services and firms that have a limited liability. In addition, the average efficiency of firms varies with region: firms in urban areas are more efficient than firms in rural areas. In contrast to Anderson et al. (1998), we find that franchise membership has an impact on efficiency. Soft franchising appears to have a positive impact on efficiency, whereas hard franchise has no significant impact. Finally, when firms grow older, they become less efficient. The empirical results are robust against different specifications. For, example we estimate efficiency per firm with in a yearly interval and an average over three years. The effect sizes of the independent variables were similar for both analyses.

Factors that have a favorable impact on the efficiency of brokerage firms are mainly exogenous variables, such as year and area. This reinforces the argument that very small business firms are not able to react on temporary changes in the market. The firms are unable to adjust the inputs downwards when the brokerages industry is in the downward trend of the conjuncture.

Surprisingly, small firms may be not as flexible as we think they are.

As usual, the results of the study should be interpreted in light of its flaws. First, the independent variables are assumed to have a linear impact on efficiency. However, some of the independent variables, for example firm size and age, could have a non-linear impact on efficiency. Second, the two competition variables have no significant impact on efficiency. This contradicts economic common sense, expecting a positive impact of competition intensity on efficiency.

This study suggests a number of potential avenues for future research. First, the regression equation explains only 11% of variation in the dependent efficiency variable. This suggests there is ample room for other factors that explain why some brokerages are more efficient than others. Second, we find that scale inefficiencies are low in this industry. The part of the sample that was too small and too large to profit from scale economies was both approximately 50%. This suggests that there is an optimal scale (or a set of optimal scales). Further research could shed more light on this. In addition, mechanisms that lead to optimal scales, such as need for coordination, opportunities for specialization could be explored. Finally, the sample for our study ended in 2002. Until that period, the industry saw very little innovations. However, in the period 2001-2003 we have seen the breakthrough of internet as an alternative for MLS. This innovation has a large impact on the operations of brokers' firms. The impact on the performance of firms is yet to be seen.

## TABLES

Table 1: descriptives of input and output categories used in the Data Envelop Analysis.

|                       | mean   | Median | stdev  | min  | Max     |
|-----------------------|--------|--------|--------|------|---------|
| Input <sup>1</sup>    |        |        |        |      |         |
| -brokerage            | 1.78   | 1.00   | 1.37   | 0.20 | 17.00   |
| -assistants           | 1.19   | 1.00   | 1.68   | 0.00 | 20.60   |
| -financial specialist | 0.20   | 0.00   | 0.76   | 0.00 | 16.40   |
| -staff                | 2.00   | 1.30   | 2.58   | 0.00 | 27.80   |
| Output <sup>2</sup>   |        |        |        |      |         |
| -selling              | 79.21  | 56.50  | 91.86  | 0.00 | 968.00  |
| -buying               | 20.04  | 11.00  | 29.81  | 0.00 | 480.00  |
| -renting              | 6.28   | 0.00   | 26.63  | 0.00 | 420.00  |
| -new houses           | 10.90  | 0.00   | 46.13  | 0.00 | 905.00  |
| -valuing              | 189.14 | 189.14 | 266.00 | 0.00 | 5700.00 |
| -mortgages            | 12.83  | 0.00   | 36.78  | 0.00 | 924.00  |

<sup>1</sup> Labor in full-time equivalents.

<sup>2</sup> Number of transactions.

Table 2: Descriptives of efficiency measures.

| Variable                         | mean  | Median | St dev | mix  | Max    |
|----------------------------------|-------|--------|--------|------|--------|
| Eff <sub>ccr</sub> <sup>1</sup>  | 50.78 | 46.67  | 22.99  | 0.86 | 100.00 |
| Eff <sub>bcc</sub> <sup>2</sup>  | 52.31 | 48.79  | 23.69  | 0.86 | 100.00 |
| Eff <sub>year</sub> <sup>3</sup> | 59.10 | 54.61  | 24.40  | 0.86 | 100.00 |

<sup>1</sup>CCR-model, the DEA model with *constant returns to scale*.

<sup>2</sup>BCC-model is the DEA model with *variable returns to scale*.

<sup>3</sup>The efficiency of brokerage firms is computed each year.

Table 3: correlation coefficients between DEA efficiency measures with different input-output specifications.

|  | Eff <sub>CCR</sub> | Eff <sub>BCC</sub> | Eff <sub>CCR</sub> |
|--|--------------------|--------------------|--------------------|
| Eff <sub>CCR</sub> <sup>1</sup>  | 1.000              |                    |                    |
| Eff <sub>BCC</sub> <sup>2</sup>  | 0.966              | 1.000              |                    |
| Eff <sub>CCR</sub> (Without the input category <i>mortgage brokers</i> ) | 0.941              | 0.920              | 1.000              |
| Eff <sub>CCR</sub> (Without the output category <i>valuations</i> )      | 0.871              | 0.858              | 0.798              |

<sup>1</sup>CCR-model, the DEA model with *constant returns to scale*.

<sup>2</sup>BCC-model is the DEA model with *variable returns to scale*.

Table 4: Descriptives of variables.

|                            | Mean  | Median | St dev. | Min  | Max    | %     |
|----------------------------|-------|--------|---------|------|--------|-------|
| Efficiency <sub>crit</sub> | 50.78 | 46.67  | 22.99   | 0.86 | 100.00 |       |
| Entropy                    | 91.10 | 92.70  | 0.53    | 0.49 | 0.98   |       |
| Share                      | 0.72  | 0.74   | 0.14    | 0.25 | 0.95   |       |
| Age                        | 19.36 | 15.00  | 18.77   | 0.00 | 150.00 |       |
| Limited liability          |       |        |         |      |        | 64.66 |
| Franchise1                 |       |        |         |      |        | 7.91  |
| Franchise2                 |       |        |         |      |        | 3.72  |
| Area1                      |       |        |         |      |        | 18.19 |
| Area2                      |       |        |         |      |        | 18.14 |
| Area3                      |       |        |         |      |        | 29.29 |
| Area4                      |       |        |         |      |        | 40.38 |
| Size                       | 5.19  | 4.00   | 5.39    | 0.50 | 76.40  |       |
| Scope                      | 3.92  | 4.00   | 1.08    | 1    | 6      |       |

Table 5: Correlation-coefficients between (metric) variables.

|                   | Eff <sub>cr</sub> | Entropy  | Share   | Age     | Size    |
|-------------------|-------------------|----------|---------|---------|---------|
| Eff <sub>cr</sub> | 1.000             |          |         |         |         |
| Entropy           | -0.025            | 1.000    |         |         |         |
| Share             | -0.069**          | 0.044*   | 1.000   |         |         |
| Age               | 0.025             | -0.013   | 0.033   | 1.000   |         |
| Size              | 0.180**           | -0.079** | 0.035   | 0.256** | 1.000   |
| Scope             | 0.111**           | 0.060    | 0.133** | 0.151** | 0.294** |

\*\*, \* correlation is significant at the 0.01, 0.05 level (two-tailed).

Table 6: Drivers of efficiency (panel dataset).

| Variable (n=2117)   | DEA constant returns to scale |         | DEA variable returns to scale |          |
|---------------------|-------------------------------|---------|-------------------------------|----------|
|                     | Coefficient                   | z-value | Coefficient                   | z-value  |
| Dependent           | Eff <sub>cr</sub>             |         | Eff <sub>bcc</sub>            |          |
| Constant            | 51.713                        | 5.217** | 52.337                        | 5.192**  |
| Entropy             | -12.540                       | -1.240  | -13.161                       | -1.281   |
| Share               | -5.701                        | -1.280  | -7.115                        | -1.565   |
| Age                 | -0.051                        | -1.824  | -0.054                        | -1.887   |
| Limited             | 3.447                         | 3.140** | 2.865                         | 2.569**  |
| Franchise 1         | -2.543                        | -1.347  | -1.375                        | -1.375   |
| Franchise 2         | 7.258                         | 2.669** | 5.664                         | 2.046**  |
| Area 1              | 8.403                         | 5.188** | 8.081                         | 4.901**  |
| Area 2              | -6.123                        | 3.190** | -6.197                        | -3.178** |
| Area 3              | -2.514                        | -1.787  | -2.238                        | -1.566   |
| Size                | 0.570                         | 5.396** | 1.299                         | 10.958** |
| Scope               | 1.847                         | 3.719** | 1.911                         | 3.778**  |
| Year2000            | 7.771                         | 6.315** | 8.057                         | 6.446**  |
| Year2001            | 1.847                         | 1.351   | 2.231                         | 1.605    |
| R <sup>2</sup> -adj | 0.103                         |         | 0.150                         |          |

coefficients and z-values come from a Tobit regression.

The following regression model is estimated:

$$\begin{aligned}
 Eff_{it} = & \alpha + \beta_1 * Entropie_{it} + \beta_2 * Share_{it} + \beta_3 * Age_{it} + \beta_4 * Limited_{it} + \beta_5 * Franchise1_{it} \\
 & + \beta_6 * Franchise2_{it} + \beta_7 * Area1_{it} + \beta_8 * Area2_{it} + \beta_9 * Area3_{it} + \beta_{10} * Size_{it} + \beta_{11} * Scope_{it} \\
 & + \beta_{12} * year2000_{it} + \beta_{13} * year2001_{it}
 \end{aligned}$$

Table 7: impact of efficiency on profit.

|                             | Coefficient <sup>4,5</sup> | t-values | Coefficient             | t-values |
|-----------------------------|----------------------------|----------|-------------------------|----------|
| Dependent                   | Profit <sup>1</sup>        |          | Profit/FTE <sup>2</sup> |          |
| Constant                    | -33,990                    | -4.51**  | -4,000                  | -3.11**  |
| DEA efficiency <sup>3</sup> | 2,547                      | 18.85**  | 478                     | 20.72**  |
| R <sup>2</sup>              | 0.143                      |          | 0.168                   |          |

Notes:

\*\* means significance on the 0.01 level.

<sup>1</sup> Profit is defined as total revenues minus operational costs.

<sup>2</sup> FTE: full times equivalence.

<sup>3</sup> DEA efficiency is based on the CRR model (Constant returns to scale).

<sup>4</sup> coefficients and t-values are from a ordinary least square regression.

<sup>5</sup> Coefficients come from the following equation:

$$Pr\ ofit_{it} = \alpha + \beta * Eff_{it}$$

Table 8: drivers of efficiency (input and output categories are averaged over the years).

| Variable<br>(N=296) <sup>1</sup> | Coefficient <sup>2</sup> | z-value |
|----------------------------------|--------------------------|---------|
| Dependent                        | Eff <sub>CCR</sub>       |         |
| Constant                         | 66.605                   | 2.168   |
| Entropy                          | -7.399                   | -0.237  |
| Share                            | -16.242                  | -1.070  |
| Age                              | -0.017                   | -0.176  |
| Limited                          | 1.460                    | 0.425   |
| Franchise 1                      | -0.492                   | -0.073  |
| Franchise 2                      | 28.19                    | 2.478   |
| Area1                            | 5.974                    | 1.068   |
| Area2                            | -9.158                   | -1.418  |
| Area3                            | -5.261                   | -1.127  |
| Size                             | 0.979                    | 2.443   |
| Scope                            | 6.092                    | 3.181   |
| R <sup>2</sup> -adj              | 0.108                    |         |

<sup>1</sup>The dependent variable is the efficiency measure of the CCR model (Constant returns to scale). Input and output categories are first averaged over the three years before they are used in the DEA analysis.

<sup>2</sup> regression coefficients and z-values come from a Tobit regression.

$$Eff = \alpha + \beta_1 * Entropie + \beta_2 * Aandeel + \beta_3 * Age + \beta_4 * Limited + \beta_5 * Franchise 1 + \beta_6 * Franchise 2 + \beta_7 * Area1 + \beta_8 * Area 2 + \beta_9 * Area 3 + \beta_{10} * FTE + \beta_{11} * Mix$$

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**EMANCIPATION OF WOMEN THROUGH ENTREPRENEURSHIP**  
**(A CASE STUDY OF JANSIKSHAN SANSTAN)**

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## **ABSTRACT**

Economic development is a complex process influenced by many economic and non-economic factors. Historically, rapid economic growth of a country was achieved through industrialization, and, entrepreneurship was considered to be one of the most important contributing factors.

The emergence of entrepreneurs in a society depends on the economic, social, religious, cultural and psychological factors prevailing in the society. They are also dependent upon awareness, motivational forces, and self-confidence in people. These skills, however, are latent in many women. Nearly 50% of the total population of a country comprises of women, and unless these skills are developed, and women are made equal partners in the development process, no development, in its truest sense, takes place in the country.

It is only when the upliftment of women takes place, the women move forward followed by the family, the village, and the nation. Today, given an opportunity, women want to do better things in lives. Government and non-government organizations must recognize this need, and women must be directed towards programs that encourage entrepreneurship.

In India, the national perspective plan for women in 1998-2000 aimed at the economic development and integration of women into the main stream of economy, with equality and social justice for all women. Many governmental agencies provide entrepreneurship development training programs for women, and 'Jansikshan Sanstan' (JSS) is one such government organization.

This paper seeks to study if the entrepreneurship development training programs, as provided by the JSS, leads to the emancipation of the women enrolled.

## INTRODUCTION

Economic development is not a mechanical process nor is it a matter of simply adding an assortment of factors. It is a complex process influenced by many economic and non-economic factors. It is, ultimately, a human enterprise, and like all human enterprises, its outcome is dependent on the skills, quality and the attitudes of the people who participate in such an undertaking.

Historical data validates that rapid economic growth of a country is achieved through industrialization, and entrepreneurship has been considered as a factor of paramount importance in influencing the pace of industrialization. This is evident as seen in countries like Japan, South Korea, Hong Kong, Singapore, Thailand, Malaysia, amongst others. Here, entrepreneurial development played a crucial role in the economic development of that country.

Unemployment is a malaise that can be stated to be at the base of all maladies affecting the economic development of a region, and the emergence of entrepreneurs in a society depends to a great extent on the economic, social, religious, cultural and psychological factors prevailing in the society. Women consist of nearly 50% of the total population of the country, and unless they are made equal partners in the developing process, and contribute to the economic growth of the country, no development takes place in its true sense. Entrepreneurial talents exist in all human beings, and its emergence is dependent upon creating awareness, providing motivational factors and building self-confidence. These latent skills must be developed in women to make them entrepreneurs. Self-employment is probably one of the most effective tools to tackle the growing problems of unemployment, and all across India, be it in rural, semi-urban or urban areas, there is a vast scope for self-employment, thereby building the Indian economy. The National Perspective Plan for Women in India, 1998 – 2000, was aimed at economic development and integration of women into the main stream of economy with equality and social justice for all women.

The objective of this case study is to determine if the capacity building, as taught by Janshikshan Sansthan (JSS), lead to the emancipation of women by building their entrepreneurial skills. In order to analyze the above objective, this study was divided into six sections.

1. Demographic profiling of Women Entrepreneurs (WE) i.e. age, education, marital status, family background etc.,
2. Capacity building effectiveness of skill-sets by JSS to WE,
3. Economic realization of skills into income generating activity by WE,
4. Whether emancipation of the women has taken place (individual level),
5. Effect on the Quality of life of WE (society level) and

6. Directional pointers for future course of action that needs to be undertaken to affect a profound change.

### **HYPOTHESIS OF THE STUDY**

This paper is based on the hypothesis that the emancipation of women takes place through entrepreneurship development programs. Acquiring a skill-set will lead to self-employment, attainment of financial independence, and the ability to make decisions. Indirectly, entrepreneurship development leads to the emancipation of a woman.

### **METHODOLOGY**

Both primary data and secondary data have been used in this study. The survey was conducted on the WE of 2 districts (Hyderabad and Ranga Reddy Districts) in Andhra Pradesh, India, who have received training and support in establishing their units. One hundred WE (50 from each district), were selected for this study. The data was collected by administering a structured questionnaire, keeping in view, the objectives of this study. The data was tabulated and analyzed. Secondary data was collected through newspapers, magazines, books, and through personal interviews with the officials of JSS.

### **SCOPE OF THE STUDY**

The scope of the study has been confined to WE enrolled in JSS program in the Hyderabad and Ranga Reddy districts of Andhra Pradesh.

In India, there exist several government agencies concerned with creating training programs and providing special schemes or offers to promote self-employment amongst women. The JSS is one such organization. They conduct awareness campaigns, provide the necessary training and equipment, and by making available credit facilities, encourage women to be entrepreneurs.

Tables I to V: Analyze the age, education, marital, and family background of the WE  
Tables VI to VIII: Data is collected and analyzed on their skill sets, and their ability to convert their skills into income generation activity.  
Likert five point scale is used to measure their emancipation at individual and at societal levels.

## TABLES

| Age group | Number of Respondents |
|-----------|-----------------------|
| 16-22     | 30                    |
| 22-28     | 26                    |
| 28-34     | 21                    |
| 34-40     | 17                    |
| Above 40  | 6                     |
| Total     | 100                   |

**Table No. I: Age of the Respondents and demographic profile of women entrepreneurs.**

Table No.1 shows the age of self employed women who have started their own units after JSS training in different activities.

Women at different age groups i.e. from 16 to 60 involved themselves in self-employment activity, to gain control over their lives.

Women who are in-between 16 to 22 of age, constitute more self employed number than any other age group. This could be because self employment is seen as an alternative for job employment, which is a welcoming sign.

In the recent years women at the age of 40 and above are also taking training programs in different activities and setting up their units which might mean that they have grown up children and they may want to convert their leisure time into constructive self employment activity.

We can interpret that women at all ages are willing to achieve economic independence provided they are given an opportunity.

| Particulars                  | Number |
|------------------------------|--------|
| Up to 5 <sup>th</sup> grade  | 65     |
| Up to 10 <sup>th</sup> grade | 23     |
| Up to High school            | 20     |
| Up to Bachelors              | 2      |
| Total                        | 100    |

**Table No.II: Literacy levels of women entrepreneurs**

Observing the literacy levels of women entrepreneurs in Table No.II, it can be seen that the majority (65%) have not even completed their primary education. However by creating awareness and imparting the definite skill sets in women entrepreneurs, restored self confidence in them to set up their units. Women who have completed primary education are coming forward to take technical training and establish their units (23%).

Counseling by JSS helped many aspiring women to identify different opportunities available for them. The necessary information, tools and support services provided by JSS made them achieve their goals i.e. to establish the unit.

| Particulars | Number |
|-------------|--------|
| Married     | 67     |
| Unmarried   | 33     |
| Total       | 100    |

**Table No.III: Marital Status of women entrepreneurs**

It can be observed from Table No.III that unmarried women constitute 33% of total respondents, which would mean that women would like to have economic independence before they go for marriage. In other words they realized the importance of economic empowerment of women. We can conclude from Table No.III that irrespective of marital status, women are venturing into self employment units.

| Particulars         | Number |
|---------------------|--------|
| Schedule Caste (SC) | 28     |
| Schedule Tribe (ST) | 2      |
| Backward Caste (BC) | 23     |
| Minorities          | 33     |
| Others              | 14     |
|                     | 100    |

**Table No.IV: Different Categories in the society and number of women entrepreneurs**

Table No.IV gives the details of minority women who consist of 33% of the total respondents which is again a welcoming sign for the society. Even the oppressed class of society like SC (28%), ST (3%) and BC (23%), women are coming forward to empower themselves by taking initiative in starting their own units. We can infer that JSS is encouraging women belonging to oppressed class (86%) of the society.

|                    |                           |
|--------------------|---------------------------|
| Activities         | Activities                |
| Tailoring          | Saree rolling             |
| Chemical products  | Making Chocolates         |
| Computer and DTP   | Fashion designing         |
| Screening printing | Beautician courses        |
| Making perfumes    | Making Juices and Jellies |
| Neem seed powder   | Fabric painting           |
| Leaf Plate         | Cloth bag making          |
| Vermi Compose      | Weaning                   |

**Table No.V: Activities in which women entrepreneurs were involved.**

The Entrepreneur Development Program (E.D.P) is designed to suit local people, identifying local resource, product and technology. E.D.P. is given short term and long duration also, after the training guidance to start the enterprise by awareness camps, interaction with other W.E. etc.

In imparting the skill set seen in Table No.V, majority of the women initially were interested in Tailoring (50%), saree rolling (20%) and beautician courses (10%). But now they are interested in building their skills in computer and DTP, Fashion Designing, Chemical products etc.

| Particulars        | Number | Particulars               | Number |
|--------------------|--------|---------------------------|--------|
| Tailoring          | 29     | Saree rolling             | 12     |
| Chemical products  | 12     | Making Chocolates         | 4      |
| Computer and DTP   | 6      | Fashion designing         | 4      |
| Screening printing | 2      | Beautician course         | 4      |
| Making perfumes    | 3      | Making juices and jellies | 6      |
| Neem seed powder   | 2      | Fabric painting           | 2      |
| Leaf Plate         | 6      | Cloth bag making          | 3      |
| Vermin Compose     | 3      | Weaning                   | 5      |

**Table No.VI: Unit setup in different activities.**

Table No.VI shows the unit setup's in different activities and how they converted their skills into income generating activities. We find majority of the women (29%) started their units in tailoring and saree rolling (12%), along with traditional units (12%) chemical products (12%), chocolate making (4%), computer and DTP (6%) etc. which means women could start units in different and varied activities and also in beautician courses (4%), making perfumes, making juices and jelly (6%), making leaf plates (6%), bag making (3%), vermin compose (3%), weaning (5%). Etc.

| Investment (Rupees) | Number |
|---------------------|--------|
| Below 1000          | 42     |
| Up to 2000          | 27     |
| Up to 3000          | 11     |
| Up to 4000          | 12     |
| Above 5000          | 8      |
| Total               | 100    |

**Table No.VII: Investment**

Table No.VII shows the investment made by the respondents for their respective units. Majority of the units were started with low investments ranging from Rs.1000 (42%) to

around Rs.2000 (27%), few in the range of Rs.3000 to Rs.4000 around (23%) and very few above Rs.5000 (8%). This is convenient for them to raise the finance on their own. Slowly they can expand the unit with retained earnings. Few of them (12%) have taken the help of JSS to raise the loan from banks.

| Income Earned (Rupees) | Number |
|------------------------|--------|
| 500-1000               | 43     |
| 1000-2000              | 21     |
| 2000-3000              | 16     |
| 3000-5000              | 12     |
| Above 5000             | 8      |
| Total                  | 100    |

**Table No.VIII: Income Earned**

Table No.VIII gives the income earned by the respondents from their units. It can be seen that the income earned by the self employed women is reasonable compared to their investment and other constraints like working from home and utilizing their leisure time.

Majority (43%) of them are getting up to Rs.1000, (21%) are getting around Rs.2000 and (16%) are able to earn Rs.3000 and 12% of them could earn up to Rs.5000. Few of them (8%) could earn Rs.5000 from making chocolates, bag making, tailoring, perfume manufacturing units.

The income earned by the WE is encouraging (i.e. Rs.1000 to Rs.5000) compared to their investment on an average. The unit initial investment is recovered within couple of months, which also contributes for their capital and hence expansion.

| S.No. | Particulars   | Strongly Agree | Agree | Don't Agree | Disagree | Strongly Disagree |
|-------|---|----------------|-------|-------------|----------|-------------------|
| 1.    | Is there any considerable change in the family – after setting the unit     | 12             | 60    | 20          | 8        |                   |
| 2.    | Is there a change in the personal front – does the family have high regards | 12             | 60    | 20          | 8        |                   |
| 3.    | Do you have much more importance in the family now                          | 15             | 70    | 15          |          |                   |
| 4.    | Do you have much more say in the decision making in the family              | 8              | 65    | 12          | 15       |                   |
| 5.    | Do you have self satisfaction for your earnings                             | 15             | 85    |             |          |                   |
| 6.    | Does your earnings has boosted your morale                                  | 10             | 80    | 10          |          |                   |
|       | <b>Society Level</b>  |                |       |             |          |                   |

|    |  |   |     |    |    |    |
|----|--|---|-----|----|----|----|
| 1. | Is there any considerable change in the social status for you        | - | 80  | 10 | 10 |    |
| 2. | Is the society accepting women emancipates through entrepreneurship  | 5 | 92  | 3  |    |    |
| 3. | Do you feel you have acquired some leadership qualities              | 8 | 60  | 20 | 12 |    |
| 4. | Do you advice other women to start similar activity                  |   | 100 |    |    |    |
| 5. | Do you think JSS has brought positive change in you                  |   | 100 |    |    |    |
| 6. | Do you believe given an opportunity women can achieve what they want | 9 | 60  | 1  | 10 | 10 |

**Table No.IX: Likert – Five Point Scale**

Likert five point scale is used to measure the women emancipation at individual level and change in her status and quality of life at societal level.

Table No.IX shows majority of women (60%) agreeing with the fact that there is considerable change in the family after starting their unit.

When asked about change in their personal front again same number of women (60%) expressed that they agree that family members have high regard for them now.

Majority of the women (70%) agree now that they are given much more importance in the family and a majority (65) of the respondents said that even their importance is increased in making family decisions due to their unit.

When enquired about their satisfaction level due to their earnings, (85%) majority agreed and 15% strongly agreed for the same.

10% strongly agreed that the earnings boosted their morale and 80% agreed and 10% of them said they don't know.

When women entrepreneurs were questioned regarding their social status and changing quality of life, 80% of the women agreed that there social status has increased but 10% each said they disagree and they don't know.

When asked whether society accepts women emancipation through entrepreneurship, a majority (92%) of respondents agreed and 5% strongly agreed and 3% of the respondents didn't know.

60% of women respondents agreed that they have acquired leadership qualities through JSS, however 32% together said they disagree.

100% respondents wanted to encourage other women to start similar income generating activity.

100% of Women respondents believed that there is positive change towards life due to JSS only.

69% of the respondents felt women can achieve anything, given an opportunity, however 31% respondents opinion is differing with this.

## **CONCLUSION**

A comparison of women before and after undergoing the JSS training program showed that the WE, after the training, were much more confident and willing to accept new challenges, and explore other avenues to generate income.

At a societal level, WE who established their units gained immense respect, enjoyed a higher social status, and exercised far greater economic freedom.

In a man-made world, these women have set their standards. By being self-reliant, they are living their expectations, and more. They inspire other women to join in this revolution to attain women emancipation. The women need 'Life Enrichment Education', creating self-confidence, and the ability to think, act and live independently.

Today, given an opportunity, women are more than willing to seek new opportunities, accept tougher challenges, and constantly strive to improve their surroundings. This need to prove themselves must be recognized by the government and other non-governmental organizations, and all efforts must be directed towards entrepreneurship, which in turn contributes towards the social and economic development of a country.

The JSS training program to create awareness, build self-confidence and self-reliance has brought about a positive change in the attitudes of the oppressed women belonging to a lower income and status group in India. Strong evidence now exists to prove that emancipation of women is more successful and attainable through entrepreneurship.

Additional training to improve literacy through short-term courses, monitoring of women owned units for a period of 2 to 3 years to overcome initial problems also needs to be provided. Taking the trained women to visit other units, and arranging for meetings between successful WE and those about to set up a new unit, adds to the enrichment of women. It is also important to maintain a database of women-owned units, create counseling centers at convenient locations, and finance units run by women at low

interest rates. Help in the marketing of products through government agencies by making it mandatory to buy 50% from women-owned units go a long way in encouraging more women to join such programs as those run by JSS.

It is only when the upliftment of a woman takes place that the women move forward, then the family moves, the village moves and the nation's economy moves.

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# **The Entrepreneurial S-Curve: A Conceptual Model for Entrepreneurial Life Cycle**

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Submitted to the  
International Council for Small Business and Entrepreneurship 2005 Annual Conference  
June 15-18, 2005

## **The Entrepreneurial S-Curve: A Conceptual Model for Entrepreneurial Life Cycle**

### **Abstract**

We develop an entrepreneurial S-curve (ENT S-curve) to describe the trajectory of the entrepreneurial process. We examine specific risks involved at each stage of the entrepreneurial process, and propose a strategic model to manage the risks occurring during the lifecycle of the ENT S-curve. The ENT S-curve is a useful predictive tool for entrepreneurs to perceive the trajectory of the entrepreneurial process. The ENT S-curve is developed from theoretical analysis based on the technological S-curve and examples of previous entrepreneurial startup ventures. The ENT S-curve provides a conceptual tool for entrepreneurs to conduct appropriate preparation and formulation of strategies to achieve higher performance and economic benefits. Moreover, venture capitalists may use the ENT S-curve to forecast the possible managerial tasks and solutions required for the venture, to formulate exit strategies, and/or to determine capital injection time frame.

## Introduction

Many scholars and researchers have examined entrepreneurial traits, behaviours, outcomes, and processes. However, most of the work on entrepreneurial processes has been piecemeal, focusing only on certain aspects, including conceiving and directing vision; financing the enterprise; planning expansion, growth, and competitive market strategies; managing resources; building social, ethical, and international networks; and examining firm boundaries and exit strategies (e.g., Johanson & Mattson, 1988; Coviello & Munro, 1995; Hakansson & Snehota, 1995; Keeble, Lawson, Smith, Moore, & Wilkison, 1998; Russel, 1999; Dana, Etemad, & Wright, 2000; Etemad, Wright & Dana, 2001; Rasmussen, Madsen, & Evangelista, 2001; Jones & Conway, 2004). However, a single, holistic model to help entrepreneurs conceptualize the entire entrepreneurial process has not yet been devised.

This paper describes the entrepreneurial process as a single, curved line, the *entrepreneurial S-curve*, characterizing the critical stages in the entrepreneurial process. The concept of the entrepreneurial S-curve is intended to help entrepreneurs predict, formulate, and execute strategies over time, taking into account changes in context.

In this paper we describe the conceptualized entrepreneurial S-curve with three stages in the entrepreneurial process as well as possible and relevant risks along each stage—the entrepreneurial risk model. We then discuss the critical elements as tools—the entrepreneurial fit models—that may be helpful for entrepreneurs to manage those stage-related risks. Finally, we correlate the entrepreneurial S-curve, entrepreneurial risks, and the fit models together, and suggest a future research agenda and three propositions.

### Development of the entrepreneurial S-curve

The concept of the S-curve has been used in several areas of business studies: the technological S-curve is a visual expression of the adoption rate of technological innovation and the innovation diffusion process (Sahal, 1981; Henderson & Clark, 1990; West, 1992; Martin, 1994; Levinthal, 1997), and international diversification and firm performance (Lu & Beamish, 2004). Product lifecycle and firm lifecycle are also described in terms of an S-shaped curve. In this paper, the S-curve represents the changes that occur over time during as the entrepreneurial process unfolds.

We identify three stages in the entrepreneurial processes: startup, high growth, and sustainability (Roberts, 1999). We do not include the global enterprise stage because some firms expand internationally at inception, a phenomenon known as “born global” (McDougall & Oviatt, 1995, 2000). Thus, we treat internationalization as a strategic move instead of a stage in the entrepreneurial process. For the three stages of entrepreneurial processes, we identify problems in terms of specific risk (Barrow, 1981) involved at that stage, and introduce appropriate tools (Roberts, 1999; Stevenson, 1999) to manage the risks. All of the risks (e.g., developmental, manufacturing, marketing, management, growth, and public finance risk) may occur at all three stages (J. Webster, university lecture, February 19, 2004). This paper, therefore, attempts to

focus on those risks that are most prominent at specific stages of the three-stage entrepreneurial process.

### **Entrepreneurial Process Development: the three stages**

We define the entrepreneurial process as one involving a business idea at the inception of a startup, opportunity identification, business plan preparation, startup strategy development, growth management, innovation management processes, and so forth over the life of an entrepreneurial firm. We do not include firms that intend to remain small. Hence, the entrepreneurial process is further defined to include a startup stage, a high growth stage, and a sustainability stage. The entrepreneurial process is not confined to these three stages, since the process evolves in relation to other factors, such as products/services/business extension or geographical extension.

During the sustainability stage, entrepreneurs extend the venture's success by preparing for development of new products, services, or business processes, or planning for internationalization that would lead to new opportunities, resulting in the formation of a new curve on the chart. This new curve represents startup, high growth, and sustainability stages, and the beginning of an ever-evolving process.

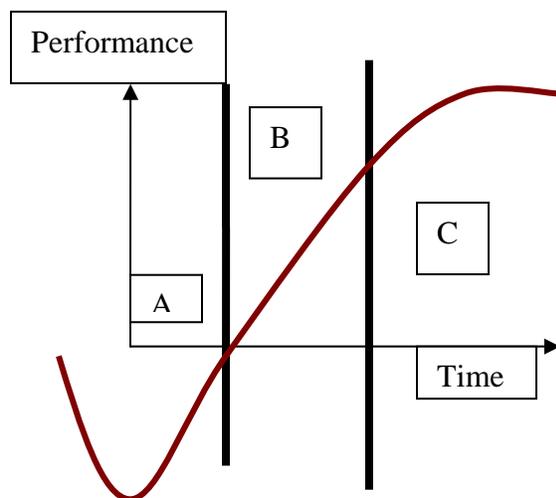


Figure 1: The entrepreneurial S-curve illustrates the three stages of the entrepreneurial process: (A) startup, (B) high growth, and (C) sustainability.

In the *startup stage*, entrepreneurs invest time and human and financial capital in the venture. The financial capital of the startup is derived from the entrepreneur's own savings, "love funds" provided by friends and family, or investments by venture capitalists. This upfront investment is a sunk cost at the startup stage, and the capital outlay can only be realized at a later stage. Thus, the curve in the startup stage (see "A" in Figure 1) is in negative territory. If the startup venture is successful and breaks even early on, investors can recoup their investment sooner. Sometimes entrepreneurial ventures, especially in biotechnology, high technology, or industries requiring a great deal of research and development, do not reach breakeven point for a long period of time, and gains on investment are delayed.

In the *high growth stage* (see “B” in Figure 1), the curve ascends steeply. This is where the learning curve changes significantly as the entrepreneurial venture grows either from market pull or competence push. Market pull is the result of high demand for certain products, general economic growth, or industry specific growth. Competence pull relates to the core competence of the venture and entails an accumulation of experience and specific human or financial capital over time. This is the stage where learning is rapid and productivity and profitability are at their highest levels. At this stage, entrepreneurs need to have the managerial mind-set and skills to take advantage of the possible profit and growth. If they fail to move from entrepreneurial mind- and skills-set, the venture could lose on many fronts (Stevenson, 1999).

The *sustainability stage* (see “C” in Figure 1) of the entrepreneurial process is characterized by slow growth. If entrepreneurs lack anticipating, acting, and reviewing techniques that are essential for managers and leaders at this stage, the survivability of the venture might be in doubt (Roberts, 1999). The venture could plateau and then take a downturn. At this stage, supreme managerial skills are required to manage incremental and radical change (Stevenson, 1999).

One of the major reasons for startup failure is lack of managerial skills. Both the high growth and sustainability stages require entrepreneurs to transform their mind- and skills-sets from entrepreneurial to managerial skills. Stevenson (1999) argues that as the venture grows, a formal organizational structure is required. Thus, administrative behaviour is preferred in terms of strategy orientation, commitment to opportunity, commitment to resources, management structure, and reward systems. At the same time, it is important for firms to sustain growth with entrepreneurial spirit and innovativeness so that the “overlapping” of entrepreneurial and managerial behaviour is essential (Stevenson, 1999).

### **Entrepreneurial Risk: The six risks**

There are many risks involved in managing a venture. Focus here is on six critical risks that are involved in an entrepreneurial process (Barrow, 1981): developmental, manufacturing, marketing, management, growth, and public finance. These risks occur at all three stages of the entrepreneurial process (J. Webster, university lecture, February 19, 2004). However, certain risks are more prevalent at certain stages. For example, both developmental and manufacturing risks are higher than growth and public finance risk at the startup stage.

We define each of the six critical risks in the entrepreneurial process as follows:

**Developmental risk:** Deals with the product or service that must meet intended/required specification at the developmental stage of the product or services. This involves the risk in the development of optimal use of opportunity and resources such as technology, human capital, and financial capital. Prior to launching a product or service, this is a critical risk.

**Manufacturing risk:** Involves bargaining with suppliers, raw materials management, sole supplier risk, and risk in management of production, outsourcing, and in-sourcing.

Marketing risk: Involves the possibility that a competitor will launch a similar product, the loss of first mover advantage, technology changes, product obsolescence, advertising and pricing wars, legal, regulation, and environmental risk.

Management risk: Lacking the capability to manage, retention of employees, human capital risk, internal risk to the firm, risk due to lack of managerial and leadership skills.

Growth risk: Risk in managing growth, retaining employees, putting organizational structure in place when dealing with growth, setting up reward systems, and having sufficient finances to deal with growth.

Public financial risk: Involves management of the IPO process pricing issues, public relations, managing external expectations (see Figure 2).

The following table illustrates risks that are involved at every stage, but that increase at particular stages.

| <b>Stage/ENT risk</b>        | <b>Startup Stage</b> | <b>Hi-growth Stage</b> | <b>Sustainability Stage</b> |
|------------------------------|----------------------|------------------------|-----------------------------|
| <b>Developmental Risk</b>    | More                 | Less                   | Less                        |
| <b>Manufacturing Risk</b>    | More                 | Less                   | Less                        |
| <b>Marketing Risk</b>        | Less                 | More                   | Less                        |
| <b>Management Risk</b>       | Less                 | More                   | Less                        |
| <b>Growth Risk</b>           | Less                 | Less                   | More                        |
| <b>Public Financing Risk</b> | Less                 | Less                   | More                        |

Table 1: Three stages in the entrepreneurial process and comparative risk at each.

Entrepreneurship is plagued with risks, which should be dealt with early on to ensure the venture stays viable. The concept of the six critical risks along the entrepreneurial S-curve provides a strategic tool for startup firms to map out the risks that can affect the company vis-à-vis its operations, employees, stakeholders, and customers (see figure 2).

Risks are apparent from the beginning of a business's development to the last stages of its lifecycle. The S-curve concept allows startups to forecast risks so that contingency and strategic plans may be formulated to prepare for strategies execution.

When starting a venture, there is always the possibility of developmental risk since the initial stages of development carry a heavy burden of expenses and a deep initial investment (see figure 2). Being able to carefully manage operations can help the process of entrepreneurial development while managing risks accordingly. Risks are also possible in the manufacturing process of a business venture. Risks regarding supplier partnerships and the manufacturing

process are prevalent in most businesses and should be noted so that contingency plans can be made to avoid future problems.

As with any business, management risks exist at all stages within the development cycle. Marketing risks play an important role during the development of an entrepreneurial venture, and effective advertising and proper public relations are crucially important. As a business begins to grow and expand, so do the risks involved. Rapid growth, if not properly managed, could potentially cause the company to spin out of control. Finally, good financial management in terms of public offerings is essential to an expanding venture in overcoming the risks involved in obtaining financing. Sound plans and strategies must be created to manage risk during the entrepreneurial process; it is important to identify the major risk areas, formulate strategies, and prepare for successful execution to achieve and sustain economic success.

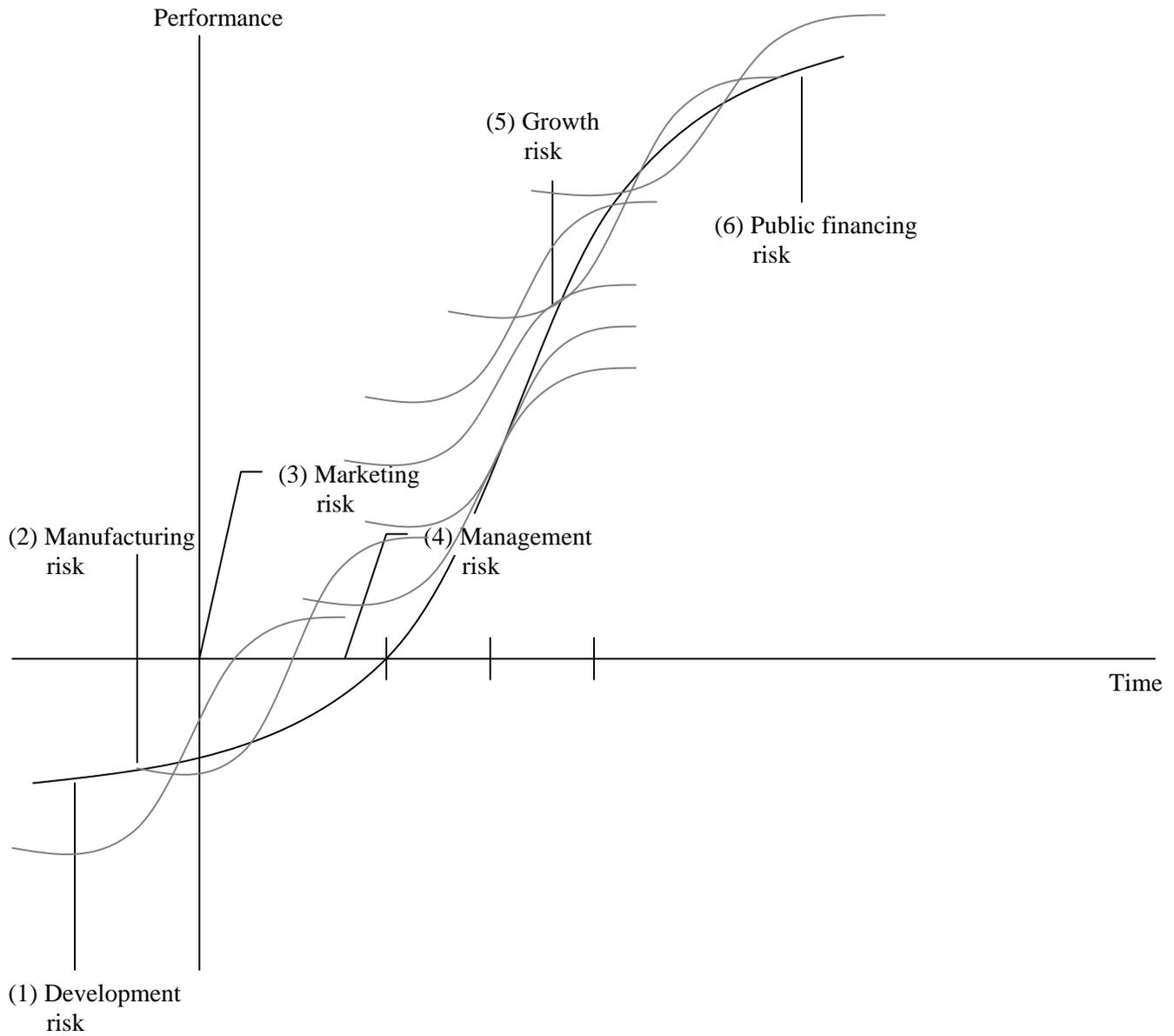


Figure 2: Six critical risks along the entrepreneurial S-curve: Overlapping curves occur because each type of risk can occur at any point in time during the entrepreneurial process.

**Entrepreneurial Fit Model: elements in the Four Fit Models**

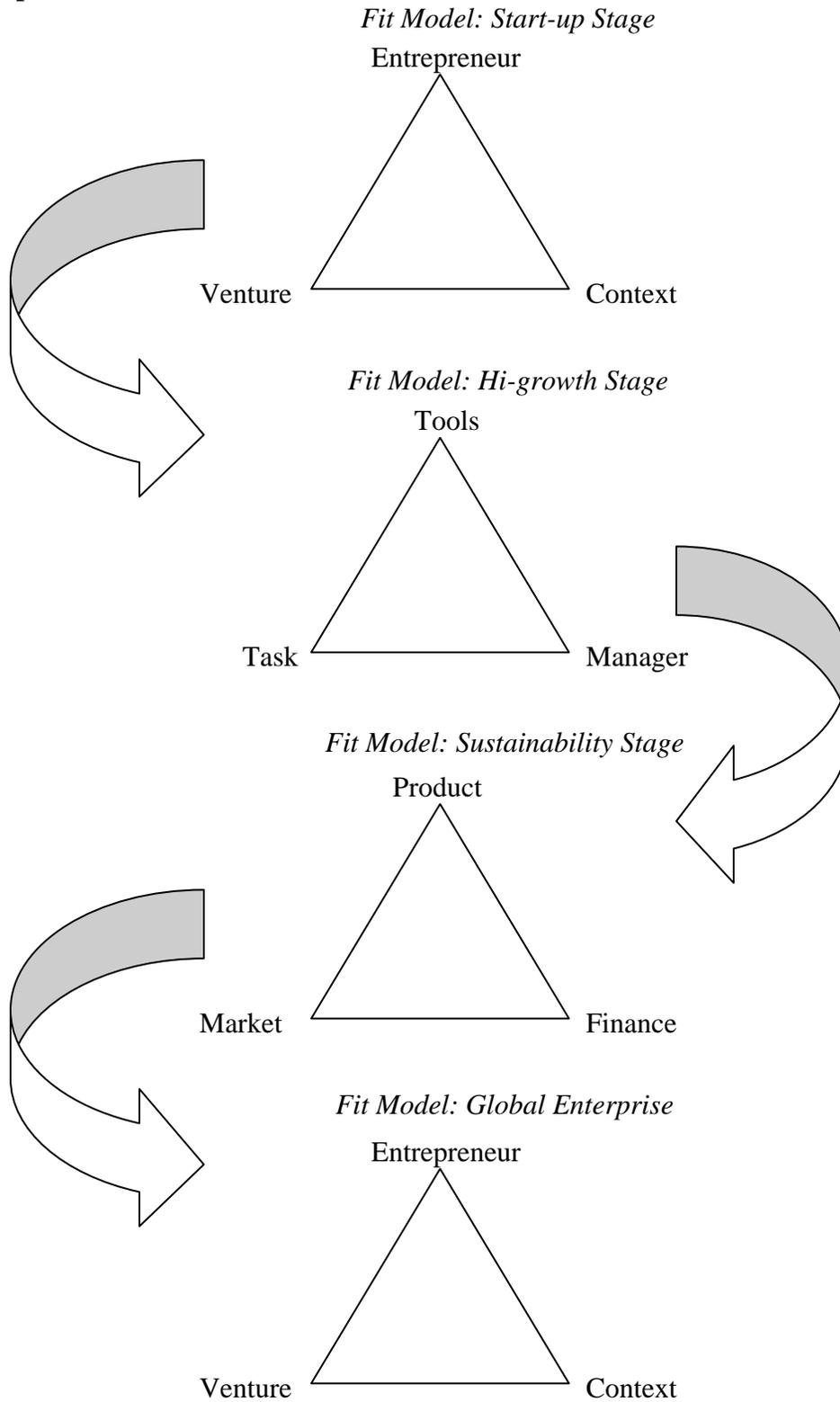


Figure 3: Critical elements of the FIT Model in various stages of entrepreneurial process.

| <b>Stage/Tool (Fit Model)</b>                     | <b>Startup Stage</b>           | <b>Hi-growth Stage</b> | <b>Sustainability Stage</b> |
|---|--------------------------------|------------------------|-----------------------------|
| <b>Elements in Startup Stage Fit model</b>        | Entrepreneur, Venture, Context |                        |                             |
| <b>Elements in Hi-growth Stage Fit model</b>      |                                | Tools, Tasks, Manager  |                             |
| <b>Elements in Sustainability Stage Fit model</b> |                                |                        | Product, Market, Finance    |

Table 2: Three stages along the entrepreneurial S-curve and the specific *fit model* for each stage

Ardichvilia, Cardozob, and Rayc (2003) explain that the venture development process is a cyclical and iterative one. As a venture grows, entrepreneurs must learn to adapt to all changes in order to survive. As the firm expands, continuous evaluations and projections are required to forecast and predict future strategic moves. The Four Stages – Fit Models (See Figure 3) may be used by entrepreneurs to plot the various stages of an entrepreneurial life cycle.

Roberts (1999) suggests that there are four stages involved in corporate venturing: (1) Start-up, (2) Hi-growth, (3) Sustainability, and (4) Global Enterprise. We treat the last stage as a strategic move, a decision to expand internationally at inception or at a later stage (McDougall & Oviatt, 1991). The global enterprise fit model is included here to illustrate that when a venture expands internationally, it must restart; thus, the elements in this model correspond with the conditions prevailing at startup stage.

Each stage in the entrepreneurial process involves three correlating and critical elements that must fit together to achieve success at that stage (Roberts, 1999). This tool works as a cyclical model as it can be used at all levels of a firm’s entrepreneurial development. During the startup stage of the entrepreneurial process, the Start-up Fit Model accounts for the (1) venture, (2) entrepreneur(s), and (3) context. The entrepreneur(s) conducting the business should match the venture initiative to the market needs/wants of the current time period. If the context of the business needs to be realigned to satisfy the needs of consumers, then the venture should be adjusted to fit the new initiatives, and the entrepreneurs should have the drive to re-formulate the business model.

Following the achievement of the elements set out in the Fit Model at the start-up stage, the Fit Model in the high growth stage is comprised of (1) tools, (2) task, and (3) manager. As a venture begins to grow and expand, strategic tools need to be developed to structure the growth of the business while tasks are built/developed for the venture. It is then the manager’s responsibility to administer and delegate tasks to subordinates while ensuring that proper tools are used to streamline operations.

Eventually, the rapid growth cycle of a business will begin to plateau, during which the Sustainability stage Fit Model and its elements of (1) product, (2) market, and (3) finance should be taken into consideration. It is important for the venture to commit to continuous improvement in its products/services/business processes to sustain its viability. Funding is also required when developing innovations and should be managed appropriately to achieve sustainability. Ardichivilia et al (2003) argue that entrepreneurial development involves three distinct processes: (1) sensing or perceiving market needs or underemployed resources, (2) recognizing or discovering a “fit” between particular market needs and specified resources, and (3) creating a new “fit” between separate needs and resources in the form of a business concept. This concept echoes our Fit Model and its four stages. Both analogies strive to portray that a sense of “fit” is needed between all elements for a venture to achieve and sustain economic success. Each stage of the entrepreneurial process involves some form of change and with that, the elements involved within the Fit Models also need to be adjusted. This proves that the entrepreneurial process is both cyclical and iterative.

### **Entrepreneurial S-Curve: S-curve, risk and fit model correlation**

The correlation between the Fit Models and entrepreneurial risks can be noted here to formulate a cycle along the entrepreneurial process. As the two approaches join, we can see that elements within the Start-up Fit Model relate to the early stages of an entrepreneur’s journey. Once the initial investment and the payback period has been achieved, a firm may begin to experience rapid growth and expansion. Using the tools provided by the Hi-growth Fit Model, managers can ensure that the organization has the potential to continue to develop into a larger business venture. Businesses at some point usually enter into a period of stagnation (commonly following a period of rapid growth). During this phase, managers of a firm may profit from an understanding of the sustainability phase and its elements of product, market, and finance to keep its operations viable. This conceptual framework may allow entrepreneurs, corporate leaders, and venture capitalists to better understand their own businesses and forecast potential risks and opportunities, thereby formulating plans to avoid obstacles, seize opportunities, and achieve new heights.

### **Implications**

Entrepreneurship is developed when an individual seeks and discovers an opportunity that is presented from within the economy and acts to take advantage of it (Holcombe, 2003). Entrepreneurial skills, tools, and frameworks can be learned and used. The entrepreneurial process begins when individuals or corporations commercialize core competencies that results in energized economic development. Entrepreneurial process involves two sets of skills: soft elements and hard elements. Soft elements cannot be learned because they include the components of vision, mission, and passion. Hard elements comprise skills that can be acquired, some of which include marketing, finance, human resources, networking, negotiation, presentation, and managerial skills. It is our belief that entrepreneurs and managers already possess vision, mission, and passion for their venture. However, many might not have hard skills before they started their ventures. Our research agenda aims to identify and examine the theoretical framework discussed above—the entrepreneurial S-curve that demonstrates changes in the entrepreneurial process and changes in context over time. In addition, we intend to

determine whether the concept of entrepreneurial risks and the entrepreneurial Fit Model, following the entrepreneurial S-curve, might help entrepreneurs to overcome challenges and formulate strategies to achieve and sustain economic success.

### **Conclusion**

In this paper, we proposed and discussed a conceptual model: the entrepreneurial S-curve that aims to help entrepreneurs better understand the entrepreneurial process.

The entrepreneurial S-curve describes the trajectory of the entrepreneurial process and allows exploration of specific risks involved in each stage and strategic models to manage these risks. We argued that the entrepreneurial S-curve is a useful predictive tool for entrepreneurs to perceive the trajectory of the entrepreneurial process. The entrepreneurial S-curve provides a conceptual tool for entrepreneurs to conduct appropriate preparation and formulation of strategies to achieve higher performance and economic benefits. Moreover, venture capitalists may use the entrepreneurial S-curve to formulate their investment strategies vis-a-vis forecasting managerial tasks and solutions required, formulating exit strategies accordingly, and determining appropriate time frame for future capital investment.

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# NICE RHETORIC, BUT IT'S NOT QUITE US: WORK-LIFE BALANCE AND NZ SME OWNERS

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## ABSTRACT

Increasing attention is being directed at the concept of work-life balance, with the often espoused benefits including improved retention rates and increased productivity. However, a significant problem with the concept is that much of the discourse is built on a language and logic based in traditional models of large bureaucratic organisations. In the small and medium enterprises (SMEs) the traditional boundaries of work and life are, more often than not, blurred. In this paper the authors challenge existing accepted rhetoric of 'work-life balance' for its appropriateness in understanding how SME owner-managers choose to manage their personal and business lives. The importance of a sense of balance is not disputed; instead the idea that it can be achieved/managed as a sort of equilibrium is

contested. A study was conducted by a team of researchers who used the business life-cycle as a framework for examining the firm's life-cycle and identifying the points at which they made decisions about key 'transitions' between one phase to another. The results revealed that several constraints were identified by SME owner-managers that defy stereotypical notions of work-life balance. A framework is presented for analysing the relationship between personal and business constraints the SME owner-manager faces and the subsequent situations of 'balance' and 'imbalance' that can occur. Finally the authors stress that in challenging the popular discourse of work-life balance it is clear that new discourses are needed for the SME context.

### **INTRODUCTION - IN PURSUIT OF BALANCE**

In New Zealand significant attention has been given in the past two years to the subject of work-life balance. This includes the establishment by Government of a project devoted to developing policies and practices promoting a better balance between paid work and life outside of work. This is congruent with the promotion of work-life balance policies as win-win for both individuals and organisations (Barnett & Hall, 2001) with the often espoused benefits including improved recruitment and retention rates, reductions in worker stress and increased productivity. The link between work-life balance and increased productivity is often used to promote the business case for work-life balance policies. There are several different theories about the connection between work-life balance and productivity. Some argue that policies lead to productivity gains by decreasing negative spill-over from workers' lives and reducing extended hours and fatigue. Other arguments use an exchange framework, suggesting that in return for the 'gift' of work-life balance policies, employees offer the 'gift' of discretionary effort, thereby increasing productivity (Department of Labour, 2004b).

In the work-life balance concept, work and leisure are commonly viewed as dichotomous and antithetical, however a significant problem with the concept according to Caproni (2004) is that much of the discourse of work-life balance is built on a language and logic that are based in traditional models of bureaucratic organisations, and "thus the discourse is likely to perpetuate and perhaps further entrench – many of the problems it promises to alleviate" (p.209). She heralds the importance of using alternative perspectives to ask: What is the current version of reality promoted by the discourse on work-life balance? This is a

particularly relevant question in terms of investigating small and medium enterprises (SMEs) in which the traditional boundaries of work and life are, more often than not, blurred. In SMEs there is often a reciprocal relationship between business success and personal success for the owner-manager. A problem though with current definitions of work-life balance, as Van Eijnatten & Vos (2002) explicate is that the predominate focus is on the perspective of individuals, whereas both an organisational and individual perspective is necessary to gain a better understanding of difficulties in addressing work-life balance related problems.

The purpose of this paper is to challenge existing accepted rhetoric of 'work-life balance' for its appropriateness in understanding how SME owners choose to manage their personal and business life. It is important to clarify that we are not disputing the importance of a sense of balance; instead we challenge the idea that it can be achieved/managed as a sort of equilibrium. The rhetoric of work-life balance is problematic for the SME sector due to the significant personal and business constraints facing operators in this context.

## **WORK-LIFE BALANCE AND SMES**

Although there is an ever-increasing body of literature on work-life balance, it is evident that studies vary in what is specifically investigated, for example flexibility versus work-family policies. This results in many of the conclusions being context specific and not necessarily generalisable. As a result, concepts related to work-life balance remain theoretically cloudy and empirically ill-defined (Felstead, Jewson, Phizackles & Walters, 2002). It is not surprising that there is a dearth of literature about the business case for work-life balance for SMEs. This is partly because work-life balance policies in this context are generally informal and individually negotiated making them difficult to pick up in surveys, but also because the presence of work-life balance policies is often correlated with businesses larger in size (Galinsky & Bond, 1998). As Evans (2001) found, in general, work-life balance policies are more likely to be reported in large firms in Australia, Japan, the UK and the US. In New Zealand, the results of case study research conducted by UMR Research for the Government's Work-Life Balance project showed that the firm size appeared to determine the attitude towards work-life balance among respondents. The research highlighted that for "small employers, initiatives were likely to be viewed as expensive and difficult to

implement, while medium-large employers were more likely to have many of the initiatives already in place” (Department of Labour, 2004a, p.37).

Aside from the ‘fuzzy’ definitions of work-life balance, another problem when investigating such issues in SMEs is the variability in accepted understanding of SME size which differs between and within countries. In the US the definition of SMEs is industry specific, meaning in some cases firms with up to 500 employees could be classified as small businesses (Small Business Administration, 2004). In the UK, Department of Trade and Industry usually uses the definitions of a micro firm having 0 - 9 employees, a small firm having 10 - 49 employees, a medium firm having 50 - 249 employees and a large firm having over 250 employees (Small Business Service, 2004). Even within New Zealand, leading academics Cameron and Massey’s (1999) definition of micro business as having fewer than five employees, a small business as six to 49 employees and a medium business as having between 50 and 99 employees is at odds with the New Zealand Government’s definition of a SME as having fewer than 20 employees (Ministry of Economic Development, 2004). The problem with such variability in SME size for researching work-life balance policies is that we may not be comparing ‘apples with apples’. For example the management structures and financial resources available for strategies of flexibility in a business of 170 staff will be in a completely different league to that of a business with seven staff.

In endeavouring to establish the cumulative body of knowledge on work-life balance, a literature reviewed conducted by the New Zealand Department of Labour (2004b) concluded that there is substantial debate about the ease with which SMEs can implement more traditional work-life balance policies particularly in terms of flexibility of hours and even about the wider business case for work-life balance policies in SMEs. One train of thought is that SMEs have certain advantages in implementing flexible policies as it is probably easier for such businesses to undertake internal reorganisation due to less role specialisation and the need for staff to be able to multitask.

On the contrary, is the argument that work-life balance policies are often correlated with luxury domain of larger businesses, with costs being often perceived as too significant for the SME and that smaller organisations have fewer staff to cover for each other. Interestingly Roper, Cunningham and James (2002) found in their study of attitudes of British human resource specialists in firms of with 20 employees that opposition to the idea of work-life

balance legalisation, based on the perceived negative impact of the policies, was higher than opposition based on principles. Another reason found for employers being less convinced by the business case for work-life balance is that worker productivity is easier to monitor in an SME. A further explanation for the irrelevance of formal work-life balance policies for SMEs that has been proposed is that employees and employers in SMEs are much more likely to have informal relationships based on trust and giving (Evans, 2001). The validity of these arguments for SMEs will differ depending on the personal choices made by the owner-manager for their firm in regard to work intensity, the nature of the business, number of staff, hours of operation and flexibility in capacity, schedules and service levels.

Personal choice of the SME owner-manager to construct their lives in terms of fit of the various facets including work, family, leisure, and rest is significant in terms of having power over the moderating factors limiting work life balance that workers in larger organisations face. As Ghazi (2003) states, “it is not necessarily about working less, rather about having personal control and flexibility over when, where and how we work (p.xiii). As Walker and Brown (2004) explain, the motivation for people to go into small business is varied, and includes financial as well as non-financial factors like personal satisfaction, independence and flexibility. In her study of women entrepreneurs in Canada, Fenwick (2002) found that many of women said they started a business because they longed for more freedom and control over their lives; “freedom that brought complete and perpetual responsibility for one’s decisions” (p.712).

Rather than traditional notions of balance, discourses emphasising health may hold more appeal for SME owner-managers. Higher levels of job demand, longer working hours and less time for leisure activities appear to be characteristics of those who are responsible for their own success (Chay, 1993). The literature on stress management emphasises the importance of locus of control and social support in influencing stress and strain and the stress-strain relationship (Rahim, 1996). Entrepreneurs are often reported as possessing a higher internal locus of control than managers. There is a fine balance though between extreme drive and health, it is generally believed workaholics tend to deny the existence of fatigue and push themselves beyond reason before physical complaints stop them working (Kanai, Wakabayashi & Fling, 1996). However others in the field also caution that the empirical data on workaholism is scant and contradictory (Burke, 2000; McMillan & O’Driscoll, 2004). Attention must be given to issues of sustainability of momentum and

energy, particularly through preservation of owner health, as the consequences of a sustained lack of balance are aligned with health problems including heart problems, high blood pressure, gastrointestinal disorders, psychological well-being and circadian disruption (Department of Labour, 2004b).

Given the dearth of literature, polarised opinion on the complexity of work-life balance policies for SMEs, and SME owner-manager capacity for freedom and choice, the question needs to be asked: Is the rhetoric of work-life balance with its associated assumptions appropriate for thinking about balance in the SME sector? A sector containing a vast array of diverse operators and operations in which the boundaries are unclear, particularly for those perhaps whose businesses are located in their homes? Or for those who work with family? As de Bruin (2004) stresses, the blurring of the boundaries and the way work and life traverse are not caught at all through the metaphor of the work-life balance. An alternative metaphor from balancing time is given by Thompson and Bunderson (2001) who conceived time as a 'container of meaning' thus allowing "us to address of the nature of the activities that occupy our time, including the significance that they assume" (p.18) which as a metaphor could hold more attraction for the SME sector rather than one striving for equilibrium between work and leisure, metaphors such as work-life balance, work/family borders, and work and non-work conflict.

Beatty and Torbert (2003) posit that work and leisure are complements that in their highest states share core elements and are best understood in dynamic relation to each other. Self-employed individuals negotiate multiple discourses and identities among which competitive individualism is not the most dominant (Fenwick, 2002). This is fundamental when challenging traditional notions of work-life balance that have been built within large organisations in which workers often have less power, freedom and personal choice in regard to construction of their work and indicators of success within those structures. Most small businesses are the products of their owners, whose personality and personal involvement dominate (Mazzarol, 2003). Many small business owner-managers are motivated by factors other than a desire for growth (O'Farrell & Hitchens, 1988) and thus may already have built many of the traditional balance ideals such as flexibility and downtime into their lives.

A review of the literature shows that the body of knowledge on work-life balance is still in an emergent state. Furthermore there is a clear lack of understanding of the work-life balance

concept in regard to SMEs. This paper aims to make a contribution to building such understanding. While the initial focus of our study was not to specifically focus on work-life balance in SMEs, we gained substantial data to build a case for theorisation about work-life balance in this context.

## **RESEARCH APPROACH**

A project team of eight researchers conducted interviews with 50 firms located throughout New Zealand. These firms were recruited from a random sample of 500 New Zealand firms employing fewer than 50 full-time staff (drawn from a commercial database). Given the aims to the research, a qualitative methodology was designed. Each firm was visited by a member of the research team and the owner or manager was taken through a semi-structured interview schedule. During the interview they were asked to identify the key events and/or milestones in the life of the business (with some approximate dates and/or some sense of chronology) and describe their objectives for the firm. Although the project team's main interest was to learn about the key 'transitions' that New Zealand encounter as they attempt to grow, and how the owners' experiences of these transitions related to the stage models of business growth, the significance of personal events emerged as a key finding. Many of the personal stories we heard of were around events such family, health, especially death, divorce, and disease (Massey, Harris & Lewis, 2004) and the impact this had on the owner(s) and other business stakeholders. Many of these events led the owners to reflect on notions of balance and lifestyle.

## **PERSONAL AND BUSINESS CONSTRAINTS IMPEDING BALANCE**

Several personal and business constraints that defy stereotypical notions of work-life balance were identified by the SME owner-managers we interviewed. We found that many owners are consciously choosing to invest substantial time and energy in their enterprise. It was clear in many cases that such investment was due to their passion for the business as a key part of their life:

*“I enjoy what I do. And I’ve got to the stage in my life where I only do what I enjoy. So I like making castings. I like running the business. We make a reasonable amount of money and I’m as happy as Larry. So, do I want anything more from it? No, not particularly.*

*(Interviewee #4)*

*“...I get out of bed in the morning and enjoy going to work and I guess the day I don’t’ enjoy getting out of bed to go to work will be the day I’ll look at changing things, right at the moment – no every day I love it (interviewee #12)*

Interviewee #21, said with a smile, almost laughing:

*“...it was a hard case, we were just looking at the holidays accrued the other day for looking at the Christmas holiday break and these guys might have 40 – 60 hours, 90 hours of holiday left and I think mine was like 560 hours or something you know, I just haven’t taken any time off really”.*

Working long hours was also frequently described as a matter of personal choice, often correlated with business success, rather than a situation of imbalance from conditions imposed by others needing to be rectified, as is the case in larger organisations:

*“I have gone back to about 65 or 70 hours a week but 100 hours a week was a doddle. And I did that for years and years and years. That’s how small businesses grow, don’t they? On the strength of the owner operator.” (Interviewee #4 ).*

Another common narrative heard was the decision to invest major time and energy into their business in the short-term for long-term lifestyle gains such as early retirement:

*“We don’t want to keep growing and growing and growing and having 20 staff, well I don’t, Dave\* might – we don’t see we’d be doing this for the next 20 years because it’s very long hours and it’s very high pressure you know you can plan to do something as a family and if a client rings and it’s cancelled and Dave\* has to work till midnight five nights running and all weekend so it’s quite high pressure (Interviewee #42) (\*names have been changed to ensure confidentiality).*

Another key issue, intersecting personal and business constraints, is that several owner-managers also possess key skills and knowledge required for operation of the business, expertise that can be difficult and costly to replace.

*“I am the business and I am absolutely aware of that - that if I went away, if I go away for a week its taken me two weeks to plan it. If I go away for four weeks I close the place down... what I carry is the inherent knowledge of the business in my head and I drive it every day myself, which is good and bad, right?” (Interviewee #4).*

The business constraints include the stark reality of limited human resources, with many of the SMEs operating with skeleton staff structures. As a result, many operators were impeded in terms of being able to take time out or away from the business. A typical example of this came from Interviewee #44

*“...when we had more staff he found he could relax a bit more and he could work more in the factory area doing mouldings, now that we have decided to cut back on staff, he works full time from 8 – 4:30 each day, he will go back and work on Saturday’s if it is absolutely necessary but I think as you get older working 7 days a week is not good for you...Your business might be doing good but you could drop dead also because it’s just too stressful, it’s very demanding”*

This was compounded by the commonly held perception of many of the owner-managers that ‘time was money’. Down time, especially for those in service sectors, means less billable hours, so trying for ‘balance’ in terms of having time out, often lead to financial imbalance. A related issue found to quantity of human resources available, was the quality as Interviewee #21 discussed in terms of not wanting to waste his time re-doing work for no charge that was not up to standard:

*“It is exceptionally difficult like our standard is very very high and I have extreme difficulty in tolerating low skill or low effort factor, you know It is like if it’s going to done, it’s going to be done the right way and done properly”*

Interviewee #21 goes on to describes the relationship between producing quality work, customer satisfaction and his personal reputation when talking about lower than desired staff work standards that he has experienced in the past:

*“The attitude of some people is just in today’s world is just unreal and you sort of – it bites at you for two reasons, one is that if it is not up to your standard it reflects on your reputation because whatever is going out of here is basically got our name on the job and the other thing is that you feel is that the customer is paying good money for a second grade type service”*

Concern by the owner-manager for their personal reputation and identity, for example not wanting to let customers down, also emerged as frequent finding. Many of the SMEs were part of networked webs, having close relationships with customers, suppliers etc, therefore keeping the owner-manager very close to their business.

*“Well I was having no time to myself at all because I was starting at 8 in the morning and I wasn’t finished till 5:30 and no lunch break and then the weekends people would ring you up, you’d go out socially, people would come and see you because they had a problem and so you – my whole life was physio, physio the whole time”* (Interviewee #25).

Business demographic characteristics such as the size of the business, the industry sector and location also presented constraints unique to each business. For example, Interviewee #21 spoke of the restrictions of being on call and needing to be accessible to customers often outside of ‘normal’ business hours.

*“... there is a lot of people if you talk to them, a comment I make is yeah I’ve escaped from jail and I’m going home, it’s just like you’re trapped in this system you know you’re on call, because you’re in a retail market, you’ve got to provide a service so you’ve got to respond, that’s what you choose to do but that’s the reality of it, you’ve got to be accessible ...”*

Other common business constraints were related to the constant demands of having your own business in terms of the paperwork; the pressures of ‘working on as well as working in your own business’. Interviewee #45 described his frustrations in running his business during a growth period:

*“We are currently heading for heart attacks if we don’t get more staff soon, I cannot keep up with the demand for this sort of thing especially as a small business because for every three hours we’ve got in here, there’s an hour of bureaucratic nonsense we’ve got to carry on with and it’s really tough for a business, if I stop working I stop earning”.*

Despite the emergence of many personal and business constraints, several interviewees conveyed an awareness of the need for ‘balance’, particularly in regard to working hours, sustainability of health and time with the family:

*“On purpose, I probably do no more than 9 a day, five days a week. Sometimes I’ll work 7 days a week if I have to or all night but on purpose I don’t work, I won’t work anymore than 45 – 50 hours a week because I’ve – in previous job worked 7 days a week, just about killed myself and realised I wasn’t productive” (Interviewee #5)*

*“Yeah there’s a balance, I like the guys to keep a balance but I mean the only other way you can get ahead in life so long as you’ve got to work each day and if they want to get ahead, the work is there for them so they’re not forced”(Interviewee #3)*

Interviewee #8 spoke of described how his fitness and health contributed to him being able to sustain his lifestyle of being able to work a lot harder in the peaks but also pursue his other many passions including family, fishing, and sailing:

*“Yeah I’ve been very fortunate because I’ve had good health all my life, hardly ever get sick, I keep reasonably fit because I’m physically active, I play hard all year around, I sail regularly, I work out at the gym three times a week, I ski hard all winter”*

## **DISCUSSION**

Like many human resource practices when compared with larger organisations, work-life balance policies in SMEs are generally informal and individually negotiated (Dex & Scheibl, 2001). As the various quotes given in the previous section reveal, the opportunities for more traditional balance policies are limited by the many personal and business constraints the

SME owner-manager can face. The personal and business constraints identified from our study are summarised in Table One. It is important to stress that some of the constraints can be conceptualised as both personal and business. The expertise and skill possessed by an individual operator can be conceptualised as both a personal and business constraint. For example, as dentist must be personally present to provide his/her skills their operation is dependent on their skill base. Furthermore industry specific licensing and legislation in such businesses require the 'expert' to be physically present during hours of operation.

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Insert Table 1 about here

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While identifying the array of constraints is an important precursor to devising strategies to pursue well-being, it is important to highlight that not all constraints are negative. For example, the 'entrepreneurial personality' - one of drive, great energy, and tenaciousness can be a positive factor for driving business. Moderation is the key though as individuals need to prevent extreme drive leading them to poor health and burnout.

A framework (Figure One) is presented for conceptualising the relationship between personal and business constraints the SME owner-manager faces and how the pressures of, and relationships between, the constraints will predominantly result in a situation of 'imbalance' for them in regard to traditional work-life balance ideals.

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Insert Figure 1 about here

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Quadrant A depicts the situation of 'balance' due to low personal constraints and low business constraints. An enviable position for any SME owner-manager; perhaps akin to having found the Holy Grail!

Quadrant B reflects low business constraints, but high personal constraints leading to a situation of 'imbalance'. For example, while the operator may not be the 'resident expert' who has to be physically present for the business to operate, they may choose to work long hours as they have trouble letting others have control in their business.

Quadrant C depicts a situation of 'imbalance' due to high business constraints and low personal constraints. This situation could arise for example in a trade service business that is short staffed and also facing high customer demand thus requiring the staff and owner-manager to work long hours to finish work and maintain revenue levels from billable hours.

Quadrant D is a particularly challenging situation of 'imbalance' due to both high personal and business constraints. Here a range of personal and business constraints will lead the owner-manager to be very close to their business, mentally, physically, and emotionally. While it could be a conscious choice for the owner-manager to be in this situation, and perhaps one they completely enjoy for example during a time of high growth, care must be taken to maintain momentum and passion without tipping the balance into one of obligation, resentment and physical burnout.

Once the owner-manager has acknowledged the quadrant they currently find themselves in, they can also think about the gap between their current and ideal situation, if there is in fact one! Not all constraints are imposed by external parties, nor are they negative. The situations of 'imbalance' (Quadrants B, C and D) according to the more traditional notions of work-life balance, may be in fact be closer to the owner-manager's desired rather than the undesired state; one that they have consciously constructed through their personal and business choices. The framework can influence owner-managers in understanding their unique lifestyle context in terms of how they have integrated their personal drivers and business demands.

The benefit of such a framework is that it acknowledges the inherent problem of the rhetoric of balance and equilibrium underpinning the work-life balance concept. Instead our framework is supported by the reality that lives of SME owner-managers are characterised by 'seasons of intensity' in terms of personal (birth, death, marriage, divorce, health) and business (start up, growth, change, downturn) events. Rather than searching for Holy Grail of balance and equilibrium, the owner-manager can plan strategies to enable them to keep their momentum while retaining their levels of passion, health and success.

We present the framework as a tool that can be used periodically by owner-managers. Movements between quadrants will be expected a logical result of the dynamic and changing nature of personal and business constraints; factors both within and external to the owner-

manager's control. Awareness of where the owner-manager places them self within the framework may encourage them to adopt more of a 'telescope' (proactive), rather than a 'rear view mirror' (reactive) approach to planning for the personal and business 'seasons of intensity' and management of negative constraints.

The framework can also be used by policy makers to contemplate about how populist policies for work-life balance, often formulated and applied in the contest of large organisations, could be problematic for adoption in the SME context. Given the significance of the SME sector in countries such as New Zealand, attention needs to be given to tailoring policies to appeal to SME owner-managers in terms of the constraints they face and personal choices they make.

Given the highly entwined nature of the business and the owner, personal success often equates to business success (Walker & Brown, 2004). In our study the significance of personal events emerged as a key finding when our team set out to learn about the key 'transitions' that New Zealand SME owner-managers encounter as they attempt to grow, and how the owners' experiences of these transitions related to the stage models of business growth. When considering the lifecycle model in regard to the framework, caution should be taken that anecdotal stereotyped groupings are not simply applied, for example, that those in the start up stage will have high personal and business constraints (Quadrant B) whereas those in the maturity stage will have low personal and low business constraints (Quadrant A). The presence of constraints and the relationship between them will be unique to each owner-manager. Cope and Watts (2000) found that while the lifecycle literature provides examples of relatively predictable development crises; their interview data produced extremely diverse and highly individual critical episodes. Nonetheless further investigation of issues of balance at various personal and business lifecycle would be interesting, as Gray (1993) found the personal lifecycle to be a strong influence on attitudes towards growth, with younger respondents tending to be more growth-oriented than older respondents.

## **CONCLUSION**

In challenging the popular discourse of work-life balance it is clear that new discourses are needed when talking about work-life integration in the SME such as that proposed by de

Bruin and Dupuis (2004) of a 'mosaic' in regard to work-life balance and non-standard work. They describe such a metaphor as useful in challenging the discourse of balance, as it can be seen as a combination of pieces, different in size, shape, colour and composition, just as a person's life can comprise of different pieces. Unlike the work-life balance concept the metaphor does not suggest equilibrium. However they also warn though that a problem with this metaphor is that it fails to fully capture both the dynamic context in which the mosaic is located and the evolving nature of an individual worker's networks and relationships.

Irrespective of the rhetoric that is adopted and popularised, whether it is work/life balance, work-life integration, work-life recipe, or life policy, what is vital is recognition that traditional dichotomies in terms of work and life postulated from the context of large organisations and formation of balance policies to address the problem are often not appropriate for the SME context. Future theorisation of work-life integration in the SME context needs to be cognisant that the owner-manager often assumes multiple roles and tasks at the same time (Harris & Arendt, 1998) in an environment where the boundaries of work and life are blurred.

This paper is an effort to make just such a contribution and stimulate new thinking in the area. Our hope is that any future studies seeking to encapsulate the importance of personal motivations and possibly the stage of the owner-manager's personal and business lifecycle use qualitative methodologies to get close to the individuals in their comfort zones. In current regimes of reflexive modernization and flexible specialization, people need to compose their own biographies as worker, choosing between different lifestyles, subcultures, social ties and identities (Edwards, 1998). Certainly during our study we were privileged to hear of many joyous as well as difficult personal events and to learn about the resultant impact of these on the owner, their families and the business. Further research in this area also needs to be cognisant of variables including sector, owner choice, business constraints, culture, family size and personal lifecycle stage. Proposed solutions or answers to dilemmas of balance need to be relevant and realistic for SME owner-managers and the resources available to them. Given that there is no 'one size fits all' concerning ideals of work-life balance, personal choice needs to be highlighted as owner-managers will make decisions about their work and personal life based on their values, attitudes and beliefs.

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**Table 1: Constraints to ‘Balance’ for SME Operators**

| <b>Personal Constraints</b>                    | <b>Business Constraints</b>                               |
|--|---|
| Passion for the business                       | Investment benefit ratio                                  |
| The ‘entrepreneurial personality’              | Lack of human resources                                   |
| Personal credibility                           | Cost of replacing human capital                           |
| Owner-manager capacity and skill               | Impact of absence on billable hours                       |
| Short term cf. long term orientation           | Multi-tasking required by owner-managers                  |
| Personal choice to invest huge time and energy | Participation in business networks (customers, suppliers) |

**Figure 1: Determinants of ‘Balance’ in SMEs**

| <b>Personal Constraints</b><br><b>Business Constraints</b> | <b>Low</b>             | <b>High</b>            |
|--|------------------------|------------------------|
| <b>High</b>  | Imbalance <sup>C</sup> | Imbalance <sup>D</sup> |
| <b>Low</b>   | Balance <sup>A</sup>   | Imbalance <sup>B</sup> |

**Entrepreneurship Research, Using Students as Proxies  
For Actual Entrepreneurs**

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## *Abstract*

*This paper considers the practice of using university undergraduate as proxies for small business owners in entrepreneurship research. A data set was gathered from a sample of university undergraduate students at a major business school as well as from a sample of actual small business owners “actual entrepreneurs”. The university undergraduate respondents were divided into those with high nascent entrepreneurial inclinations and those low in nascent entrepreneurial inclinations. A discriminate analysis between the three groups was then done and results were then and examined for similarities or differences with regards to life aspirations, life goals, and work goals of each group. Unlike the undergraduate respondents with low entrepreneurial potential, undergraduate respondents with high entrepreneurial potential were found to be very similar to actual entrepreneurs. Results of this research suggest that, when using students as proxies in the study of entrepreneurship, one needs to separate nascent from non-nascent students and use only those students who are high in nascent entrepreneurial inclinations.*

## *Entrepreneurship Research, Using Students as Proxies For Actual Entrepreneurs*

This paper considers the practice of using students as proxies for small business owners in entrepreneurial research. Past research has been done using undergraduate students (Segal, Borgia, Schoenfeld, 2002), always with the assumption that results are generalizable to the overall population of practicing entrepreneurs, but, to date, no study has examined the validity for this assumption. This study begins the process of correcting that. A population of 815 undergraduate students at a major university located in the Midwest were sampled using a questionnaire method while, in a similar time frame, a population of practicing entrepreneurs were given the same set of questions. The data was analyzed and results are provided in the discussion section of this paper.

A common theme found in entrepreneurship research is that entrepreneurship plays a critical role in the US economy. Of the 25.5 million businesses in the United States today, approximately 25.1 million or 98.5 % are small businesses. These small businesses are largely entrepreneurial and are responsible for 75.8% of our nation's new jobs. (Scarborough & Zimmer , 2003). Potential entrepreneurs appear to be critical to the notion of a resilient "self renewing" economic environment (Shapiro, 1982). Entrepreneurial growth is a critical part of our nation's economic health. Past research has also noted that Entrepreneurial potential seem to provide the best predictive power when attempting to predict the movement of the populace in the practice of entrepreneurship ( Kureger & Brazeal, 1994; Bagozzi & Yi, 1989). Research into entrepreneurial potential, therefore, serves us well, both in improving our predictive abilities and in providing a fertile ground from which the seeds of entrepreneurship can sprout.

Attracting the interest and time from existing entrepreneurs, however, is a difficult proposition. Acting entrepreneurs are pressed for time, resource short, and suspicious of anyone asking sensitive questions which might give away their competitive edge. A proxy, if found, without the above mentioned constraints, would be a welcome resource for entrepreneurship researchers.

In the past, undergraduate students, in university business schools, have been considered to be these proxies and, as such, representative of actual entrepreneurs. Students are not as time constrained as actual entrepreneurs. They are more accessible to researchers, assumed to be representative of the overall population, and are at the headwaters of their career path. The purpose of this paper is to explore the suitability of undergraduate students to serve as proxies for actual entrepreneurs in entrepreneurial research.

### **Ways of predicting Entrepreneurial Behavior**

Research exploring entrepreneurial behavior can be divided into four categories, how entrepreneurs act, what happens when they act, why they choose to act as entrepreneurs (Stevenson & Jarillo, 1990), and research into the identification of environmental and situational factors that predict entrepreneurial activity (Segal, Borgia, & Schoenfeld ).

Because of the above mentioned difficulties of studying actual entrepreneurs, environmental and situational factors, if effective, would be excellent avenues from which to study entrepreneurial behavior. Environmental and situational factors include job displacement, previous work experience, availability of resources, and governmental influences, all of which can be gleaned from data available outside the internal entrepreneurial environment. However, while each of these factors are considered to be important to the development and

encouragement of budding entrepreneurs, empirical studies of these contextual factors have found low explanatory power and predictive ability (Krueger, Reilly, & Carsrud, 2000).

Levesque, Shepherd, & Douglas, 2002 and Praag & Cramer, 2001, have proposed models using economic perspectives to predict self-employment. These economic models suggest that the decision to become self employed is based on maximizing the net usefulness, utility, or desirability of an entrepreneurial career. Shapero's model of the entrepreneurial event (SEE) assumes that inertia guides human behavior until something interrupts or displaces that inertia. All of the above methods remain wedded to various ad hoc profiles of personality and demographic characteristics. They do not depend on intimate contact with the actual entrepreneur and get around the difficulties in acquiring the more difficult internal information of the actual entrepreneur. However, they also appear to have minimal predictive ability (Krueger & Brazeal 1994).

Within the context of how and why entrepreneurs act, two theories, Ajzen's theory of planned behavior (TPB), and Social Cognitive Career Theory (SCCT) seem to hold some promise on the front of prediction of entrepreneurial behavior (Segal, Borgia, & Schoenfeld; Krueger & Brazeal ). Ajzen's theory of planned behavior suggests that three key attitudes predict entrepreneurial inclinations; (1) Attitude towards the act, (2) Social norms, and (3) Perceived behavioral control. Social Cognitive Career Theory suggests that Career interests, goals, and choices are related to self-efficacy beliefs and outcome expectations (Lent, Brown, & Hackett, 1994,1996). Segal, Borgia, and Schoenfeld make the suggestion, then, that peoples self efficacy beliefs and outcome expectations with regard to self-employment can predict their goals to become self employed.

Therefore, if entrepreneurship is viewed through the lens as simply one of many career choices, SCCT becomes a good benchmark from which to operate. It is a good place to hang ones theoretical hat as it is one of the most accepted and validated models discussed in the careers literature regarding the understanding of career interests and goals (Segal, Borgia, & Schonefeld; Gore & Leuwerke, 2000; Smith & Fouad, 1999; Swanson & Gore, 2000).

### **Social Cognitive Career Theory**

SCCT is anchored in social cognitive theory and highlights the importance of self-beliefs and self-thought in fostering an individual's motivation and subsequently guiding their behavior (Segal, Borgia, & Schoenfeld). Core variables of the SCCT model are (1) self efficacy-- which affects an individual's expectations for outcomes as well as their intentions toward performance, (2) outcome expectations---which affects their future performance or goals, and (3) goals--- for entrepreneurs towards self employment.

This model bases much of its predictive powers on Vroom's (1964) work in expectancy theory. Expectancy theory states that in order for an outcome to be achieved, three things must be in place; (1) a person must believe that he or she can do it (expectancy), (2) accomplishment of the task must be clearly connected to an outcome (outcome expectations), and (3) the outcome must be desired by the individual (valence). according to Vroom, an individual will choose among alternative behaviors by considering which behavior will lead to the most desirable outcome. SCCT suggests that these outcome expectations are important determinants of career interests (Segal, Borgia, & Schoenfeld). Bandura (1986) noted that a person's behavior results from the interaction of that person and their environment but, as noted above, issues of the

environment contain low explanatory power and predictive ability when used alone (Krueger, Reilly, & Carsrud, 2000).

Therefore the researcher finds himself dealing with other methods of studying entrepreneurial behavior, expressed in general terms of how and why entrepreneurs act and what happens when they act. Past studies have shown these areas to be more fruitful in their predictive and exploratory powers to explain entrepreneurial behavior. However, the thorny issue of gaining access to actual entrepreneurs remains. Since the more easily gathered data (economic and demographic) appears to be ineffective, the obvious alternative is to use some form of a more accessible proxy for the ever busy and difficult to reach actual entrepreneur. This effort to locate proxies high in entrepreneurial potential is seen as a major stumbling block to a precise description of the entrepreneurial effort (Reynolds, 1995). One possible source for these nascent entrepreneurs is located in universities. However, results of past entrepreneurial research using students have been mixed at best.

### **Focus of This Paper**

This paper looks, in particular, at the issue of using students as proxies for actual entrepreneurs in entrepreneurial research. We suggest that an acceptable proxy will be one with high potential to become an actual entrepreneur.

Because recent research suggests promise for Social Cognitive Career Theory this paper concentrates on those traits and issues that best fit into the Social Cognitive Career Theory realm to provide discrimination between students exhibiting nascent entrepreneurial tendencies and students low in these nascent entrepreneurial tendencies (Segal, Borgia, & Schonefeld; Gore &

Leuwerke, 2000; Smith & Fouad, 1999; Swanson & Gore, 2000). In particular, we look at measures of life aspirations along with work and life goals within a sample of junior and senior level undergraduate students at a major Midwest university. We also look at the same measures within a sample of actual entrepreneurs who agreed to participate in our research.

Students high in nascent entrepreneurial inclinations, for the purposes of this research, are defined as those individuals who exhibit high potential to become actual entrepreneurs (Reynolds, 1995; Palit & Reynolds, 1993; Reynolds & White, 1993). Undergraduate respondents were divided into two categories. We develop a nascent entrepreneurship index and make a distinction between those who score high on this index and those who scored low. Our expectations were that students exhibiting high levels of nascent entrepreneurship, as evidenced by their score on the nascent entrepreneurship index will respond similarly to actual entrepreneurs in the administration of the questionnaire.

Our attempt is to validate the link between those undergraduate students with a high level of nascent entrepreneurial inclinations and actual entrepreneurs and as such validate their use as proxy's for the much more difficult to obtain data from actual entrepreneurs. Furthermore, we look at the lack of correlation between the answers given by those students who are low in nascent entrepreneurial inclinations and actual entrepreneurs and suggest that, in order to improve the reliability of using university students as proxies for actual entrepreneurs, one needs to separate out those students who exhibit low nascent entrepreneurial inclinations.

## **Methodology**

The study was done through the use of a nearly identical questionnaire administered to a group of approximately 500 university students as well as 286 actual entrepreneurs. The

questionnaire items are grouped into two main categories of work goals (Table 1) and life aspirations (Table 2). These items were derived from those used in current entrepreneurial research. The respondents were asked to rate the importance of (1=not at all important, 7=extremely important) seventeen job characteristics (work goals) in their ideal jobs. They were also asked to divide one hundred points among ten life goals/aspirations to indicate the relative importance of each in their lives.

**Table 1; Work Goals**

|  |
|--|
| <p>To be able to use my skills and talents to the maximum</p> <p>To be able to achieve something that I personally value</p> <p>To work with others as members of a group</p> <p>To have the freedom/opportunity to make my own decisions</p> <p>To have job security</p> <p>To have the opportunity to learn new things</p> <p>To receive attractive pay and benefits</p> <p>To perform challenging and exciting work</p> <p>To be able to extend my range of abilities</p> <p>To have opportunity for advancement/promotions</p> <p>To be friends with, and be liked by my co-workers</p> <p>To have the authority to influence others</p> <p>To always know specifically and exactly what I am expected to do</p> <p>To have fixed working hours</p> <p>To be able to set my own working hours</p> <p>To have control over the pace of my work</p> <p>To be ultimately involved in the entire operation (i.e. the whole enterprise)</p> |
|--|

**Table 2; Life Goals and Aspirations**

|   |
|---|
| <p>Accumulate wealth</p> <p>Control my own future</p> <p>Be my own boss</p> <p>Have free time for family, hobbies, leisure, and other interests</p> <p>Live an adventurous and exciting life</p> <p>Be recognized by family/friends for my accomplishments</p> <p>Become an influential person</p> <p>Have a steady paycheck (i.e. job and income I can count on)</p> <p>Have financial security</p> <p>Have peace of mind (i.e. peaceful and stress-free life)</p> |
|---|

The sample was already naturally divided into two groups, that of students and actual practicing entrepreneurs. We further divided the student group into those students with low nascent entrepreneurial qualities and those with high nascent entrepreneurial qualities. This was done through deriving an average score for each student based on responses to four questions (Table 3). Students responded to the questions in the form of a likert scale of 1-7. Students who scored an average response of three or less to the questions in Table 3 were classified as having low nascent entrepreneurial qualities. Students who scored an average response of five or higher to the questions in Table 3 were classified as having high nascent entrepreneurial potential. Students who scored an average of 3 were discarded as being too ambiguous to classify into either category for the purposes of this research.

**Table 3: Nascent/Non-nascent questions**

|   |
|---|
| My ultimate goal is to be self employed               |
| My goal is to start my own business                   |
| Having a job is more appealing than owning a business |
| I intend to strive for an idea to own my own business |

This process allowed three distinct groups to emerge. These were actual entrepreneurs, students exhibiting high nascent entrepreneurial potential (referred to as nascent), and students exhibiting low nascent entrepreneurial potential (referred to as non-nascent). The entrepreneurially nascent students numbered 156. The entrepreneurially non-nascent students numbered 183. 161 students delivered scores of 3 and were considered too close to differentiate. Total students participating in the research were 500. These groups were then subjected to three combinations of a two way discriminate analysis using work goals and life aspirations as independent/predictive variables. The first analysis looks at the non-nascent student group compared to nascent student group. The second analysis looks at the non-nascent student group

compared to actual entrepreneurs. The third and final analysis looks at the nascent student group compared to actual entrepreneurs.

## **Results**

Results from a discriminate analysis are found in Table 4: Analysis 1. Responses of students categorized as non-nascent are compared to those categorized as nascent. In this analysis our results showed that work goals and life aspirations correctly classified 75.5% of the two cross validated groups of students (nascent and non-nascent) in the analysis. This indicates a strong difference between these two types of students. This supports our assertion that there is a significant difference in work goals and life aspirations between students exhibiting strong nascent entrepreneurial qualities and those exhibiting weak or non-nascent entrepreneurial qualities. Perhaps even more relevant is that only 21% of non-nascent students were incorrectly classified as actual entrepreneurs, which is exactly the same as the percent of non-nascent students who were incorrectly assigned to the nascent group.

Analysis two moves the discussion forward by comparing the non-nascent student group to actual entrepreneurs. Here the results are even stronger with 82.7% of cross validated grouped cases correctly classified in the analysis (Table 5). This indicates that there is a difference between the non-nascent group and the group of actual entrepreneurs and suggests that the non-nascent group of students may not be representative of or serve as proxies for the actual entrepreneur in entrepreneurial research.

Analysis three moves the discussion in a final step by comparing the nascent student group to actual entrepreneurs. Here the results are weaker with only 70.1% of cross-validated

grouped cases correctly classified (Table 6). However, the separation becomes even more indistinct when it is noted that, of the nascent student group, the discriminate analysis was only able to correctly identify them 48.1% of the time. Furthermore, the discriminating variables are not only different from those that separate non-nascent from the other two groups but also different from those which are supported by the literature as being a part of the entrepreneurial profile. This lack of discriminatory ability using questions previously identified as being a part of the entrepreneurial profile. This highlights the similarity of the nascent and actual groups and their dissimilarity with the non-nascent group thereby suggesting that nascent entrepreneurial students are very much like actual entrepreneurs and can serve as inexpensive and accessible proxies in their absence for both predictions of entrepreneurial activity and other forms of entrepreneurial research.

Table 7 shows the most discriminating questions found in the analysis. Reported are those questions with a factor loading of .2 or more. 18 questions were found to have a factor loading of .2 or greater in at least one of the three analyses. In fact, characteristics that most significantly discriminate between the actual/non-nascent and between the nascent/non-nascent subjects are virtually the same. Again highlighting the fact that actual and nascent entrepreneurs are very similar to each other and very dissimilar to non-nascent subjects. Twelve questions were found to have a factor loading in either or both of analyses one and two. In fact, both groups attach significantly more levels of importance to eight questions in particular. These questions have a factor loading of at least .25 in both analyses one and two (Table 7), and include; Be my own boss(high inclination), number one in both analyses; Be able to set my own working hours(high inclination), number two in both analyses; Have freedom to make my own decisions(high inclination); Be intimately involved in entire operation(high inclination); Had a

role model owning business(high inclination); Have control over pace of work(high inclination); Have a job and income I can count on(low inclination); Have fixed working hours(low inclination); Father occupation (high inclination); and to have job security (low inclination).

## **Implications**

As previously mentioned, acting entrepreneurs are pressed for time, resource short, and suspicious of anyone asking sensitive questions which might give away their competitive edge. Our results indicate that students can serve as proxies for acting entrepreneurs as long as we separate those with high nascent entrepreneurial inclinations from those without such inclinations (referred to here as non-nascent). This can be done through the use of student responses to Questions concerning their entrepreneurial inclinations (Table 3). As noted from discriminate analysis three, students registering high in the nascent entrepreneurial index are found to be quite similar to actual entrepreneurs with the analysis having difficulty discriminating between the two groups. On the other hand, students in the nascent group are found to be quite dissimilar to the non-nascent student group (Table 7: Analysis one). Students in the non-nascent group are found to be quite dissimilar to actual entrepreneurs as well (Table 7: Analysis two). Therefore, when using students as proxies for actual entrepreneurs, researchers would do well to distinguish between those who score high in nascent entrepreneurial inclinations and those who do not.

**Table 4: Analysis 1**

| Analysis 1 (Non-nascent compared to Nascent) |             |         |
|--|-------------|---------|
| Predicted Group Membership ( % Correct)      |             |         |
|  | Non-nascent | Nascent |
| Non-nascent                                  | 79.2%       | 20.8%   |
| Nascent                                      | 28.8%       | 71.2%   |

75.5% of cross-validated grouped cases correctly classified

Table 5

| Analysis 2 (Non-nascent compared to Actual Entrepreneurs) |             |        |
|---|-------------|--------|
| Predicted Group Membership ( % Correct)                   |             |        |
|   | Non-nascent | Actual |
| Non-nascent   | 79.2%       | 20.8%  |
| Actual Entrepreneurs                                      | 15%         | 85%    |

82.7% of cross validated grouped cases correctly classified

Table 6

| Analysis 3 (Nascent compared to Actual Entrepreneurs) |         |                      |
|---|---------|----------------------|
| Predicted Group Membership ( % Correct)               |         |                      |
|   | Nascent | Actual Entrepreneurs |
| Nascent   | 48.1%   | 51.9%                |
| Actual Entrepreneurs                                  | 17.8%   | 82.2%                |

70.1% of cross-validated grouped cases correctly classified

Table 7

| <b>Questions with most discriminatory power</b> | <b>Analysis 1<br/>Nascent/Non-<br/>nascent</b> | <b>Analysis 2<br/>Non-<br/>nascent/Actual</b> | <b>Analysis3<br/>Nascent/Actual</b>        |
|---|--|---|--|
|   | <b>Question Rank<br/>(Factor Loadings)</b>     | <b>Question Rank<br/>(Factor Loadings)</b>    | <b>Question Rank<br/>(Factor Loadings)</b> |
| Be my own boss                                  | 1 (-.534)                                      | 1 (-.586)                                     | 4 (.308)                                   |
| Be able to set my own working hours             | 2 (-.456)                                      | 2 (-.410)                                     |  |
| Have freedom to make my own decisions           | 3 (-.392)                                      | 7 (-.329)                                     |  |
| Be intimately involved in entire operation      | 4 (-.365)                                      | 3 (-.369)                                     |  |
| Had a role model owning business                | 5 (-.342)                                      | 10 (-.233)                                    |  |
| Have control over pace of work                  | 6 (-.295)                                      |   |  |
| Have a job and income I can count on            | 7 (.290)                                       | 9 (.248)                                      |  |
| Have fixed working hours                        | 8 (.253)                                       | 4 (.367)                                      | 8 (-.212)                                  |
| Father Occupation (Dummy Variable)              | 9 (-.239)                                      |   |  |
| To have job security                            | 10 (.230)                                      | 6 (.339)                                      | 10 (-.205)                                 |
| Be friends/liked by co-workers                  |  | 5 (.348)                                      | 1 (-.605)                                  |
| Control my own future                           |  | 8 (-.285)                                     |  |
| Have opportunity for advancement                |  |   | 2 (-.376)                                  |
| Live an adventurous and exciting life           |  |   | 3 (-.362)                                  |
| Earn attractive pay and benefits                |  |   | 5 (-.273)                                  |
| Socio-Economic family background                |  |   | 6 (-.265)                                  |
| Have authority to influence others              |  |   | 7 (-.249)                                  |
| Become an influential person                    |  |   | 9 (-.210)                                  |
| Group Centroid                                  | Nascent (-.932)                                | Non-nascent<br>(1.142)                        | Nascent (-.709)                            |
| Groups Centroids                                | Non-nascent (.794)                             | Actual (-.731)                                | Actual (.387)                              |

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**RISK MANAGEMENT PRACTICES IN GERMAN SMES:  
AN EMPIRICAL INVESTIGATION**

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**ABSTRACT**

This paper reports current risk management practices in German small to medium-sized enterprises (so-called German “Mittelstand”). In particular, it studies possible relationships between risk management and business planning activities. Additionally, it determines to what extent the Balanced Scorecard is used, for the general purpose of performance measurement and especially for the purpose of risk management. The inquiry was carried out by means of a postal questionnaire. The results show that in German SMEs the handling of risks is strongly concentrated on owner-managers. Risk management is carried out in a rather rudimentary way. Only few SMEs have established a comprehensive business planning system, and the link between their risk management and their business planning is in most SMEs not well developed. But a sound risk management requires an elaborate business planning, together with a direct

mapping of risk figures into the planning system. In general, the Balanced Scorecard was met open-minded, but its use for risk management is mentioned by only a few enterprises. This investigation is a first step of a larger empirical approach to risk management practices in German SMEs.

## **INTRODUCTION**

Concerning risk management practices in Germany, there have been conducted many studies that deal with large enterprises. SMEs, however, have been neglected in risk management considerations. This empirical investigation aims at filling this gap. It is a first step of a larger project to study risk management practices in German SMEs.

The paper is structured as follows: This introduction section contains some preparatory remarks on enterprise size classes, the definition of SMEs and the basics of risk management. Then a risk management framework is outlined that is fundamental for the rest of this paper: it connects risk management with business planning and the Balanced Scorecard (BSC). The literature review following focuses on just these topics, together with some remarks on SMEs' behaviour. After that the research method of questionnaire survey is described by which this investigation has been carried out. Next, the questionnaire results are presented. The paper concludes with a discussion about the research findings, their practical implications and the need for further investigation.

SMEs form the backbone of the West European economy. About 90 per cent of them are enterprises with less than 10 employees (so-called micro firms). In Germany there are about 3

million SMEs with a total of about 20 million employees (Bretz, 2003; Statistisches Bundesamt, 2004).

In quantitative terms, the category of SMEs is made up of enterprises satisfying at least the following conditions: fewer than 250 employees, annual turnover not exceeding 50 million Euro and/or annual balance sheet total (total assets) not exceeding 43 million Euro. Moreover, an additional independence criterion must be fulfilled: a maximum of 25 per cent of its capital may be held by other enterprises that do not satisfy the above employee and turnover/balance sheet total conditions (The Commission of the European Communities, 2003).

Size classes for enterprises have been defined because the range of firms does not show a homogenous structure, for example with respect to the knowledge of business methods or their decision-making.

Referring solely to the number of employees, the following definition is shared by many researchers (and also by EUROSTAT, the statistical office of the European Union; see The Commission of the European Communities, 2003):

- micro firm:                up to 9 employees
- smallfirm:                10 to 49 employees
- medium-sized firm:    50 to 249 employees
- large firm:                250 and more employees

Risk and uncertainty – the basic terms of risk management – characterize situations where the actual outcome for a particular event or activity is likely to deviate from the estimate or forecast value. Risk can travel in two directions: the outcome may be better or worse than originally

expected. These are known as upside and downside risks. The distinction is usually that risk is taken to have quantifiable attributes, whereas uncertainty does not. Uncertainty, on the other hand, is used to describe situations where it is not possible to attach a probability to the likelihood of occurrence of an event (Raftery, 1994).

Risk management is a continuously monitored integrated formal process for defining objectives, identifying sources of uncertainties, analyzing these uncertainties and formulating managerial responses, to produce an acceptable balance between risk and opportunities. As usual, the steps of the risk management process are called identification, evaluation and monitoring. Enterprise risk management must be a top-down process. Management has the overall view and can define the thresholds of risk figures. Conversely, information must be fed back to the top from those closest to the sources of risk (Dickinson, 2001).

In 1998 the German Control and Transparency Act (KonTraG) had come into force, which in Germany led to new discussions on the problems of risk management. This law distinctly demands establishing a so-called “early warning system” by which enterprises can perceive in time those developments that endanger their existence. The act directly addresses only public limited companies. Although it has a spillover effect also on SMEs, recent empirical studies on German risk management practices concentrate merely on large enterprises (see, for example, Fischer, 1999; KPMG, 2000; PriceWaterhouseCoopers, 2000; Reichmann and Diederichs, 2003; Federation of European Risk Management Associations et al., 2004).

The general approach of this paper aims at establishing a link between risk management and business planning, with the Balanced Scorecard supporting risk identification. The following

figure shows the constituents of this risk management framework, together with their relation to the corresponding classical steps of the risk management process.

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Figure 1 Risk management framework

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Some remarks on the connections (1) to (3) in Figure 1 follow:

**(1) Identification of risks and the corresponding master budget entries by the Balanced Scorecard**

Risks are identified with the BSC. The ratios of all perspectives of a BSC can be associated with certain entries of the master budget. For ratios of the financial perspective this is obvious.

Similarly, the ratios of the other perspectives (e.g. customer complaints rate) can be related in a more or less complicated way to corresponding master budget entries (e.g. repair and maintenance expenses). Thus developing the control measures of a BSC allows it to identify those corresponding entries of the master budget that are of risky nature. The BSC has proved (Chow et al., 1997; Oepping and Siemes, 2003) to be a popular instrument for a comprehensive enterprise performance measurement. Hence this established instrument could be easily used for the purpose of risk management in SMEs.

**(2) Evaluation of risks using the link between risk management and business planning**

Risks are identified according to the entries of the master budget. Threshold values for the identified risk entries are fixed without referring to mathematical or statistical procedures.

Measures are planned that should be taken if risk figures violate the corresponding thresholds,

and the development of these thresholds is included in the reporting. The short personnel and financial resources of SMEs do not permit a separate risk management with risk management experts. Thus a link between risk management and business planning ensures a systematic and complete risk assessment within a familiar frame.

### **(3) Monitoring the effects of risks on the target figures for profit and liquidity**

The usual input values of the master budget lead to the planned values of the target figures for profit and liquidity. Analogously, one can estimate the effects of risks on profit and liquidity if one replaces the usual input values by threshold values of risk entries. This assumes a certain embedding of the risk figures into the business planning system. The risk awareness of the staff is developed if they are confronted with this “playful” way of demonstrating the effect of risks. The range defined by the variation of the target figures profit and liquidity when performing risk considerations is included in the form of ratios in the BSC.

The risk management framework, as presented in Figure 1, gives rise to the following research questions:

- Under what conditions is risk management carried out in the main industries of German SMEs?
- In which way has their risk management process been linked to the business planning?
- To what extent do German SMEs use the Balanced Scorecard? In particular: Do they use it for the early warning of risks?
- Do their organization and techniques of risk management depend on enterprise size classes?

## **LITERATURE REVIEW**

The literature review assembles sources that cover the main issues of the risk management approach of this paper: general risk management, followed by business planning and the Balanced Scorecard with the focus on their respective support of risk management purposes. Before dealing with these areas, some studies about SME behaviour are summarized.

Up to now there are no empirical investigations on risk management practices in German SMEs. Hence the literature has been reviewed critically to detect which risk management techniques proposed for foreign SMEs and even for larger enterprises in general could also be suitable for German SMEs.

### **SME Behaviour**

McKiernan and Morris (1994) point out the following qualitative characteristics of SMEs: central role of the owner with multiplicity of duties and close identity with employees, combination of ownership and control and inherent flexibility and mobility.

SMEs mainly operate on the domestic market, partly because of short resources and the fear of unknown foreign business practices. In general, SME owners have no broad knowledge of business administration (Dutta and Evrard, 1999).

According to Lyles et al. (1993), SMEs show little separation between the entrepreneur's strategic thinking and decision-making and the enterprise's formal planning system.

Brouthers et al. (1998) stated that decision processes in SMEs occur more intuitively and that for analyzing strategic alternatives quantitative methods are used rather seldom. With increasing size enterprises act “more rational” with respect to planning and decision-making.

Enterprises in their start-up phase often underestimate risks or even ignore them completely (Smith, 1998). Start-up SMEs usually face a high degree of uncertainty and the necessity to make quick decisions (Frese et al., 2000).

Empirical studies show that the attitude of SMEs towards risks and their risk assessment differs significantly from that of large enterprises. Since risk considerations in SMEs take place in a more holistic way, elaborate mathematical methods for risk evaluation should be avoided.

Risk management practices in small firms relate to the beliefs and attitudes of founding entrepreneurs. SMEs do not tend to use special techniques to optimize single risks. They make decisions in terms of their business as an entity rather than in terms of managing specific risks. Despite having performed some form of risk identification and evaluation, small business owners may simply ignore a particular risk (Sparrow, 1999; Sparrow and Bentley, 2000).

## **Risk Management**

In large German enterprises, primarily the board of directors and secondly a special risk manager (probably leading a separate risk management function) are reported to be responsible for risk management. In more than half of the large enterprises internal audit is responsible for supervising and reviewing risk management. Concerning risk identification and evaluation, large enterprises primarily name designated employees of business units; then management and risk managers follow (PwC, 2000).

According to Reichmann and Diederichs (2003) and KPMG (2000), large enterprises use to review their risks annually or quarterly. The risk monitoring horizon in large enterprises is about 2 to 5 years. KPMG (2000) found out that 77 per cent of all large enterprises have established a direct integration of risk management into their business planning. The majority of large enterprises come to investments for their risk management system of 50.000 Euro to 250.000 Euro (Fischer; 1999). A recent study of the Federation of European Risk Management Associations et al. (2004) reports that in Germany the main activities of the questioned large enterprises consist of implementing and embedding their risk management process.

A fundamental study of Turpin (2002) examines the state of risk management in SMEs of various European countries, including Germany. This is the only empirical investigation on current risk management practices in SMEs. Unfortunately, its focus is on the specific characteristics of insurance. Moreover, the size classes of micro and small firms are neglected. Turpin also states that 4 out of 10 enterprises have no official risk strategy, which is due to problems of communication and of delegating risk management competencies to employees. In European SMEs the five most frequently mentioned risk are: increasing competition, loss of employees to competitors, changing customer demands, wrong strategies due to lack of market data and personnel absence rate.

According to Turpin (2002) in Germany 60 per cent of the surveyed enterprises review their risks monthly, 24 per cent quarterly. Then 9 per cent with reviewing if required and 4 per cent with reviewing every 6 months follow. The large proportion of monthly reviewing may be a consequence of the enterprise size; the study covers SMEs up to 500 employees, which is far beyond the classical definition. Summarizing, only few German enterprises could answer

detailed questions concerning the structure of their risk management and their actual risk position.

Eck et al. (2000) is the first study that concretely implements a direct connection between risk management and business planning, a central element of the framework of Figure 1. The authors present a simulation model for financial planning, that had been extended to include risk management aspects. They have carried out a case study with a construction enterprise where their system had been implemented. The cited financial planning model uses as a pre-system an integrated planning system in the form of a master budget. Omitting the technical details, Eck et al. indicate how risk considerations can be handled by this simulation model. There is no precise description how the entered risk data are processed within the planning model.

The approach of Eck et al. assumes that an enterprise has already established a comprehensive business planning system. Regarding SMEs, it must be investigated whether this assumption is justified. The simulation system may be easy to apply, but establishing and customizing it seems to be a complicated process. The empirical testing of the system has taken place within only one firm. Finally, the model of Eck et al. does not consider qualitative risks.

SMEs identify two barriers to risk assessment: time pressure and access to suitable guidance.

The time commitment associated with the various aspects of risk assessment is mentioned by a majority as being problematic. Given access to appropriate guidance and information, SMEs can implement risk assessment effectively (O'Hara et al., 2005).

## **Business Planning**

Planning in small-scale enterprises is related to success only in cultures that value uncertainty avoidance. Germany is such a country with high uncertainty avoidance. In Germany, the quality of planning is positively related to success. Business planning is considered to be an important instrument to achieve success. SMEs judge business planning as a useful instrument to deal with uncertainties (Rauch et al., 2000).

In general, Weber (2000) claims that the literature shows that business planning in German SMEs is not carried out in great detail. Planning has a rather short time horizon. Comparing planned and actual values and analyzing deviations takes place rather seldom. Often business plans are not written but only fixed in the mind of the owner-manager. Risk aspects do not occur in business planning.

In order to expand, SMEs heavily rely on external funding sources for their support, and these sources usually impose planning requirements on the firm (Matthews and Scott, 1995).

Peel and Bridge (1998) stated that many SMEs use strategic thinking and planning techniques only in critical circumstances. The more turbulent the environment is, the more strategic planning is a success factor. Those enterprises that used strategic planning had a better financial performance.

Buchner and Weigand (2002) propose that business planning systems can support the identification of risks effectively, the systems' forecast options being particularly helpful.

## **Balanced Scorecard**

Nørreklit (2000, 2003) critically analyzes the key assumptions and relationships of the BSC, as introduced by Kaplan and Norton (1996). The author thinks the BSC to be a good alternative to the classical financial control instruments. She emphasizes two essential weaknesses where the BSC needs improving to become an optimal performance measurement system: one weakness is that there are no time perspective considerations.

On the other hand, business planning admits strategic (i.e. long-term) and operational (short-term) considerations. Thus, in the opinion of the author of this paper, establishing a close connection between the BSC and the business planning system can overcome the cited weakness with respect to the time dimension.

According to the experiences of Chow et al. (1997), the BSC is, until now, used mainly in large companies. External and internal scanning is stated to be an important task to deliver information for the BSC. Using the BSC for risk management is only mentioned implicitly. A detailed description of a link between risk management and the BSC is lacking.

Geiger and Hermann (2003) established a BSC in some German SMEs. They recommend to chose distinctly less than 20 strategic objectives since – compared to large enterprises – in SMEs the company organization is less complex. Having fewer strategic objectives means at the same time concentrating on essential contexts and easier manageable actions. In their day-to-day operations, SME treat strategic considerations rather poorly. The BSC may contribute to the aim that strategy revision and strategy translation become a natural and permanent process.

Rossmann and Kabela (2004) introduced a BSC in a small enterprise and report the following improvements: operationalization and effectiveness when formulating strategic objectives, concentration on fundamental business processes, reduction of reporting to essential target figures and improvement of internal communication. The authors recommend to develop the BSC by workshops of management and designated employees. In this way a common understanding of strategic objectives and strategies can be achieved.

## **RESEARCH METHOD**

To investigate the current risk management practices of German SMEs, as a first step a questionnaire survey has been carried out. The use of a questionnaire was preferred to rapidly obtain data at relatively low costs. The questionnaire was designed along the lines of the general risk management framework of Figure 1.

At the beginning of developing the questionnaire, discussions with experts had been held, such as university lecturers and risk management specialists of two international auditing and consulting firms (both firms also work for medium-sized enterprises). Furthermore, 10 interviews with German SMEs had been performed.

Subsequently a test pilot study was carried out in the form of an online questionnaire. About 170 German SMEs have been contacted by e-mail requesting them to fill it in. This led to the return of 28 usable questionnaires. The results of the pilot study were not included in the evaluation of the main mailing action.

To gain an overview of the number of SMEs in different industries, the German Value Added Tax statistics (VAT; Statistisches Bundesamt, 2004) have been referred to. These statistics are

divided into industries in accordance with the standard industrial classification, namely the Nomenclature Activity Classification Europe (NACE code). Regarding all enterprises with annual turnover up to 50 million Euro (these statistics do not allow another classification using the number of employees) shows that the industries of construction, engineering, information technology, auditing/consulting/training and service/logistics together make up about 60 per cent out of a total of about 3 million enterprises. The questionnaire of this study addresses German SMEs of just these five industries.

As a source to draw the questionnaire sample from, the Hoppenstedt (2000) SME database was used. This database is annually updated and contains information about c. 200,000 German SMEs; it is the largest SME database in Germany, and it is also classified according to the NACE code. By the technique of cluster sampling, all enterprises with a number of employees up to 250 and an annual turnover up to 50 million Euro within the above five industries were selected. This led to a mailing list with a total of 1,292 SMEs.

To improve the response rate, a freepost envelope and a coupon to order the results of the study were attached to the mail. It was decided not to carry out a follow-up for the mailing action. Newby et al. (2003) and Dennis (2003) found out that, in the case of SMEs, a follow-up does not lead to an improvement of the response rate. Crucial for a good response rate is that a questionnaire deals with issues that are interesting for SMEs.

A total of 304 questionnaires had been returned making up 24 per cent of those sent out. The number of usable questionnaires returned by enterprises having at most 250 employees was 240, which is a response rate of 19 per cent. This response rate is in line with other SME studies (Clink, 2001).

35 questionnaires were returned with some remarks about why they had not been filled in. Most frequently it was stated that the enterprise had already been closed or was insolvent. Less frequently “Filling in not wanted.” was returned. Another reason for not filling in was that the respondent may not meet the research requirements: “No SME, but part of a group”. This is due to the effect that, at the time of survey, the Hoppenstedt database was slightly out of date.

The questionnaire format is highly structured. Close-ended questions facilitate the evaluation. A multiple choice approach helps the respondents to give the applicable answers. There are two fundamental types of questions: those that demand exactly one outcome to be selected and those that allow multiple selection.

Evaluating the questionnaire results depends on the type of scale by which they can be appropriately encoded. On the one hand, there are nominal scales (e.g. industries). On the other hand, there are metric scales (e.g. number of employees). As usual, outcomes measured by metric scales are grouped into classes (in the case of the number of employees this is done in accordance with the classical enterprise size classes). And then there are many questions where the possible outcomes have an intrinsic ranking, like good / intermediate / bad (see, for example, the link of risk management to business planning in Table 7, where good = direct integration / intermediate = no direct integration / bad = no link at all). Encoding the outcomes of such questions by integer numbers corresponding to their “natural” ranking (for example, 2 / 1 / 0) leads to ranking scales, that can be treated as a special case of metric scales. Finally, dichotomous (“Yes / No”) questions are encoded in the usual way by the numbers “1 / 0”.

The outcomes of single questionnaire results are treated by means of descriptive statistics. When discussing whether certain questionnaire outcomes depend significantly on enterprise size,

Pearson's correlation coefficient  $r$  is computed (which, at least, needs ranking scales). Here, when the significance of these correlation results is estimated, inferential statistics comes into play. Deriving from  $r$  (by means of Student's  $t$ -distribution) a corresponding  $p$ -value, the significance can easily be obtained (see Tables 9 and 10).

## RESULTS

For the sake of clarity, the following frequency tables of the questionnaire results contain only the summarized proportions of all SME responses. Interesting results referring to details of the size classes of micro firms, small firms and medium-sized firms are mentioned additionally within the comments.

### Basic Enterprise Data

The main industries of German SMEs addressed by the questionnaire have the following distribution:

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Table 1 Response by industries

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The dominating industries are engineering and construction, each with about 1/3 of the respondents. The other three industries each make up about 10 per cent.

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Table 2 Response by enterprise size

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With more than 80 per cent the size class of medium-sized firms is clearly dominating, while micro firms are underrepresented. The original employee data have an average of 85.7 employees per enterprise.

### **Business Planning**

Only one third use a master budget (integrated system), which shows that business planning in SMEs is often carried out in a rather rudimentary form. In other words: their business planning does not correspond to the classical model. The budgeted profit statement is used most frequently. A cash budget is applied by about 1/3. This is questionable because many SMEs have problems with their liquidity and with managing their finances and are in danger of becoming insolvent. Balance sheet planning has no meaning for SMEs. It is generally accepted that business planning is basic for a risk management system. Hence business planning must be improved.

It is interesting that in the size class of micro firms only 12.5 per cent (1 out of 8) use a master budget. 37.5 per cent do not even make any statement about planning, which means there might be no formal planning system at all.

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Table 3 Business planning systems

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Concerning the time aspect of business planning, a short planning horizon dominates. On the one hand, SMEs work in small market segment or niches where large firms do not want to offer

products. Therefore SMEs must continuously watch market changes and cannot plan for the long term. On the other hand, SMEs must adapt to the customer needs more rapidly.

In the class of micro firms the planning horizon of 50.0 per cent is one year. It is remarkable that within this class often no statement was made (16.7 per cent). A size effect is recognizable: In the classes of medium-sized firms a planning horizon of 4-5 years most frequently occurs.

### **Risk Management**

Most of the respondents report the board of directors as responsible for organizing risk management. Then the controlling department and the chief financial officer follow. Only very few have a special risk manager, i.e. risk managers have no practical meaning for SMEs.

Because of the strong link between the owner-managers' well-being and that of their enterprise, in most cases in SMEs the management is responsible for risk management. The owner-manager's own best interests are the handling of risks. The extent and the quality of risk management in SMEs widely depend on how much time the owner-manager invests in the development and implementation of an official risk strategy and how it is communicated to the respective employees.

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Table 4 Responsibilities for risk management

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Concerning the supervision and review of the risk management system, within all SME size classes, the board of directors also dominates, confirming that risk management in SMEs is orientated towards the owner-manager. Then controlling department follows, showing a distinct

domination within the class of medium-sized firms. The internal audit has no meaning for supervising and reviewing SMEs risk management.

The documentation of the risk management process is mostly contained in the general procedural manual. Other statements such as documentation within the quality manual or the minutes of board meetings nearly make up the same proportion of about a quarter. A special risk management manual or documentation has not an issue for SMEs. It is interesting that 60 respondents (out of 227) made no statement at all, which again makes up about a quarter.

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Table 5 Risk categories

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The most important risk categories are market risks, strategic risks and business process risks. Financial risks – presumably from liabilities and credit worthiness – follow. Financial risks can extend to many other types of risk: risks from interest rates, exchange rate movements and the value of investments, for example. Acting on the domestic market and working with fixed interest rates, all these risks are of no importance for German SMEs (see Dutta and Evrard, 1999; Müller et al., 2004). A clear size effect can be recognized: with increasing size the enterprises deal with more risk categories.

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Table 6 Risk identification and evaluation

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Risk identification and risk evaluation is concentrated on management alone and on management together with departments. The controlling department follows, the medium-sized firms strongly

dominating within the sizes classes. In micro and small firms the identification and evaluation of risks is clearly concentrated on management, being in accordance with the results concerning risk management responsibilities (see Table 4).

Most enterprises review their risks quarterly (in contrast to the domination of monthly reviewing, as reported by Turpin, 2002). The other frequencies of risk review (every year, every 6 months, every month, other period) are approximately uniformly distributed. In the class of micro firms, 25.0 per cent of the questioned enterprises review risks every 6 months, and 62.5 per cent of them have filled in “other period” (such as: current, as required, depending on the risk).

The time horizon of risk reviewing concentrates on a short-term period of 1 to 2 years (more than 2/3). It is interesting that 13.7 per cent have chosen the option “Open”. Fixing no period for risk review indicates that risk management is not carried out very systematically. Rather short periods correspond to the results considering long-term business plans (see Table 3). Short-term review cannot perceive strategic risks in time. Since 2/3 assert to deal with strategic risks, this cannot be carried out in a very systematic way. In the class of micro firms the time horizon for risk review is extremely short-term (1 year). Here even 37.5 per cent state their risk review to be open.

Management is informed about risk within the general reporting system (72.6 per cent). A separate risk reporting has no importance for SMEs (8.7 per cent).

About two third of all SMEs use standard business software for their risk management (such as MS Excel, MS Access). Standard business administration software comes second, and in-house software comes third. Special risk management software is used by only 3.0 per cent. The low degree of automation and interlinking of risk management solutions by standard business

software leaves risk communication to the initiative of the employees. There are problems to coordinate information and thus to give management an overview of the current risk position. Because of high cost and the request with respect to technical know-how risk management software for SMEs is out of the question.

Two third of the enterprises have made no investment to establish or to improve their risk management. This clearly shows that SMEs do not want to spend additional money for establishing or developing a risk management system. Hence a risk management model being acceptable for SMEs must get along without additional investment cost and be linked into the existing information technology.

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Table 7 Link of risk management to business planning

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Only 1/3 of the surveyed cases showed a direct link between risk management and business planning. This means, that 2/3 of the SMEs are not able to determine the effect of risks on the target figures for profit and liquidity. The results suggest that the questioned enterprises perform risk management in a rather simple and not very comprehensive way. Combining risk management and business planning is clearly favoured but the decisive step to a direct integration of risk into the business planning still has to be done. Since SMEs in their founding phase show an increased danger of becoming insolvent (Bretz, 2003; Günterberg and Kayser, 2004), such a step would be an important measure of preventing business failure. In the class of micro firms, a direct link of risk management and business planning is developed in the weakest way, and in the class of micro firms it is stated very frequently that there is no link of risk

management and business planning at all (37.5 per cent). Both results may be up to the business planning being not very detailed (see Table 3).

### **Balanced Scorecard**

The use of the Balanced Scorecard is surveyed in two directions: firstly, its general use as a comprehensive measurement system, and secondly, its specific use for risk management purposes. 28.1 per cent of the enterprises already use the BSC or plan to use it. Hence SMEs show great interest in the BSC, in contrast to their behaviour with respect to other management concepts being proposed by business administration literature. It is pointed out that about half of those 25 enterprises already using the BSC employ it for risk management purposes. Here a questionnaire survey cannot determine the details how SMEs use the BSC for their risk management. Considerably few micro and small firms use the BSC.

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Table 8 Use of Balanced Scorecard

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### **Correlations**

To detect significant size effects, some important questionnaire results have been correlated with the enterprise size, as measured solely by the number of employees (see Introduction). To compute Pearson's correlation coefficient, the size classes of micro firms, small firms and medium-sized firms have been used, where the latter has been divided into further subclasses.

A correlation is called to be of type 1 if it relates enterprise size with the outcomes of a question that demands unique selection from the options it offers.

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Table 9 Some correlation coefficients of type 1

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Risk management: Risk review frequency, risk review time horizon and the integration of risks into the business planning all do not depend significantly on enterprise size. In contrast to what one would expect, with increasing enterprise size risks are not reviewed more frequently, the time horizon of risk reviewing is not longer, and there is no tendency that risks are linked to the business planning or even directly integrated into it. The reason is that – independent of the size of SMEs – there is no risk management framework being suitable for them.

Balanced Scorecard: With increasing size enterprises significantly tend to use the BSC or at least plan to use it. On the other hand, the use of the BSC for risk management purposes does not depend on enterprise size (it is emphasized that this second result is based on a relatively small total number).

A question allowing multiple selection from the options it offers can be viewed as a set of independent “Yes / No” options. A correlation is called to be of type 2 if it relates enterprise size with the outcome of one single (dichotomous) option of a question that allows multiple selection.

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Table 10 Some correlation coefficients of type 2

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Responsible for risk management: The influence of the Board of Directors decreases with increasing company size. A reason is that larger enterprises may have more competent employees to take on these tasks and that from a certain size on risk management becomes too

complex to be performed by the Board alone. In addition, with increasing size a designated risk manager and the controlling department with high significance both become more important for risk management. Finally, with increasing size companies report other persons as responsible for risk management; internally they name quality management representatives, and externally they are supported by chartered accountants or management consultants.

Risk categories: Among all risk categories considered, group company risks are the only ones that significantly depend on enterprise size: With increasing size, these risks are considered by more enterprises. Larger enterprises are more likely to be involved in investments in a company which needs an appropriate controlling of investments and risk assessment.

Risk identification and risk evaluation: The influence of management decreases with increasing company size (high significance). Conversely, with increasing size the influence of the controlling department increases, and other ways of risk identification and evaluation are considered more frequently (with the same specifications for internal and external support as in the section “Responsible for risk management”). Again this shows that larger enterprises tend to take advantage of external advice.

## **CONCLUSION**

The questionnaire results have shown that risk management in German SMEs is clearly orientated towards the owner-manager. It is carried out in a rather unformalized way. Any risk management approach must take into account that SMEs have limited personnel and financial resources and are not willing to carry out high investments.

The business planning of SMEs needs substantial improvement. It is stressed that a comprehensive business planning system is the prerequisite for a sound risk management. A direct link between risk management and business planning is found seldom. Hence most SMEs are not able to determine the total risk position of their enterprise and to estimate the effect of the risks being identified on the target figures for profit and liquidity.

For micro firms and small firms the Balanced Scorecard yet has no meaning. Medium-sized firms, however, are open-minded with respect to it. Despite its well-known weaknesses, the BSC, in connection with business planning, could become an instrument for risk identification and risk evaluation that is suitable for SMEs.

To overcome their deficits with respect to risk management, German SMEs firstly must make an effort to improve their business planning. This is in their own best interests, since in this way they reduce their danger to become insolvent, thus saving their business. In addition, new legal regulations (e.g. Basel II rules; 2003) of SMEs require comprehensive planning systems. It must be emphasized that German SMEs to a large extent are funded externally (Hall, 2004) and that the banks' lending policy makes great demands on the development of the enterprises' business planning.

The questionnaire survey led to interesting results that need further investigation. In 2005 research interviews with some German SMEs will be held to deepen the understanding of the results and to inquire details that a questionnaire survey cannot produce. Special focus will lie on the following aspects:

- How is the business planning organized in detail? If there is a link of planning with risk management: In which form are risks mapped into the business planning?

- What are the reasons for using or not using the Balanced Scorecard? What is the general understanding of this concept and the various possibilities of implementing it?

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## TABLES AND FIGURE

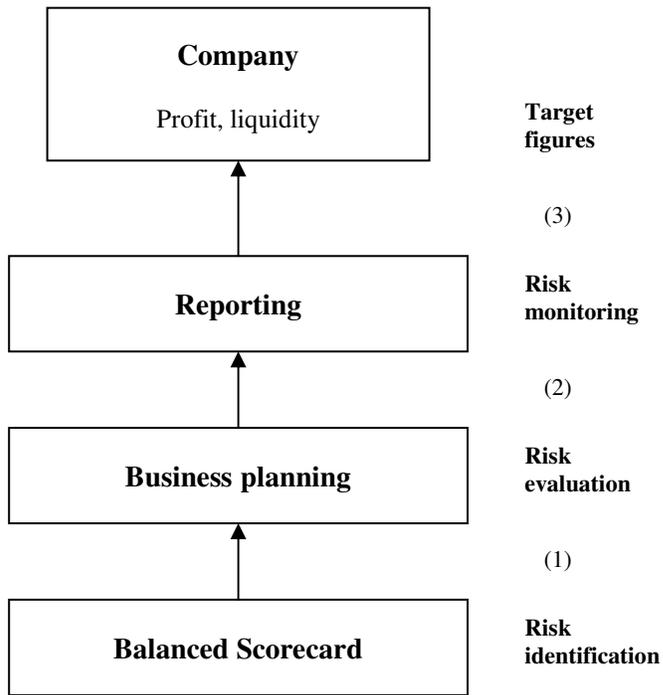


Figure 1 Risk management framework

Table 1 Response by industries

|                                  |             |
|----------------------------------|-------------|
| Construction                     | 78<br>32.5% |
| Engineering                      | 81<br>33.8% |
| Information technology           | 26<br>10.8% |
| Auditing/consulting/<br>training | 28<br>11.7% |
| Service/logistics                | 27<br>11.3% |
| Total                            | 240         |

Table 2 Response by enterprise size

|  |              |
|--|--------------|
| Micro firm<br>(up to 9 employees)                        | 8<br>3.3%    |
| Small firm<br>(10 to 49 employees)                       | 33<br>13.8%  |
| Medium-sized firm<br>(50 to 250 <sup>1)</sup> employees) | 199<br>82.9% |
| Total  | 240          |

<sup>1)</sup> Firms with 250 employees  
are counted as medium-sized.

Table 3 Business planning systems

|   |              |
|---|--------------|
| Budgeted profit statement <sup>1)</sup> | 117<br>48.8% |
| Cash budget <sup>1)</sup>               | 77<br>32.1%  |
| Budgeted balance sheet <sup>1)</sup>    | 32<br>13.3%  |
| Master budget                           | 67<br>27.9%  |
| Other planning                          | 16<br>6.7%   |
| No statement                            | 26<br>10.8%  |
| Total                                   | 240          |

<sup>1)</sup> Multiple selection allowed

Table 4 Responsibilities for risk management

|                               |              |
|-------------------------------|--------------|
| Board of Directors            | 210<br>92.5% |
| Controlling department        | 76<br>33.5%  |
| Chief financial officer       | 73<br>32.2%  |
| Head of accounting department | 32<br>14.1%  |
| Staff of business units       | 31<br>13.7%  |
| Designated risk manager       | 8<br>3.5%    |
| Internal audit                | 4<br>1.8%    |
| Other                         | 13<br>5.7%   |
| No statement                  | 0<br>0.0%    |
| Total                         | 227          |

Multiple selection allowed

Table 5 Risk categories

|                            |              |
|----------------------------|--------------|
| Market risks               | 163<br>70.6% |
| Strategic risks            | 141<br>61.0% |
| Business process risks     | 124<br>53.7% |
| Financial risks            | 87<br>37.7%  |
| Legal risks                | 75<br>32.5%  |
| Corporate governance risks | 70<br>30.3%  |
| Group company risks        | 23<br>10.0%  |
| Other risks                | 4<br>1.7%    |
| No statement               | 4<br>1.7%    |
| Total                      | 231          |

Multiple selection allowed

Table 6 Risk identification and evaluation

|  |              |
|--|--------------|
| By management together with departments    | 116<br>50.2% |
| By management alone                        | 93<br>40.3%  |
| By controlling department                  | 90<br>39.0%  |
| By designated employees of business units  | 55<br>23.8%  |
| Inquiries by questionnaires or check lists | 25<br>10.8%  |
| By workshops with business units           | 20<br>8.7%   |
| By internal audit                          | 7<br>3.0%    |
| Other way                                  | 4<br>1.7%    |
| No statement                               | 1<br>0.4%    |
| Total                                      | 231          |

Multiple selection allowed

Table 7 Link of risk management to business planning

|   |             |
|---|-------------|
| Direct integration of risk figures      | 77<br>35.2% |
| No direct integration of risk figures   | 91<br>41.6% |
| No link to the business planning system | 51<br>23.3% |
| Total                                   | 219         |

Table 8 Use of Balanced Scorecard

|                              |              |
|------------------------------|--------------|
| Used                         | 25<br>11.3%  |
| Used for risk management     | 13<br>5.9%   |
| Not used for risk management | 12<br>5.4%   |
| Planned to use               | 37<br>16.7%  |
| Not planned to use           | 159<br>71.9% |
| Total                        | 221          |

Table 9 Some correlation coefficients of type 1

| Questions correlated with enterprise size | Total N | Pearson's r | p-value | Significance |
|---|---------|-------------|---------|--------------|
| <u>Risk management</u>                    |         |             |         |              |
| Risk review frequency                     | 227     | 0.055       | 0.408   | -            |
| Risk review time horizon                  | 226     | 0.002       | 0.976   | -            |
| Risk integration into business planning   | 219     | -0.029      | 0.667   | -            |
| <u>Balanced Scorecard</u>                 |         |             |         |              |
| Use of BSC                                | 221     | 0.281       | 0.000   | ***          |
| Use of BSC for risk management            | 25      | 0.105       | 0.617   | -            |

\*\*\* significant at the 0.01 level  
 \*\* significant at the 0.05 level  
 \* significant at the 0.1 level

Table 10 Some correlation coefficients of type 2

| Questions, each of their option correlated with enterprise size | Total N | Pearson's r | p-value | Significance |
|---|---------|-------------|---------|--------------|
| <u>Responsible for risk management</u>                          |         |             |         |              |
| Board of Directors  | 227     | -0.119      | 0.075   | *            |
| Controlling department  | 227     | 0.192       | 0.004   | ***          |
| Chief financial officer   | 227     | -0.031      | 0.642   | -            |
| Head of accounting department                                   | 227     | -0.042      | 0.525   | -            |
| Staff of business units   | 227     | 0.053       | 0.423   | -            |
| Designated risk manager   | 227     | 0.205       | 0.002   | ***          |
| Internal audit  | 227     | 0.040       | 0.550   | -            |
| Other   | 227     | 0.162       | 0.015   | **           |
| <u>Risk categories</u>  |         |             |         |              |
| Market risks  | 231     | 0.023       | 0.730   | -            |
| Strategic risks   | 231     | -0.069      | 0.297   | -            |
| Business process risks  | 231     | 0.014       | 0.837   | -            |
| Financial risks   | 231     | -0.012      | 0.858   | -            |
| Legal risks   | 231     | -0.053      | 0.423   | -            |
| Corporate governance risks                                      | 231     | -0.021      | 0.746   | -            |
| Group company risks   | 231     | 0.121       | 0.067   | *            |
| Other risks   | 231     | -0.041      | 0.536   | -            |
| No statement  | 231     | 0.103       | 0.117   | -            |
| <u>Risk identification and risk evaluation</u>                  |         |             |         |              |
| By management together with departments                         | 231     | 0.056       | 0.394   | -            |
| By management alone   | 231     | -0.196      | 0.003   | ***          |
| By controlling department                                       | 231     | 0.140       | 0.034   | **           |
| By designated employees of business units                       | 231     | 0.007       | 0.921   | -            |
| Inquiries by questionnaires or check lists                      | 231     | 0.089       | 0.177   | -            |
| By workshops with business units                                | 231     | 0.008       | 0.898   | -            |
| By internal audit   | 231     | -0.091      | 0.166   | -            |
| Other way   | 231     | 0.153       | 0.020   | **           |
| No statement  | 231     | -0.022      | 0.740   | -            |

\*\*\* significant at the 0.01 level  
 \*\* significant at the 0.05 level  
 \* significant at the 0.1 level

**ACTIVATING HIGH-TECH START-UPS:  
TESTBED AS A MEANS OF SME R&D AND BUSINESS ACCELERATION**

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# **ACTIVATING HIGH-TECH START-UPS: TESTBED AS A MEANS OF SME R&D AND BUSINESS ACCELERATION**

## **Abstract**

The present study used competence block theory to study if an open testbed could accelerate mobile service development, testing and business activities of high-tech start-ups in Finland. In the study it was analysed if the six categories of actors presented by the competence block theory are present in the Octopus actor network and are they taken into account in Octopus service. The analysis showed that in Octopus actor network the customers are poorly present. One of the big problems from the start of the project has been how to get the customers of mobile services to participate in the Octopus project. Innovators are quite well present in the network. The developer companies have very good competence in developing innovative new technological solutions that integrate technologies in new ways. At the start of the Octopus project there were fairly *few entrepreneurs* that would identify profitable innovations and develop them further into marketable service products. After two years of operations these actors were somewhat greater amount and they were more visible to innovators. Competent venture capitalists were virtually non-existent when the project started. After two years the venture capitalist actor category is slightly better present in the network while a few public venture capitalists are begun partnering with the Octopus project. The fifth category, exit markets, is somewhat out of scope of the Octopus project. While not concentrating on finding exit markets Octopus has however in some very few cases helped a service developer to find a new owner for service product. The last category is present as the core partner involvement in the project. The core partner Nokia can be regarded as an industrialist willing to take successful innovations to markets through Nokia's own delivery channels.

## **1. Introduction**

This paper provides an overview of a unique approach to accelerate mobile service development, testing and business activities of high-tech start-ups in Finland. The Octopus program, an open innovation, development and testing environment for mobile applications joins together the needed industrial, educational and governmental players to provide elements needed to bring new mobile services from innovation to business. The core of Octopus is a live testing environment (Octopus test-bed) that can be used by anyone interested in developing mobile services whether it's a company, research institute, individuals or groups of students. In addition to the testing environment, Octopus provides valuable services for its customers and partners. Services, such as

development, testing and business support, cover every phase of product development and launch process. One of the key advantages of Octopus is the open network of actors that cooperate to create added value for the cluster members.

The objective of the present study is to explore value creation in a new and emerging context of technology intensive services. The aim is to understand the value created and perceived by the cluster of mobile service providers, developers and operators. In addition, this study aims at conceptualising the different time-related aspects of value in the specific context of technology intensive services. The research method of the study is explorative longitudinal case study.

Information and telecommunications technology has changed the way people communicate, work and spend their leisure time. Telecommunications and information technologies are converging into a seamless communications infrastructure that is based on IP technology and ubiquitous services. These technologies have brought many new services and applications that people use to either increase productivity at work or enrich their everyday life at spare time. Mobile communications is still mainly voice calls and messaging but the convergence of information technology and mobile communications together with the technological development of mobile phone platforms, communications standards and protocols enable possibilities for new value added services and new business. To take advantage of the emerging markets entrepreneurs, start-ups and pre-established companies need information about the new technological possibilities, service ideas, tools to create and test services and business models.

## **2. Theoretical framework**

The present explorative case study can be described by the competence block theory and model of an experimentally organized economy presented by Carlsson (2003). Companies that develop or distribute mobile services, finance the development or their business is otherwise dependent or

linked to mobile services, constitute a competence block that is driving the mobile service business. Octopus environment can be seen as a safe environment where the new technologies and innovations can be tested without a fear of technological or business mistakes. Octopus is a place for learning, creating competence and using it for business opportunity creation.

Carlsson (2003) also presents six categories of actors that are present in the competence block: 1) customers, 2) innovators, 3) entrepreneurs, 4) venture capitalists, 5) exit markets and 6) industrialists. It is assumed that these categories exist within mobile services competence block and this paper includes a preliminary evaluation of the actor categories that are present in Octopus environment and service network. The evaluation considers only whether the categories are present or not. A deeper analysis of each actor category and evaluation of the how well are they functioning in light of the overall results of the project would be a further study that is yet undone and is therefore not included in this paper.

### **3. Octopus-testbed**

**Origins.** Telecommunications technology, mainly network technology and mobile phones, has for about fifteen years been one of the main industries in Finland. Highest market growth was achieved in the late 90's after which the growth stagnated due to the delay in 3<sup>rd</sup> generation mobile networks and the overpriced 3G licenses in Europe. When telecommunications network infrastructure and mobile phones were not enough to maintain business and economy growth there was a need to develop mobile services and content that would create new business and also drive the investments for 3G mobile infrastructure and mobile phones. The innovative competitiveness of firms and the Finnish ICT-sector would be improved by introduction of previously unavailable mobile services to existing or completely new markets (Rouvinen 2002).

The government of Finland and the city of Oulu share the same interests in increasing

employment and economical growth, and mobile service business have been seen as a great opportunity to increase – or at least sustain – both. Plain market volume and business development has been too slow to take the mobile service business into growth curve therefore there's a need to accelerate the service development. The acceleration effect can be achieved in different ways. The government can e.g. provide funding for industries and companies that have high growth potential or take even more active role. The industry has formed alliances (e.g. 3GPP, Open Mobile Alliance) that aim to create common sets of open standards and protocols that enable developers of mobile services to distribute their applications to the widest possible markets. Large companies with a lot of resources can create their own developer support organizations, processes (e.g. Nokia Forum) and delivery channels.

To accelerate the mobile service business the city of Oulu took the industry initiative and started a partially EU-funded development project with other a few core partners in spring 2002. Three of the core partners were companies: Oulu Telephone Company, Nokia and Technopolis, and one of them was an educational partner: Oulu Polytechnic. The development project aimed at creating and maintaining a live mobile development and testing environment for mobile services that would later become a privately owned company that would cover expenses of its own. The first two years was partially public funded. Other part of funding came from the core partners and customer revenues. In the next chapters the history and properties of Octopus project is described in general, and the challenges met are analyzed.

**The history.** The idea for a development and testing environment for mobile services was born in year 2001. Certain interest groups in Oulu area got together and created a project plan and funding model for an ambitious project, which was later named as the Octopus project. When funding from Northern Finland's Innovative actions EU-program was approved in spring 2002, the project started in September 2002. The first phase of the Octopus project was the pilot phase, which was carried out with five selected pilot customers – various mobile application developers that were

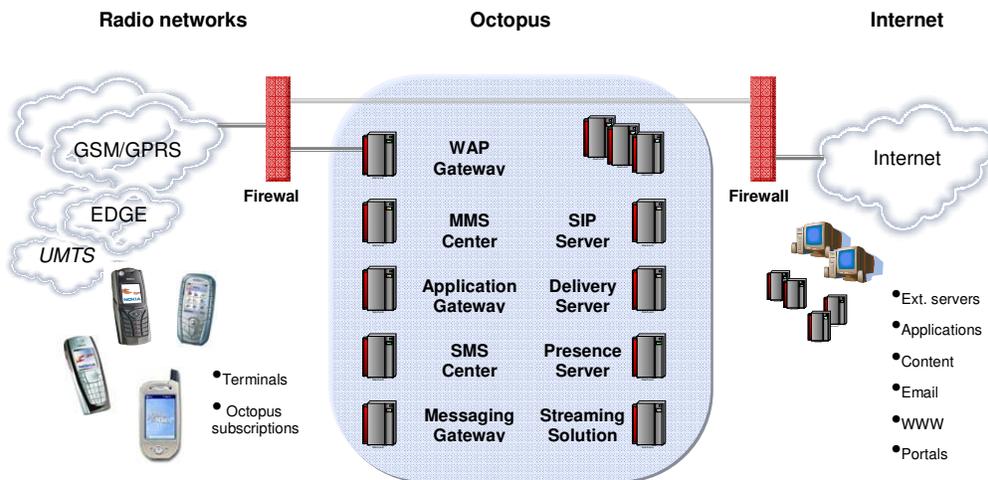
interested in using the Octopus environment to develop and test their services. Pilot phase was necessary for the Octopus project to create and test out the customer processes needed to run an independent mobile testing network. After the successful pilot phase Octopus gained a lot of good publicity in Finland. Marketing of the development and testing environment started and the first customer contracts of the Octopus project were signed during autumn 2003. Also most of the pilot customers signed testing contracts after their successful pilots.

The second phase of the testing environment was up and running in summer 2003 with new technology enablers. After the summer the first success stories were published and the testing network was already in use by many companies, research and educational organizations. The technical environment has been constantly updated with the newest technology to enable the mobile application developers to gain the best possible time-to-market. During the year 2004 one new core partner was announced when TeliaSonera, a northern European teleoperator, joined the Octopus project. By connecting TeliaSonera's radio network to Octopus environment Octopus was able to provide two alternative radio networks and an international coverage for mobile application developers. By the end of the year 2004 there were close to 40 direct Octopus customers and about a few tens of partner organizations in the Octopus network. From year 2005 Octopus continues its' operations with about the same funding structure as before.

**Octopus testing and development environment.** Octopus provides a stable mobile development and testing environment in live radio network that can be utilized by companies, individuals and educational and research organisations developing innovative mobile services and systems. The environment consists of technologies that are already available but also some advanced technologies unavailable in commercial telecommunication networks. The technology is constantly updated with the newest technology to give the developers an edge to their competitors.

The core of the Octopus is the development and testing environment in a live radio network. Octopus technology enablers create a closed cluster of servers (hardware and software) that can be

used with special mobile subscriptions, which have access through the dedicated access point in the radio network and the firewall protecting Octopus servers from unauthorized access. The mobile subscriptions that have access to Octopus servers are called Octopus test subscriptions and these subscriptions don't have access to commercial network services other than GSM and GPRS/EDGE. Connections to and from Octopus subscriptions can only come from other Octopus subscription, Octopus servers or servers connected to Octopus environment. However, with TeliaSonera commercial subscriptions (to which access to Octopus environment have been established) the normal commercial mobile connections together with Octopus testing connections are both available. The above is illustrated in Figure 1.

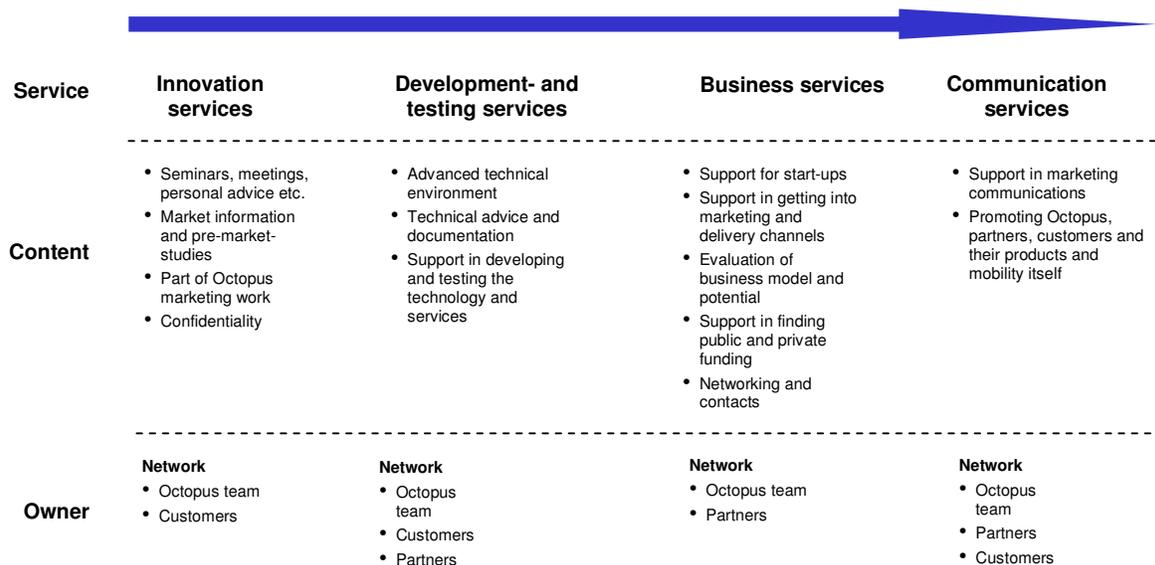


**Figure 1.** Octopus architecture.

In addition to the technology there are also different services that Octopus provides to customers and core partners. Services cover the whole range from idea generation to the product launch. The provider of the services varies depending on the type of service and the subject at hand. Octopus provides testing and development services, which include testing support, configurations

of the Octopus servers, connecting external servers, terminal settings and log tracing for errors. Octopus also provides consultative support for individuals, start-ups and new businesses in starting and developing their mobile business. This is done in cooperation with the wide network of other companies, organisations and the public sector. The Octopus network of actors consists of many local/national/global large/sme companies in the fields of telecommunications, IT, media and other, local and national incumbents, educational and research institutes. Octopus cooperates also with other testing environments, e.g. Rotuaari, DIMES, Testplatz Botnia and NEWT, to bring more possibilities for testing and development activities of the customers. Through deep cooperation with the core partner Oulu Polytechnic Octopus provides training in the field of mobile service development.

Octopus project operations are run by a small group of professionals. The team consists of various types of expertise: technical, marketing, communications etc. in an attempt to cover all the services offered. The network of partners and interest groups are also taking part in the delivery of these services. The figure 2 below summarizes Octopus service portfolio, the contents of the services and the responsible actor for the service delivery.



**Figure 2.** Network of services from innovation to business

**Challenges.** During the Octopus project many challenges have been faced. Most of them are due to the nature of project: starting up and developing something that had not been done before. New technology itself poses many challenges most of which are unexpected. Other challenges are related to funding, operational and service structure, and marketing.

Octopus acts as a pilot operator for Nokia, a world's leading network equipment and terminal vendor. Nokia delivers the newest technology: server software and updates, to Octopus before delivery to commercial operators. Therefore Octopus customers have the chance to develop and test services in an early phase to create a better time to market for their new solutions and/or ensure the functionality of their existing solutions after the update has been done. The new technology upgrades usually don't include training of operation personnel (because there is no training available yet), which requires a lot of time consuming self-learning from the Octopus personnel. Sometimes it is a case of learning it the hard way: trial and error. Also the new technology, especially in the field of ICT, is not always in the "top shape" when introduced into the markets. The incomplete protocols and standards developed by the large communities, e.g. OMA, IETF etc. usually appear as a compromise of the best possible solution and therefore don't always include all the features needed by many particular service solutions. Interoperability issues like service roaming and platform compatibility are very hard to manage by a single equipment vendor, let alone a small software development company. These inadequacies create many particular problems for both the network operators and the service developers.

In developing and testing mobile services the live testing network is a very good to have but it's not enough. The developers need terminals. However, the development speed in the mobile terminals is rapid and it is almost an impossible – or too expensive - task to maintain an up-to-date pool of various terminals that the Octopus customers could use to test their applications. The market leader Nokia alone releases over 50 phone models per year. A pool of testing terminals is not

available through Octopus, however octopus has partially solved the problem by cooperating with a dealer network that is willing to rent commercial phone models to Octopus customers. The not-yet-commercial phone models remain very hard to get for testing purposes even while Nokia is one of the core partners of the project.

At the start of the Octopus project it was not clear what kind of services the customer organizations would need. The start was very technology driven and the emphasis was on the use of the core network and technology enablers. Very soon, during and after the pilot phase, it was found that providing test subscriptions and operating the technical environment was of much smaller importance than expected and the customers needed other types of services. The customers needed many types of information about the new technologies, induction to the technologies and possible service creation opportunities. Also for example, market information about estimated future penetration levels of a particular new technology is of interest. The Octopus service strategy was modified to suit better to the needs of the customers. The services were categorized as (1) innovation, (2) development and testing, (3) business and (4) communication services. The development and testing services is regarded as the core service and the others as value-added services. All the services are available to all customers at a bundled and fixed cost. The categorization of the services is somewhat vague and the services overlap each other. However, that poses no problems as the customer service is carried out in a consultative process that aims to support the customer in a particular business or product development case.

The customer service processes had to be created for Octopus testing environment and many of the processes were imitated from procedures already available. The innovation and business services were carried out in cooperation with a partnering incubator service organization and the processes were already in place. The cooperative processes shaped up on the side. The aim is to facilitate innovation within and across different design spaces (Carlsson 2003) to create new technological possibilities that lead to emerging business opportunities. The communication service

processes needed to be created basically from scratch and required a lot of attention in the start of the project and they have been revised at a few stages when modification has been needed. The provision of test subscriptions and network services was realized through existing processes from the mobile operator operating the environment. However some of those procedures created for commercial telecommunication networks and customers needed many adjustments to fit the needs of a dynamic testing environment and many times the standard way was discarded because the particular issue needed more detailed attention. The dynamic nature of the Octopus services, i.e. ever-changing requirements from the end-customer and a continuous need to develop something new, created a long learning process that is time-consuming but also fruitful. However, after a year of running the Octopus services most of the everyday customer service activities were automated in a manner that could be regarded as repeatable service processes. Still there are many times cases where a detailed look into the subject at hand is needed, and many types of expertise are needed to create the best possible solution.

The goals of the Octopus project in year 2002 were set at a time when the anticipated market growth for mobile services were very high and the industry was starting to recover from the market decline at the start of the century. The ambitious goals for customer acquisition were not reached mainly due to reasonably slower than expected market growth. Also the marketing of the Octopus environment proved a lot harder than expected. A test-bed with new technology enablers that the customer has not previously heard about is not an easy thing to sell, and many times the service developer companies regarded the prices too high or they already used commercial networks for testing their services and did not need the new technology enablers. Last two years there has been a fierce cost-competition in Finnish telecommunication markets, which creates competition for Octopus in terms of cost efficiency. All in all, the test-bed did not sell as well as expected. The marketing challenges were managed by restructuring the service portfolio and creating services to better meet the customer needs. The goals for customer acquisition were modified (reduced) by the

project steering group. Sales and marketing efforts were increased through direct sales and publicity, which paid off at an extent. These efforts have still not been enough to reach the reduced goals. However, the customer satisfaction has been very good every time during the project, which proves that the Octopus customers receive what they pay for.

Funding arrangements for a project like Octopus was not an easy task. The initial funding 5 million Euros was gathered up with a lot of work done by the city of Oulu. Half of the funding was public and the other half came from the core partners. Most of the initial funding was allocated to investments in the testing environment. The annual operational expenses reach almost one million Euros. After two years of project operations the project needed additional funding – as it did not cover its expenses, which was the initial goal, the funding requirements of the core partners increased, and that was not seen as the most pleasant thing. The operation and maintenance of a testing environment like Octopus is very expensive and it also includes some unanticipated costs. The frequent updates and upgrades of the technical environment required e.g. expensive hardware upgrades and software licenses, in addition to expensive software maintenance fees. These costs were not adequately budgeted initially and therefore it created unexpected cost overruns that needed to be covered by the core partner funding. Also the marketing costs of Octopus were budgeted too small. The goals for customer acquisition were set high but the small traveling budget did not serve the purpose. The cost overruns together with the below par realization of the income funding increased the funding pressure from the core partners.

A partially publicly funded development project with so many interest groups: private companies, public financiers, EU-officials, and educational and research organizations, has also many challenges in administration and steering of the project. In addition to the paper work, which had to be done for the public financiers, and operational activities Octopus project had three different steering groups with representatives from all of the core partners. The steering structure was slow and somewhat inflexible not only because of the amount of groups but also because of the

somewhat different interests of the parties involved in funding and steering the project. The slow steering structure and sometimes indecisive steering groups created uncertainty in the operation of the project. However, despite the heavy and bureaucratic steering structure the steering of the Octopus has been surprisingly good. This is mostly due to parties sharing the same main interests; different views have been mainly only in nuances of the issues.

#### **4. Results: Octopus and competence block actor categories**

Carlsson (2003) presented six categories of actors that are present in the competence block: 1) competent and active *customers*, 2) *innovators* who integrate technologies in new ways, 3) *entrepreneurs* who identify profitable innovations, 4) competent *venture capitalists*, 5) *exit markets* that facilitate ownership change and 6) industrialists who take successful innovations to industrial scale production. Following is an analysis of whether these categories exist within the frame of the Octopus actor network and are they taken into account in Octopus service portfolio.

In case of mobile services there are different types of *customers*. Depending on the particular service the customers can be consumers, individual business professionals or organizations in need of mobile tools for their work force. In Octopus actor network the customers are poorly present. One of the big problems from the start of the project has been how to get the customers of mobile services to participate in the Octopus project. The testing environment is mainly designed for service and technology developers and very little can be done to attract e.g. organizations that need mobile services to participate in the project.

*Innovators* are quite well present in the network. The developer companies have very good competence in developing innovative new technological solutions that integrate technologies in new ways. Also the annual competition for mobile services has generated 20-30 new mobile service ideas every year.

At the start of the Octopus project there were fairly few *entrepreneurs* that would identify profitable innovations and develop them further into marketable service products. After two years of operations these actors were somewhat greater amount and they were more visible to innovators.

Competent *venture capitalists* were virtually non-existent when the project started. There were a few core partners and a public incubator that had declared their interest in financing a possible service case that would sound profitable. However, these transactions never occurred during the 1<sup>st</sup> two years. After two years the venture capitalist actor category is slightly better present in the Octopus actor network while a few public venture capitalists are begun partnering with the Octopus project.

The fifth category, *exit markets*, is somewhat out of scope of the Octopus project. While not concentrating on finding exit markets Octopus has however in some very few cases helped a service developer to find a new owner for its' service product. The last category is present as the core partner involvement in the project. The core partner Nokia can be regarded as an industrialist willing to take successful innovations to markets through its' delivery channels. Also a few Octopus customers have delivery capability to mass markets.

## **5. Conclusions**

While the initial targets set in year 2002 were not reached, there are many good visible results of the Octopus project. The concrete and calculable results of the Octopus project after almost two and a half year of operations were a functioning live mobile testing environment with services, a network of 50 organizations (38 customers), hundreds of users testing their applications, 18 commercial mobile services, 10 of them which could be regarded as success stories, 820 attenders of 24 training courses, almost 200 media hits in Finland, many new and maintained jobs and 2 new companies (note: only one third of the companies have reported their results in feedback questionnaires). Many

other positive results may and very likely have occurred but there's little possibility to verify them. Many customers have been pleased with the possibility to reach viable new contacts through networking with the Octopus partners and customers. The effect of this contact creation through Octopus is hard to calculate. It is however very likely that the overall result of the Octopus is more than the sum of its' parts.

At the present moment the Octopus project and environment has been in operation for two and a half years and it serves the customers well – meets the demand of industry and the academic and educational institutes. The project is very expensive but its' impact in the economy and industry remains very little at present. The next strategic step for Octopus would be to become an international mobile service test-bed. The international launch would require a lot of marketing resources, which would mean at least doubling the project budget.

Octopus testing environment competes with the commercial mobile networks for customers and sometimes it is a lot cheaper for the customer to test their services in the commercial network. Is a development and testing environment for mobile services needed? And what would be the prerequisites for this kind of environment? Should it focus on cost efficiency, services or newest technology? How much public funding should be allocated for the test-bed operation and what would be the expected outcome in terms of e.g. new business, employment, payback period? If the public funding covers most of the test-bed expenses, should the test-bed and the services be free of charge to companies and/or educational/research institutes?

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**Costs Of Developing A Foreign Market For A Small Business: The Market & Non-Market Barriers to Exporting by Small Firms**

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**ABSTRACT**

This study uses the case method to interview nine small firms to investigate the costs and difficulties they face when initializing export activity. The sample firms initiated exporting following a reactive strategy; generally responding to customer inquiries, rather than as the result of a carefully planned strategic initiative. None were heavily export oriented. Opportunity costs, especially of time, are significant barriers to exporting or to increasing export behavior. Exporting takes time and energy that is more profitably spent on domestic operations. The sample firms identified transaction costs as problems to be anticipated and overcome, but not as insurmountable barriers to exporting and depended heavily on modern information technology to initiate and support their exporting efforts. The firms were either largely ignorant of governmental export assistance, or had a low opinion governmental export assistance.

## INTRODUCTION

The literature on international entry among small firms is rather detailed, but fragmented. We seem to know a great deal about a variety of factors associated with international market entry. However, we know very little if anything about the costs or processes of developing a foreign market for a small business (Lloyd-Reason, Sear and Mughan, 2003). This conclusion is startling when one considers how far our knowledge of international activities among small firms has come in the last twenty years.

The importance of exporting by small firms cannot be understated. A research report conducted by the International Trade Administration (2003) indicates that 230,736 small and medium-sized firms (companies with fewer than 500 workers) exported goods in 2001. Small and medium-sized companies account for 97 percent of U.S. exporters, a percentage that has only varied slightly since 1995. These firms exported goods valued at \$182 billion that represented 29.2% of total U.S. goods exported.

The purpose of this study is to investigate the costs of developing a foreign market for a small business. A variety of issues have been considered within the literature on exporting by small businesses. Yet, researchers and public policy officials continue to struggle with the identification of the factors or barriers that may raise the costs of foreign market entry by small firms. Though the present research examines motivation for entry into international markets, the costs of entry, the process of entry, and firm size, this research primarily examines the transaction and opportunity costs of exporting--both out-of-pocket costs and the psychological costs. The psychological costs include fear of the unknown and the opportunity costs of acquiring new market and operational information. Thus, the research questions of this study are: What is the primary motivation for small U.S. firms to begin exporting to foreign markets? What costs do small firms incur when they initially seek to export? What is the magnitude of exporting costs relative to the firm size? Which of these costs inhibits the small firm from exporting? How might the U.S. government better assist small firms to overcome these costs? This study uses the case method to evaluate the export practices of nine small firms in South Carolina, using CEO/VP interviews and secondary company information to augment the interview findings.

## LITERATURE REVIEW

An attempt to gain an understanding of small firms has emerged as an important research issue in the past quarter century. Rather than attempt an exhaustive review of past research, this section will emphasize the dominant research relevant to small firm foreign market development.

### **Motivational Factors**

Czinkota and Tesar (1982) find that motivation can be categorized into proactive and reactive categories. Proactive reasons are based on the firm's internal situation and are firm initiated, while reactive reasons are based on the firm's behavior with respect to the environment and are in response and adaptation to changes from outside the firm. Firms

with proactive motivations go international because they want to, while reactive firms go international because they must. Pope (2002) finds that very small firms export because they have a unique product or a technological advantage. Larger firms export also to achieve economies of scale and to avoid losing foreign opportunities. The major conclusion is that proactive motivations dominate when pursuing exporting. However, the literature has focused largely on the motivations of larger firms. It is possible that small firms have a different rationale for selling in foreign markets. Thus:

*Research Question 1. What is the primary motivation for small U.S. firms to begin exporting to foreign markets?*

### **Costs – The missing variable**

The literature does not document the costs associated with expansion into international markets especially well. The actual costs of foreign market entry may be critical, because of their relative magnitude to small firms compared to larger firms. Wright (1993) reports that both personal costs and personnel costs should be considered before deciding whether to export and points out that these questions may lend themselves to a case-based smaller-sample approach.

Perhaps the most promising research on costs comes from Economics. The costs of international transactions generally are far from negligible (Abdel-Latif, Abla M. and Jeffrey B. Nugent, 1996, p. 1). Transaction costs include information costs, contracting costs, delivery and payment costs, and control and enforcement costs (Williamson, 1971 and 1981). International transaction costs tend to be much higher than domestic transaction costs due to language, cultural, and legal differences, and the inherent difficulties of enforcing contracts overseas (Kim, Nugent, and Yhee, 1997). The literature uses transaction cost economics (TCE) to evaluate the small firms' export efforts (Kim, Nugent, and Yhee, 1997; Abdel-Latif, Abla M. and Jeffrey B. Nugent, 1996). In international research, TCE has been used to describe the mode of entry rather than whether transaction costs prevent small firm entry. Thus, TCE has been limited in its ability to identify the magnitude or relative importance of transaction costs. Thus:

*Research Question 2. What costs do small firms incur when they initially seek to export?*

A proactive motivation to export will likely result in different costs than a reactive motivation. The literature emphasizes out-of-pocket transaction costs (Atherton and Sear, 1997; Abdel-Latif, et. al., 1996). This study examines the out-of-pocket costs, but also any psychological, personal, or opportunity costs that may emerge.

*Research Question 3. What is the magnitude of exporting costs relative to the firm size?*

In order to determine the expected value of an entrepreneurial endeavor in a foreign market, the owners or managers of a small firm must evaluate the costs of the opportunity. Transaction costs of international market entry may be so large for some

small firms because some costs of exporting are fixed and thus may be prohibitive to a small firm.

*Research Question 4. Which of these costs inhibits the small firm from exporting?*

Pursuing an overseas opportunity requires analysis and may require both formal planning (Olson and Gough, 2001) and informal planning (Atherton and Sear, 1997). In this assessment process, one would expect the firm's strategists to identify those costs that are the most difficult obstacles to overseas expansion.

*Research Question 5. How might the U.S. government better assist small firms to overcome these costs?*

The U.S. government offers a variety of programs to assist American companies seeking to export their goods and services (Moini, 1998). Thus, an underlying theme of this research must be the public policy implications of the findings. In their work in the United Kingdom, Atherton and Sear (1997) and Lloyd-Reason, Sear, and Mughan (2003) point out that potential problems with government assistance programs arise due to incomplete understanding of the government assistance process.

## **RESEARCH METHODOLOGY**

This research uses a case-study method as a valuable qualitative research strategy (St. John and Heriot, 1991; Abdel-Latif and Nugent, 1996; and Rialp-Criado, Urbano and Vaillant, 2003, Audet and d'Amoise, 1998). Thus, the case-based methodology is applicable to the understanding the development of a foreign market.

### **Interview Firms**

A list of small firms was provided to the researchers by the South Carolina Export Consortium, a not-for-profit organization that assists companies with international trade issues. As the literature recognizes the unique differences between small firms that have an ongoing export strategy and those that are deciding whether to export or not, we made every effort to select a broad, cross-section of small firms that were engaged in exporting. Most of the firms were fairly new to exporting while other firms had considerably more experience with exporting. Nine firms were carefully selected to ensure that both manufacturing and marketing firms of different sizes were chosen. They were selected in such a way that should make them differ, though by *a priori* predictable reasons, along key dimensions previously developed according to our literature review. The researchers interviewed the founder, CEO, or other senior officer of the small firm. These individuals are directly responsible for the strategic direction their companies pursue. They possess direct knowledge of their company's experience.

## **Analysis**

We collected data from several information sources (in-depth interviews with senior managers deeply involved with international decision-making processes, company websites, internal and external documentation, product and firm brochures, and other secondary data). The nine case studies were cross-analyzed to identify generalizations from firms with similar theoretical conditions. According to Yin (1998), analytical – not statistic - generalization of the results of the several cases being used can be obtained.

## **RESULTS**

The researchers asked a series of 39 questions to senior management of each of the nine firms. The questions in the instrument are divided into five sections: the firm's background, exporting experience, product information, target market information, and feedback on costs and barriers of exporting, as well as feedback on exporting assistance. Because of space constraints, only a summary of the answers to the questions relating to exporting experience of the nine firms is reported in Table 1.

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Table 1 About Here

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## **DISCUSSION**

The purpose of the proposed research was to investigate the barriers to foreign market entry by small U.S. firms. The basic premise was that identifying these barriers would better help the researchers identify the costs of internationalizing. By identifying these costs, advice could be provided to small business owners seeking to export. Policy makers could also use this information to better assist small business owners through training programs and other forms of public assistance.

Most of the firms in this study could be categorized as reactive in their motivations. Their stimuli for exporting were usually in response to unsolicited orders which required them to follow-up on the lead. Their motivations to export were not necessarily indicative of aggression. Yet, it is not surprising that these firms were not pursuing exporting with greater commitment or enthusiasm when one recognizes just how small these firms were. They have very little time to emphasize both domestic and prospective international firms, so they emphasized their current operations.

Despite the differences among the firms and the characteristics of their products, each of the firms emphasized extensive use of the Internet for communication and international marketing activities. Some firms developed extensive web sites for their customers while other firms relied on e-mail to communicate with overseas customers. The introduction of the electronic mail via the Internet and the use of websites to promote products and to conduct business transactions have changed the nature of distribution and marketing for some firms.

A firm that develops a web site is not directly soliciting orders from customers, but is allowing potential customers to easily contact them. The Internet affords these firms the opportunity to bypass traditional distribution channels in order to directly communicate with the customer while also avoiding significant costs. Today, firms with an Internet site have the ability to be contacted by many more prospective customers regardless of their relative locations, but the percentage of sales closed will be much lower than from personal sales. However, the much larger number of potential sales multiplied by the lower closer percentage may result in larger sales. The firms in this study seem to be trying to capitalize on the benefits of the Internet.

A fundamental issue in strategic management is to know your target market. The firms do not have a clear understanding of their top international markets or do not have adequate business plans to reach the markets. This points to the opportunity costs these firms have due to their lack of resources (time and personnel). The participants in this study clearly had to overcome opportunity costs that prevented them from devoting time, their most valuable resource, to the process of exporting. Transaction costs such as packaging, travel, customs clearances, shipping and logistics appear to be challenges, rather than insurmountable barriers to market entry. Opportunity costs were much more of an issue for these small firms.

## CONCLUSIONS

This section reviews the findings as they specifically relate to each of the research questions that guided this study.

*1. What is the primary motivation for small U.S. firms to begin exporting to foreign markets?*

The firms interviewed were generally reactive and entered the export market in response to inquiries from potential customers because they are small and do not have the time to be proactive. One firm said, "They will find me. They know how to find me better than I know how to find them."

*2. What costs are incurred by small firms when they initially seek to export?*

For the firms in this study, out of pocket costs do not appear to be the primary barrier to exporting. Rather, psychological, personal, and opportunity costs were more important barriers. For example, a small retailer showed the researchers how difficult and time consuming it is to properly prepare labels for international shipments of small orders. This study found that opportunity costs were profoundly important to the small firms.

*3. What is the magnitude of exporting costs relative to the firm size?*

Transactions costs of international market entry may be so prohibitive for some small firms because certain costs of exporting (primarily start-up) are fixed and thus may be prohibitive to a small firm. For example, the largest firm in our study discussed how

important it is to efficiently pack shipping containers to maximize the amount of goods that can be shipped. It took some time to learn this skill.

#### *4. Which of these costs inhibits the small firm from exporting?*

This research study found that psychological, opportunity, and personal costs were the largest barriers to exporting. Several firms expressed concern that if they pursued overseas opportunities, U.S. opportunities would be forgone. Psychological costs were also an issue. In this regard, uncertainty seemed to be the most critical psychological barrier. One of the firms had uncertainty over how to pursue his international efforts. “We are struggling to get to the next level – international. The problem is finding the right alliance to do that.” Typical transaction costs, including logistics, travel, shipping etc., were discussed, but not emphasized as barriers that could not be overcome.

#### *5. How might the U.S. government better assist small firms to overcome these costs?*

Most small firms tend to be reactive as they respond to international sales opportunities rather than proactively seek them, especially in their initial approaches to foreign markets. In spite of the reactive nature of many small firms, their sheer percentage of the overall export market suggests that existing government export promotion programs should pay attention to them. In order for these government programs to assist small exporters, they need to have a better understanding of the nature of small exporters. Thus, government export promotion programs should tailor their programs to meet the unique needs of these small firms.

### **Limitations**

This research did have one major limitation that should be noted. This study clearly used a small number of respondents, which prevents generalization usually sought in more objectivist research. However, the primary goal of this research was to explore in depth the issues associated with barriers to foreign market entry.

### **Summary**

Using a case method, this study gathered detailed feedback from nine small firms in South Carolina that have begun exporting their goods to foreign markets. The feedback from the CEOs of these firms suggests that **psychological, personal, and opportunity** costs such as the time it takes to learn how to perform the logistics of exporting and overcoming the fear of exporting are often more important than the out-of-pocket costs of exporting. Thus, this study argues that researchers and public policy makers would be better served by developing a process to communicate information to small firms so that the firms can more effectively export.

### **REFERENCES**

Available upon request.

| SBA FOREIGN MARKET ENTRY STUDY      |                           |              |                | Table 1       |                   |                |                   |                   |               |                |
|-------------------------------------|---------------------------|--------------|----------------|---------------|-------------------|----------------|-------------------|-------------------|---------------|----------------|
| BUSINESS BACKGROUND                 |                           | 1            | 2              | 3             | 4                 | 5              | 6                 | 7                 | 8             | 9              |
| I                                   | FIRM BACKGROUND           | PT           | TK             | SC            | SP                | BL             | TT                | AF                | IM            | BS             |
| 1a                                  | Type of business          | Music Inst   | Food Order Sys | Solar Inst    | Measuring Devices | Heavy Manufact | Textile Converter | Textile Converter | Reseller      | Nutra-ceutical |
| 1b                                  | Person Interviewed        | Owner        | Co-Owner       | Co-Owner      | CEO               | Of Owner       | CEO               | Owner             | Owner         | Co-Owner       |
| 2a                                  | Strategic decision Maker? | Owner        | Co-Owner       | Co-Owner      | CEO               | Owner          | CEO               | Owner             | Owner         | Co-Owner       |
| 2b                                  | Who Made Int'l Decision?  | Owner        | Co-Owner       | Co-Owner      | CEO               | Owner          | CEO               | Owner             | Owner         | Co-Owner       |
| 3                                   | Years In business         | 10           | 9              | 4             | 33                | 50             | 16                | 13                | 6             | 1              |
| 4                                   | Number of Employees       | 13           | 24             | 2             | 50                | 130            | 12                | 8                 | 2             | 10             |
| 5                                   | 2003 Sales (Millions)     | 1.5          | 1.2            | 0.5           | 6                 | 15             | 1.5               | 2.8               | 0.5           | 0.5            |
| 6                                   | % Sales That Are Export   | 3            | 18             | 5             | 10                | 15             | 3                 | 15                | 15            | 5              |
| 7                                   | % of production capacity? | 100%         | 35%            | Low           |                   | 60%            | 50%               | 100%              | NA            | Low            |
| <b>II EXPORTING EXPERIENCE</b>      |                           |              |                |               |                   |                |                   |                   |               |                |
| 8a                                  | Currently exporting?      | Yes          | Yes            | Have In Past  | Yes               | Yes            | Yes               | Yes               | Yes           | Yes            |
| 8b                                  | Strategy                  | MildlyProact |                |               | TradePartner      |                |                   |                   |               | ReactInternet  |
| 9a                                  | Export motivation?        | Belgium Dist | ActivePursue   | ProdForIsrael | IncSalesBase      | Cust. Inquiry  | GrowthOpp         | Responds          | Web Inquiries |                |
| 9b                                  | Proactive or Reactive?    | MildlyProact | Proactive      | Reactive      | Proactive         | Reactive       | Reactive          | Reactive          | Reactive      | Reactive       |
| 10                                  | Qualified staff for int'l | Owner        | Co-Owner       | Co-Owner      | CEO               | Owner          | CEO               | Owner             | Owner         | Co-Owner       |
| 11                                  | FocusGrowth?Profit?       | Growth       | Profit         | Growth        | Growth            | Profit         | Profit            | Profit            | Both          | Growth         |
| 12                                  | SacProfForInt'lGrowth?    |              | Yes            | Yes           | Yes               | Yes            | Yes               | Yes               | No            | A Little       |
| 13                                  | Adequate Working Cap?     | Line of Cr   | Yes            | Yes           | Yes               | Yes            | Yes               | Yes               | NA            | No             |
| <b>III PRODUCT INFORMATION</b>      |                           |              |                |               |                   |                |                   |                   |               |                |
| 14                                  | HS/SIC Code               | 339992       | 339950         | 238220        | 334513            | 331319         | 333292            | 336360            | 333415        | 325411         |
| 15                                  | Prod Unique?HighTech?     | Lic. Tech    | Moderate       | Moderate      | Unique Proc       | No             | No                | No                | No            | No             |
| 16                                  | Int'l Price Competitive?  | Yes          | Higher         | No Compet.    | Yes&Better        | Unknown        | Unknown           |                   | Yes           |                |
| 17                                  | Int'l More Profitable?    |              | Same           |               |                   |                | Yes               |                   | No            |                |
| 18                                  | End Users?                | Retailers    | Retailers      | Govt&Man      | Manufact          | Manufact       | Manufact          | Distributors      | Commercial    | Consumers      |
| 19                                  | Require Much Training?    | Some         | Yes            | No            | Yes               | No             | No                | No                | No            | No             |
| 20                                  | After-sale Support?       | No           | Internet       | No            | Some              | No             | No                | No                | No            | No             |
| 21                                  | Modification For Int'l    |              | Certification  | No            |                   | No             | No                | No                | Some          | Some           |
| 22                                  | Alter Packaging For Int'l | Some         |                | No            | No                | Protective     | No                | No                | Yes           | Labels         |
| 23                                  | Export License?           | No           | No             | No            | No                | No             | Unknown           | No                | No            | No             |
| 24                                  | Payment Terms?            | Prepay       | Prepay, n30    | PreLOCDocs    | Prepay, LOC       | Wire           | Prepay            | PreLOCDocs        | Prepay, LOC   | Prepay         |
| <b>IV TARGET MARKET INFORMATION</b> |                           |              |                |               |                   |                |                   |                   |               |                |
| 25                                  | Know Top Int'l Market?    | Unknown      | Ger,Fr,UK      | Unknown       | Yes               |                | Unknown           | Middle East       |               | Researching    |
| 26                                  | Favorable Int'l Mkts?     | Unknown      | Yes            | Yes           | No                | Yes            | Yes               | Yes               |               |                |

|          |  |                |               |             |               |             |             |             |             |               |
|----------|--|----------------|---------------|-------------|---------------|-------------|-------------|-------------|-------------|---------------|
| 26       | Favorable Int'l Mkts?                    | Unknown        | Yes           | Yes         | No            | Yes         | Yes         | Yes         |             |               |
| 27       | Domestic&Int'l Competition?              | Yes            | 2 or 3        | No          | Several       | China       | Yes         | 3 Firms     | Many        | Yes           |
| 28       | Import Duties                            | 3.10%          | Unknown       | Unknown     | Unknown       | 17%         | Unknown     |             | Unknown     | Unknown       |
| 29       | Have Int'l Agents?                       | Hard To Find   | No            | Later       | Ger & UK      | No          | No          | No          | No          | No            |
| 30       | Int'l Busn & Mkt Plan?                   | No             | Inadequate    | Yes         | Continuous    | Continuous  | No          | No          | No          |               |
| 31       | Advertise In Int'l Journal?              | US(Int'l Circ) | Use Web       | Not yet     | Yes           | No          | No          | No          | Cat Show    | Some          |
| <b>V</b> | <b>COSTS &amp; BARRIERS TO EXPORTING</b> |                |               |             |               |             |             |             |             |               |
| 32       | Importance Of Int'l?                     | Export Dept    | Export Dept   | Not Import  | Export Dept   | Reactive    | Reactive    | Not Import  | Export Dept | Reactive      |
| 33       | Plan To Inc Int'l Effort?                | Yes            | Yes           | Yes         | Yes           | Yes         | Yes         | Yes         | Yes         | Yes           |
| 34       | Challenges To Int'l?                     | Logistics      |               | Logistics   | Logistics     | Logistics   |             | Logistics   | Logistics   | Logistics     |
|          |  | Customs        | Customs       |             | Customs       | Customs     |             |             |             |               |
|          |  |                |               | Language    | Language      |             | Language    |             |             | Language      |
|          |  |                |               |             | Prospecting   |             | Prospecting | Prospecting |             |               |
|          |  |                |               | Get Paid    |               |             |             |             | Get Paid    |               |
|          |  |                |               |             | Pol. Barriers |             | Resources   | Ethics      |             | Pol. Barriers |
|          |  |                |               |             | Int'l Info    |             |             | Time Zones  |             |               |
| 35       | Type Of Useful Assist.                   | Trade Shows    | Trade Shows   |             | Trade Shows   |             |             |             |             |               |
|          |  |                |               | Ex Counsel  |               |             |             | Ex Counsel  |             |               |
|          |  |                | Seminar       |             |               |             | Mkt Plan    |             |             |               |
|          |  |                | Market Study  |             |               |             |             |             | Cat. Shows  |               |
| 36       | Trade Assist. Used                       | Ex Consort.    | Ex Consort.   | Ex Consort. | Ex Consort.   | Ex Consort. | Ex Consort. | Ex Consort. | Ex Consort. | Ex Consort.   |
|          |  |                | SCDOCom       | SCDOCom     |               |             | SCDOCom     |             | SCDOCom     | SCDOCom       |
|          |  |                | USDOCom       | USDOCom     |               |             | USDOCom     |             | USDOCom     | USDOCom       |
|          |  |                | ExImBank      |             |               |             |             |             | SC DOAg     |               |
| 37       | Costs Of Int'l Sales                     | Travel         |               | Travel      |               | Travel      |             | Travel      |             |               |
|          |  | Shipping       |               |             |               | Shipping    |             | Shipping    |             |               |
|          |  |                |               | Bank Chg    |               |             |             | Bank Chg    |             |               |
|          |  |                |               | Exch Risks  |               | Exch Risks  |             |             |             |               |
|          |  |                |               | Regulation  | Regulation    |             | Mkt Res     |             |             |               |
|          |  | Trade Shows    | Psychological |             | Docs          | Time Zones  | Uncertainty | Frnt Ins    |             |               |
|          |  |                |               |             |               |             | Tech Theft  |             |             |               |

ANALYSIS OF FACTORS INFLUENCE THE PERFORMANCE OF  
INDONESIAN SMALL AND MEDIUM ENTERPRISES  
(A RECOURSE-BASE THEORY APPROACH)

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Abstract

This research is aimed at explaining the relationship based on resource-base theory and contingency theory used in developing research framework. Specifically, the relationship is between personality values, business strategy, environmental uncertainty, and firms' performance. The three hundreds (300) respondents who are entrepreneurs from various manufactures of small and medium companies in Indonesia have been used to test research hypothesis. Based on hierarchical regression, it can be concluded that business strategy is mediating variable on the relationship between entrepreneur's personality values and firms' performance, and environmental uncertainty is moderating variable towards the relationship between business strategy and firms' performance.

**Introduction**

Small and medium enterprises (SME) play an important role (Yu, 2001), therefore they dominant the most number of firms in the world, both in developed and developing countries (Day, 2000; Wijewardena & Tibbits, 1999; Sanjaya, 1997). The role of SME is more important in developing country, especially for Indonesia (Swasono, 1986). The development of SME has brought some positive impacts although they haven't been able to change Indonesian economic structure as a whole (Marzuki, 1997; Tambunan, 1999). However, there are still some findings about SME bankruptcy while some SMEs are very success running their business instead.

The influences of factors on firm's success are different from one country to another country. The differences are due to economic condition, location, and culture (Wijewardena & Tibbits, 1999). Some researches have found that factors determining bankruptcy also influence the firm's success (Gaskill, Auken, & Manning, 1993). Previous researches have not explained comprehensively the reasons of bankruptcy of many firms (Gaskill et al., 1993). Researchers often used rational theory (Jennings & Beaver, 1993), and there have not unified theoretical model that explain factors influence SME's performance (Kangasharju, 1997).

Research on the success of IKS may use four approaches, they are (1) personality approach, (2) business management approach, (3) sectoral approach, dan (4) organization development approach (Gibb & Devis, 1990). This research will focus on personality characteristics of an entrepreneur because personality characteristics of an entrepreneur are often used as the base on many previous studies (Bab & Bab, 1992). Some researches have found personality characteristics of an entrepreneur are an important factor that influences firm's performance (Luk, 1996; Theng & Boon, 1992; Ibrahim & Goodwin, 1986; Montagno, Kuratko, & Scarcella, 1986). However, many previous researches relate directly between personal characteristics and firm's performance.

Based on resource-based theory, the influence of personality factor towards firm's performance is not only directly but also indirectly, that is, through the application of business strategy. Therefore, this research has purpose to examine the influence factors on SME's performance by applying resource-based theory as a base in developing research framework. Besides, this study also uses contingency theory to explain the influence of environmental uncertainty towards firm's performance.

## **LITERATURE REVIEW**

### **Theory**

Resource-based theory explains that firm's sources are the main factor that determines competitive advantage and profitabilities (Michalisin, Smith, & Kline, 1997; Bates & Flynn, 1995; Mahoney & Pandian, 1992). One of the unique sources that possibly possessed by firm are personality values of an entrepreneur. Personality values will influence business strategy that result competitive advantage. Therefore, SME's performance will also be influenced by environmental uncertainty, therefore this research will use contingency theory to explain the relationship between business strategy and firm's performance..

### **Personality, Strategy, and Performance**

Some previous research found that personality characteristics and managerial skills of an entrepreneur is critical factor on SME's performance (Al-Shaikh, 1998; Box, White, & Barr, 1993; Cragg & King, 1988). However, until at present there has not a universal agreement on the scope of managerial field (Cragg & King, 1988). Management and planning functions have overall characteristics and included in all aspects in business (Gaskill et al., 1993). As a result, the difference between one researcher to other researchers is sometimes using different focus of personality and managerial.

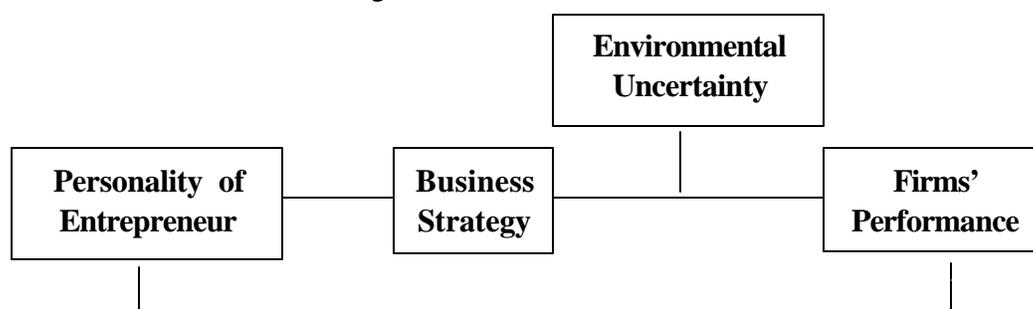
Research conducted in Indonesia found that need for achievement and locus of control are the main personality characteristics comparing to other entrepreneur's personality characteristics (Riyanti, 2003; Sukardi, 1991). Pandey and Tewary (1979) stated that both personality characteristics are important and main entrepreneurship values. Therefore, this study will focus only on two personality characteristics, they are, need for achievement and locus of control.

Research conducted by Miller and Toulouse (1986) found that there is correlation between need for achievement and locus of control with business strategy as well as on firms' performance. Research conducted by Kotey and Meredith (1997) indicated that one who has high entrepreneurship characteristics will use more proactive strategy and apply that strategy in the firm and therefore firm will gain higher performance. Research focuses on locus of control conclude that locus of control has positive relation with business strategy and as a result it will influence firm's performance (Boone, Brabader, & Witteloostuijn 1996; Nwachukwu, 1995).

### Research Framework

Based on resource-based theory and contingency theory, and findings on previous studies, this research framework can be diagrammed as follows:

Figure 1. Research Framework



### Hypotheses

Based on the literature review and research model therefore the hypotheses of this research are:

Hypothesis 1: Business strategy is mediating variable that relates between personalities of entrepreneur and firms' performance

Hypothesis 2: Environmental uncertainty is moderating variable that relates between business strategy and firms' performance.

## RESEARCH METHOD

### Population and Sample

The size of SME used in this research is firms that have the numbers of employees from 1 to 99 (BPS, 2002). Data selection of firms found in Directory of Manufacturing Firms in 2001 found 15.593 firms categorized as SME. Four provinces as the center of medium manufacturing firms in Indonesia, they are, DKI Jakarta, West Java, Middle Java, and East Java with the numbers of firms 12.326. These four provinces are approximately representative of small and medium size of manufacturing firms in Indonesia.

Due to the limitation of time and cost therefore sample was selected by purposive random sampling to 300 firms. Since the list of sample frame address was not available, technique “*snow ball*” is used in selecting sample, that fulfill the criteria outlined by the definition of SME according to Central Bureau for Statistics in Indonesia.

## **Variable Measurement**

### ***Need for achievement***

Need for achievement construct was adopted from Steers and Braunstein (1976), this is a common practice for similar studies that conducted earlier such as Entrialgo, Fernandez, and Vazquez (2000), Box, et. Al (1993), and Miller and Toulouse (1986). The measurement used to measure this variable consisted of five items, and the seven-point likert-type scale (from 1 to 7) were used for the purpose of this study.

### ***Locus of control***

The measurement of locus of control that developed by Rotter (1996) and modified by Lumpkin (1985) has been used for this study. However, the Lumpkin (1985) modified measurement was recognized and used by many researchers such as Entrialgo et al. (2000) and Box, et.al (1993), and thus, in a line with the previous research, this study will use the modified measurement of locus of control. This measurement as modified by Lumpkin (1985) consists of two categories, namely, high internal locus of control, and low internal locus of control, each of which have three items. Seven points Likert-type scale ranging from 1 to 7 will be used for the purpose of this study.

### ***Business Strategy***

The Strategy Hierarchy comprises with corporate level, strategic business unit level, and functional level. The measurement of business strategy is based on functional strategy has been used by Kotey and Meredith (1997) and Gadenna (1998). The questionnaire on functional strategy consists of 36 items, including production strategy, marketing strategy, financial strategy, research and development strategy, and human resource strategy. Measurement is conducted by using Likert scale, that is, 1 to 7.

### ***Environmental Uncertainty***

Environmental uncertainty will be measured by using questionnaire developed by Miles & Snow (1978). The measurement used some questions related to environment dimension such as: marketing condition, government policy finance, labor and competition. The measurement uses Likert scale from 1 – 7 (from very predictable to very unpredictable). From the questionnaire acquired some values which describe perception of manager owner of SME toward environmental uncertainty, the higher the value, the higher the environment uncertainty.

## *Firms' performance*

An extensive literature review of 52 empirical research on entrepreneurship were conducted by Murphy et al. (1996), they concluded that five measurements of firms' performance were used frequently in this area of research, these are: sales growth, profit margin, return on investment, return on equity, and return on asset. Therefore, this research intends to utilize three out of these five measurements, namely, sales growth, profit margin, and return of asset. The respondents of this study will be requested to indicate their firms' average of these performance measurements for the last three years. Furthermore, in order to obtain total firms' performance measurement, the average of these three performances measurements was calculated and named as financial performance, this procedure is similar to that used by Boone, et al. (1996).

## **Method of Analysis**

This research used some statistical analysis methods to assist data analysis and hypothesis testing. Before applying regression analysis, analysis factors analysis and reliabilities were conducted firstly. Based on the concept of analysis on mediating variable proposed by Baron and Kenny (1986), and Ndubisi, Jantan, and Richardson (2001), hierarchical regression model used to test first hypothesis is:

$$Z = a + b_1 X_1 + b_2 X_2$$

$$Y = c + d_1 X_1 + d_2 X_2$$

$$Z = e + f Y$$

$$Z = g + h_1 X_1 + h_2 X_2 + j Y$$

### Full Mediating

- $b \neq 0$
- $d \neq 0$
- $f \neq 0$  also  $j \neq 0$
- $h = 0$

### Partial Mediating

- \*  $b \neq 0$
- \*  $d \neq 0$
- \*  $f \neq 0$  also  $j \neq 0$
- \*  $h \neq 0$  but  $h < b$

To test the second hypothesis, the following model is used:

$$Z = e + f Y$$

$$Z = e + k_1 Y + k_2 M + k_3 YM$$

where:

- X1 = Need for achievement
- X2 = Locus of control
- Y = Business strategy
- Z = Firms' performance

M = UnvIRONMENTAL uncertainty

YM = Interaction business strategy and unvIRONMENTAL uncertainty

## FINDING

### Samples Characteristics

The result of descriptive statistic of the characteristics of firms' samples can be seen in Table 1, and the characteristics of entrepreneurs' samples can be seen in Table 2.

Table 1  
Firms Profile

|            |                     | Total | Percent |
|------------|---------------------|-------|---------|
| Location   | West Java           | 80    | 26.67   |
|            | Middle Java         | 70    | 23.33   |
|            | East JAva           | 80    | 26.67   |
|            | DKI Jakarta         | 70    | 23.33   |
| Legal form | Limited corporation | 62    | 20.7    |
|            | Commanditor         | 48    | 16.0    |
|            | Proprietorship      | 110   | 12.7    |
| Age        | ≤ 10 tahun          | 151   | 63.3    |
|            | >10 – 20 tahun      | 107   | 35.7    |
|            | > 20 tahun          | 42    | 14.0    |
| Employee   | ≤ 19                | 229   | 76.3    |
|            | > 19 - 99           | 71    | 23.7    |

Following are the entrepreneur's characteristics of this study

Table 2  
Entrepreneur profile

|             |                      | Total | Percent | Mean | Standard Deviation |
|-------------|----------------------|-------|---------|------|--------------------|
| Age (years) | ≤ 40                 | 180   | 17.0    | 39.2 | 9.9                |
|             | > 40                 | 120   | 46.6    |      |                    |
| Sex         | Male                 | 236   | 78.7    |      |                    |
|             | Female               | 64    | 2.3     |      |                    |
| Education   | ≤ Junior high school | 69    | 23.0    |      |                    |
|             | Senior high school   | 160   | 53.3    |      |                    |
|             | Diploma              | 30    | 10.0    |      |                    |
|             | Bachelor             | 41    | 13.7    |      |                    |

|                                 |          |    |      |      |     |
|---------------------------------|----------|----|------|------|-----|
| <b>Length of tenure (years)</b> | ≤ 5      | 61 | 29.6 | 15.7 | 7.3 |
|                                 | > 5 – 10 | 52 | 25.2 |      |     |
|                                 | > 10     | 49 | 23.8 |      |     |

### **Validity and Reliability**

To test the validity to the measurement, factor analysis was conducted, and the reliability of the measurement can be seen from its Cronbach Alpha. The measurement is reliable if its' Cronbach Alpha is at least .60. Moreover, loading factor is equal or more than to .3 is accepted, and cross loading equal or more than to 0,3 is rejected (Hair, Anderson, Tatham, & Black, 1998).

Factor analysis towards instrument of entrepreneur's personality characteristics results 3 factors, named as locus of control, need for achievement, and risk taking. Factor analysis to instrument of environmental uncertainty results four factors, which can explain 72,19 varians factor formed. The second order of factor analysis towards mean factor formed results one factor only, consists of 17 items and expains environmental uncertainty. Factor analysis on business strategy instrument results five factors, consist of 30 items. The second order of factor analysis towards mean factor formed results one factor, called business strategy.

### **Test of Hypotesis**

Testing on the first hypothesis is conducted through 3 stages of regression. The first stage is to test relationship between entrepreneur's personality values and business strategy. Second is business strategy and firms performance. Third stage is conducted through hirarchical regression, that is the relationship between personality values and firm's performance, and so forth between personality values and business strategy and firm's performance. The summary of regression analysis can be seen in Table 3.

Table 3 indicates that model 1 can explain the positive influence of personality values towards business strategy ( $R^2 = 12.8$ ,  $F = 14.336$ ,  $p \text{ value} = .01$ ). This means that 12.8 percentage of varians of business strategy can be explained by personality values of an entrepreneur. Partial analysis also indicates that all dimensions of personality values of an entrepreneur have positive influence towards business strategy. Therefore, either simultaneously or partially, personality values of an entrepreneur can contribute towards the formation of business strategy.

In Table 3, the influence of business strategy towards firms' performance can be seen. The ability of business strategy to explain firms performance is moderately high, that is, 19.2 percent. Three dimensions of personality values of an entrepreneur, locus of control, risk taking, and need for achievement are able to explain 25.8 of varians of firms performance. The ability to explain the varians of firm's performance is higher if in regression analysis of personality values, business strategy is added. Personality values and business strategy are able to explain 34.6 percent of the varians of firm's performance.

Partially, locus of control, risk taking, and need for achievement have positive influence towards firm's performance. Similarly, business strategy also has positive influence towards firm's performance. If standardized coefficients ( $\beta$ ) of personality values and business strategy are compared, it can be concluded that locus of control and business strategy have ability to explain the higher varians of firm's performance comparing with need for achievement and risk taking.

All of analysis requirements on mediating variable explained by Baron and Kenny (1986) can be fulfilled in testing conducted. Standardized coefficients ( $\beta$ ) of locus of control, risk taking, and need for achievement indicate the decreasing between before and after business strategy is added in the equation of regression. Therefore, business strategy is partially mediating variable towards the relationship between locus of control, risk taking, and need for achievement and firms' performance.

Table 3.  
Business Strategy is Mediating Variable

| Independent Variable    | Business Strategy |          | Firms' Performance |          | Firms' Performance |          | Firms' Performance |          |
|-------------------------|-------------------|----------|--------------------|----------|--------------------|----------|--------------------|----------|
|                         | b                 | T Value  | b                  | T Value  | b                  | T Value  | b                  | T Value  |
| Locus of Control        | .116              | 2.050**  |                    |          | .382               | 7.356*** | .327               | 6.573*** |
| Risk Taking             | .208              | 3.665*** |                    |          | .156               | 3.056*** | .101               | 2.004**  |
| Need for Achievement    | .185              | 3.223*** |                    |          | .159               | 2.976*** | .125               | 2.534**  |
| Business Strategy       |                   |          | .439               | 8.428*** |                    |          | .313               | 6.271*** |
|                         |                   |          |                    |          |                    |          |                    |          |
| R <sup>2</sup>          | .128              |          | .192               |          | .258               |          | .346               |          |
| R <sup>2</sup> Adjusted | .119              |          | .190               |          | .251               |          | .337               |          |
| R <sup>2</sup> Change   |                   |          |                    |          | .258               |          | .087               |          |
| F Value / F Change      | 14.336***         |          | 71.036***          |          | 34.359***          |          | 39.322***          |          |

\*\*\* = Significance .01      \*\* = Significance .05      \* = Significance .1

The second of hypothesis testing is conducted by using hirarchical regression. This is conducted after forming interaction variable between business strategy and environmental uncertainty. The result of testing on the influence of environmental uncertainty as moderating variable towards the relationship between business strategy and firms' performance can be seen in Table 4.

Table 4 indicates the ability of business strategy in explaining higher varians of firms' performance after inserting the variable of environmental uncertainty to the equation of regression, that is, 19.2 percent to 22.2 percent. Partially, the influence of business strategy is positive towards firms' performance, but the influence of environmental uncertainty is negative. This means that busines strategy implemented by firm

will motivate firms' performance, however environmental uncertainty will weaken the achievement of good firms' performance.

If variable interaction between business strategy and environmental uncertainty is added into regression equation, the result of regression shows that interaction variable is able to explain the change in firms' performance significantly (F Change =2.974 at p= .1). Therefore, it can be concluded that environmental uncertainty is moderating variable towards the relationship between business strategy and firms' performance.

Table 4.  
Environmental Uncertainty is Moderating Variable

| Pembolehubah Bersandar Non Standard Change? | Firms Performance |          |           |           |         |          |
|---|-------------------|----------|-----------|-----------|---------|----------|
|   | $\beta$           | T Value  | $\beta$   | T Value   | $\beta$ | T Value  |
| Business Strategy                           | .439              | 8.428*** | .417      | 8.043***  | .851    | 3.311*** |
| Environmental Uncertainty                   |                   |          | -.197     | -3.796*** | .147    | .713     |
| Interaction Bs x Eu                         |                   |          |           |           | -.545   | -1.725*  |
| R <sup>2</sup>                              | .192              |          | .222      |           | .230    |          |
| R <sup>2</sup> Adjusted                     | .190              |          | .216      |           | .222    |          |
| R <sup>2</sup> Change                       |                   |          | .222      |           | .008    |          |
| F Value / F Change                          | 71.036***         |          | 41.470*** |           | 2.974*  |          |

\*\*\* = Significance .01 \*\* = Significance .05 \* = Significance .1

## DISCUSSION

This research result indicates that business strategy is partially mediating variable between personality values and firms' performance. This means that firms' performance is not only influenced directly by personality values but also influenced by business strategy. This research finding support previous research conducted by, like Boone et al. (1996), Nwachukwu (1995), Entrialgo et.al (2000), and Kotey and Meredith (1997).

In accordance with personality values of an entrepreneur, that is, dissatisfaction with what he has gained, always enhance his performance, highly confidence on his job, risk-taking, therefore these values will influence him in the implementation of business strategy related to environmental condition faced with. Therefore, personality values will also give positive influence towards the implementation of business strategy, and, so forth, competitive advantage and profitabilities can be achieved.

The competitive advantage formed through personality values will face negative influence from

environmental uncertainty. This research finding indicates that the relationship between business strategy and firms' performance will be moderated by environmental uncertainty, in which, the environmental uncertainty weakens the relationship between business strategy and firms' performance. Some previous research supports this research, some of them are conducted by Kumar and Strandholm (2002), and Herri (2002).

## CONCLUSION AND SUGGESTION

Internal factors such as personality of entrepreneur and business strategy have contribution to SMES's performance. High performing SMEs tend to have proactive strategy, internal locus of control, high need for achievement, and risk taking. Higher environmental uncertainty influenced by long lasting economic crisis in Indonesia results negative influence towards SMES's performance.

### Implication

This research gives contribution to evaluate the practice of SMEs management, and is made as basis for compilation of policy. This also adds research related to aspects determining SMEs performance. Among its implication is the importance of developing of nature of entrepreneurs giving contribution to SMEs performance like nature of locus of control, need for achievement, and risk taking. Besides, the development in the implementation of appropriate business strategy to environment condition is necessarily performed so that high firms' performance can be achieved.

### Future Research

To support this research finding, future research may be conducted by modifying into some other characteristics. The possibility to include cultural factor or ethnic may be also performed since this factor probably also influences SMEs' performance.

Most of samples are coming from manufacture sectors, for future research, it is possible to have research in different sectors such as trading or service hence it will broaden the knowledge about the factors contribute to the performance of SMEs in Indonesia. Moreover, data of this research merely come from the perception of the respondents; research by using an objective data is one of the possibilities in the future.

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## INNOVATION AND INTERNATIONAL INVOLVEMENT OF DUTCH SMES

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Paper to be presented at the ICSB World Conference, June 15-18, 2005

*“Golden Opportunities For Entrepreneurship”*

### **ABSTRACT**

This exploratory study focuses on the possible relation between innovation and international involvement of SMEs. Some studies have suggested that innovation has a positive impact on the likelihood of enterprises to internationalise their business activities. We have tested this proposition using indicators for innovativeness that are specifically developed for SMEs and focusing on exporting as well as importing activities of enterprises. The results of our study suggest that there is a significant positive effect of several measures for innovation on international involvement. The results are based on a representative sample of more than 1.800 Dutch SMEs using logistic regression analysis.

**Keywords:** internationalisation, innovation, SMEs.

## **INTRODUCTION**

The aim of this study is to explore whether a link exists between innovativeness of enterprises and internationalization (imports and exports). Research into internationalization of SMEs used to be primarily focused on exports. In recent years however it is increasingly acknowledged that exporting and importing are interrelated processes and there is more attention in research for imports and other inward modes of internationalization (e.g. Korhonen, 1997; 1999; Liang & Parkhe, 1997).

It is known that access to know how and technology is an important motive for SMEs for internationalizing their business activities (European Commission, 2004). A number of studies have explored the relationship between internationalization and innovation. These studies mainly focus on the relationship between innovation and export. Also indications can be found that a relation exists between innovation and import. For example, the results of one study reveal that SMEs that import are above average importing innovative (new) products (Van de Graaff and Overweel, 2002). Therefore it was decided to include imports as well as exports in the analysis.

Innovativeness is assessed by a number of indicators for innovativeness, such as the recent introduction of new products or services, the recent introduction of new or improved internal business processes and inter-firm co-operation. International involvement is defined as being involved as a firm in exporting and/or importing activities. It is examined whether a positive relation exists between innovation and international involvement of the enterprise. A distinction is made between enterprises that only export, enterprises with both exports and imports, and enterprises that only import. The analysis is based on SMEs located in the Netherlands. The data relate to a representative sample of Dutch SMEs. Elaborating on existing research into innovativeness of SMEs indicators for innovation will be used that are specifically developed for SMEs.

## **LITERATURE ON INNOVATION AND INTERNATIONALISATION**

### **Innovation of SMEs**

Innovation involves targeted renewal of products, services or working methods. Entrepreneurs innovate in order to be able to better address the demands of customers, to improve their competitiveness or to achieve better financial results for their businesses. For this reason innovation is as important for small enterprises as it is to large firms (Van de Graaff and De Jong, 2004). However, there are a number of differences with respect to the way innovation takes place between SMEs and larger enterprises. For example, SMEs traditionally have more limited resources for conducting R&D. Also, innovation is often less formalized in smaller enterprises. However, on the other hand SMEs are more flexible than larger firms, which enables them to respond quickly to changes in the environment. For this reason SMEs are often successful in developing new product-market combinations and in adapting products to the demands of niche markets or individual customers (Bernardt, 2001). These differences between small and larger enterprises affect the ways in which innovation is measured in SMEs. Many traditional indicators of innovation, such as expenditures on R&D are not very useful in measuring innovation in SMEs. That is why specific indicators have been developed for measuring

innovativeness of SMEs (Van de Graaff and De Jong, 2004). In this study we will focus on these indicators that are specifically developed for measuring innovativeness of SMEs.

### **Internationalisation of SMEs**

Traditionally, research on internationalization of enterprises is strongly focused on large multinational enterprises. Currently there is more attention for SME internationalization since it is recognized that SMEs are increasingly involved in international markets (European Commission, 2004). Studies on the internationalization of SMEs were traditionally mainly focused on export activities (e.g. Bloodgood *et al.*, 1996; McDougall and Oviatt, 1996). More recently there is more attention for imports and other inward modes of internationalization in internationalization research (e.g. Korhonen, 1997; 1999; Liang & Parkhe, 1997). It is increasingly acknowledged that imports may be important for national economies, for example because imports may contribute to the upgrading of national products or services.

Research has found that the majority of internationalized enterprises are involved in outward (e.g. export, foreign direct investment) as well as inward (e.g. import) international activities (Fletcher, 2001). The majority of Dutch SMEs that are involved in exporting activities, for example, are also involved in importing activities (Hessels *et al.*, 2005). It is increasingly recognized that inward and outward modes of internationalization are interrelated processes (Korhonen, 1999; Van De Graaf and Overweel, 2002). For example, the step to start exporting may be smaller when an enterprise already imports goods or services from abroad. The reason for this is that an enterprise that imports already has business contacts in foreign countries, and thus maintains a channel to the foreign market through which it gets information about this market. In this study inward (imports) as well as outward (exports) modes of internationalization are included in the analysis.

### **Innovativeness and internationalization of SMEs**

There are several reasons for presupposing that innovativeness will influence the internationalization of enterprises. First of all, product and process innovations may make it possible for enterprises to target new markets. The potential market for products of innovative firms may be much wider than is the case for less innovative firms (Autio *et al.*, 2000). Normally, innovation efforts will result in improved, modified or new products that may give enterprises a (temporary) competitive advantage in foreign markets (Van Dijken and Prince, 1997).

Furthermore, improved or renewed business processes make it possible for firms to adapt or innovate products, to increase the speed of the production process and to reduce costs (Van Dijken and Prince, 1997). The acquisition of new process technology may stimulate enterprises to review or revise their strategic direction and market focus (Bell *et al.*, 2004). This may stimulate enterprises to undertake international business activities or to accelerate their internationalization process. In addition, innovative firms often have to anticipate competitive responses which may stimulate them to make international commitment (Franko, 1989). Therefore, innovation may result in (more) international involvement.

Most previous studies only focus on the link between innovation and export. A number of empirical studies suggest that innovativeness of enterprises is likely to affect

the probability or propensity of enterprises to export, for example because innovation may improve the international competitiveness of an enterprise ((see e.g. Wakelin, 1998; Sterlacchini, 1999; Roper and Love, 2001; Karagozoglu and Lindell, 1998). For example Karagozoglu and Lindell (1998) argue, in their study on small and medium-sized technology based firms, that innovative enterprises are more likely to export, because prospects in international markets are more promising as compared to prospects in national markets.

Innovation, however, may not only stimulate enterprises to export but may also have an effect on the propensity of enterprises to import goods or services from abroad. In order to realize the necessary product and/or process innovation enterprises may need to import foreign inputs. Indications can be found that a positive relationship exists between innovativeness and the likelihood of enterprises to be involved in importing activities. For example, one study has shown that innovative SMEs are above average importing innovative (new) products (Van de Graaff and Overweel, 2002). However, there is a lack of empirical studies that address the link between innovation and import. In addition, no distinction is made between enterprises that are only involved in exporting activities and enterprises that are involved in importing as well as exporting activities. Since a positive relation between innovation and the propensity of enterprises to export and import is expected, it is likely that the relationship will be strongest for enterprises with exporting as well as importing activities as compared to enterprises that are only involved in one of these modes of internationalization. In the research design, therefore, the following hypotheses are formulated:

*Hypothesis 1: A firm's innovativeness is positively related to a firm's international involvement in terms of exporting goods or services.*

*Hypothesis 1A: A firm's innovativeness is relatively more positive related to enterprises that are both exporting and importing goods or services than to enterprises that are only exporting or only importing goods or services.*

## **DATA**

### **Sample**

The analysis is based on a representative sample of 1,846 Dutch SMEs (up to 100 occupied persons). The business owners were interviewed during July 2004. This resulted in detailed information on the international activities and innovativeness of Dutch SMEs.

### **Measures**

In the panel data were available for internationalization activities and innovation efforts at the firm level.

#### *Internationalization activities*

Several measures of internationalization activities are used in this paper. The measures were identified by asking the entrepreneurs whether they are currently undertaking exporting and or importing activities. Enterprises were categorized into the following categories:

- (1) **International involvement**; This variable takes the value 1 for enterprises that are exporting and/or importing goods or services and 0 for enterprises that are not involved in these modes of internationalization.
- (2) **Exports (and no imports)**; This variable gets the value 1 for enterprises that are only involved in exporting activities and that do not import goods or services from abroad, and the value 0 for all other enterprises.
- (3) **Exports and imports**; This variable is coded 1 for enterprises that are involved in exporting as well as importing activities and otherwise coded 0.
- (4) **Imports (and no exports)**; This variable takes the value 1 for enterprises that are involved in importing activities without undertaking exports, and 0 for all other enterprises.

### *Innovativeness*

Innovativeness was measured by several dichotomous (0/1) variables developed specifically for measuring innovativeness of SMEs. The following measures for the realization of innovations were used:

- **Recent product introductions (new to the firm)**. This variable is a proxy for product innovation or the renewal of products and/or services that a firm offers. The variable is coded 1 when the firm introduced at least one product new to the firm ‘during the last 3 years’; otherwise coded 0.
- **Recent changes or innovations in internal business processes**. This variable is a proxy for process innovation or the renewal or improvement of the working methods that are used. The variable is coded 1 when the firm has introduced changes or innovations in internal business processes ‘during the last three years’, and coded 0 otherwise.

Also, a number of measures for innovative practices were included in the analysis:

- **Strategic attention for innovation**. When the firm is continuously seeking for and providing support to innovative opportunities this variable is coded 1 and coded 0 in all other cases.
- **Use of external networks**. This variable is coded 1 for enterprises that keep up regular contacts with an external network of universities, suppliers and/or knowledge institutes to extent its knowledge base and is coded 0 otherwise.
- **Inter-firm co-operation**. When the firm formally co-operated with other firms or institutes to initiate or develop any renewal activities (evidenced by a formal agreement) this variable is coded 1 and otherwise it is coded 0.

### *Control variables*

The following control variables were used:

- **Sector of industry**: The firms were assigned to one of the following five industries: (1) manufacturing, (2) trade, (3) transport, (4) business services, and (5) other industries. ‘Other industries’ was used as a base case in the regression analysis (and was therefore not included in the regression equation). So four industry dummies were used to represent the industries.
- **Firm size**: Two size classes were distinguished for the SMEs in our sample: (1) 0-9 occupied persons, (2) 10-99 occupied persons.
- **Gender**: This variable takes the value 0 for females and the value 1 for males.

## EMPIRICAL ANALYSIS

The bivariate correlation coefficients between the variables for internationalization and current innovativeness are presented in Table 1. For enterprises with international involvement a significant positive correlation is found with all indicators of innovation. Recent product introductions ( $r= 0.237$ ;  $p \leq 0.01$ ) and recent changes or innovations in internal business practices ( $r= 0.130$ ;  $p \leq 0.01$ ) are positively related to enterprises that export and/or import goods or services from abroad. Also the innovative practices ‘strategic attention for innovation’ ( $r=0.169$ ;  $p \leq 0.01$ ), ‘use of external networks’ ( $r=0.109$ ;  $p \leq 0.05$ ) and ‘inter-firm co-operation’ ( $r=0.165$ ;  $p \leq 0.01$ ) show a significant positive correlation with international involvement. The variables firm size ( $r=0.101$ ;  $p \leq 0.01$ ) and gender ( $r=0.118$ ;  $p \leq 0.01$ ) also show a significant positive bivariate correlation with international involvement. Next, a significant positive effect exists for trade. On the other hand a significant negative correlation is found for business services and other industries.

Furthermore a significant positive correlation is found between ‘recent introductions of new products’ and enterprises with only exports (and no imports) ( $r= 0.116$ ;  $p \leq 0.01$ ). The variables ‘strategic attention for innovation’ ( $r= 0.106$ ;  $p \leq 0.01$ ), ‘use of external networks’ ( $r=0.059$ ;  $p \leq 0.05$ ) and ‘inter-firm co-operation’ ( $r=0.084$ ;  $p \leq 0.01$ ) also have a significant positive correlation with enterprises that are only involved in exporting activities (and that do not import goods or services from abroad).

For enterprises that both export and import a significant positive correlation can be identified between all indicators for innovation. First, a significant positive correlation is found with the variables for recent product innovations ( $r=0.256$ ;  $p \leq 0.01$ ) and recent process innovations ( $r=0.131$ ;  $p \leq 0.01$ ). The indicators for innovative practices ‘strategic attention for innovation’ ( $r=0.177$ ;  $p \leq 0.01$ ), ‘use of external networks’ ( $r=0.107$ ;  $p \leq 0.05$ ) and ‘inter-firm co-operation’ ( $r=0.195$ ;  $p \leq 0.01$ ) also show a significant positive bivariate correlation with international involvement.

For enterprises that only import goods or services from abroad (and that have no export activities) a significant positive correlation exists with the variable ‘recent changes or innovations in internal business processes’.

(INSERT TABLE 1 ABOUT HERE)

Table 2 shows percentages for each of the indicators for realization of innovation and for innovative practices across the categories for internationalization in the sample.

(INSERT TABLE 2 ABOUT HERE)

To confirm the identified relations of the correlation analysis we have to take account of other factors that may influence the propensity of enterprises to undertake international trading activities. To this end a regression analysis is carried out. International involvement is taken as the dependent variable. In order to investigate whether estimation results become different also alternative measures for internationalization are used as dependent variables. Considering the nature of the dependent variables binary logistic

regression analysis is used. Table 3 shows the results of the logistic regression analysis. The first column for each of the dependent variables pertains to the analysis where only the control variables were included in the model, whereas the second column for each of the dependent variable includes both the control as well as the predictor variables. From the model that only includes the control variables it is found that larger enterprises are more likely to undertake international trading activities than smaller ones ( $p \leq 0.01$ ). Also it can be seen that males show higher international involvement than females ( $p \leq 0.01$ ). Further, for all industry categories a positive impact is found on international involvement.

(INSERT TABLE 3 ABOUT HERE)

The following picture emerges from the analysis when the predictor variables for innovativeness are included. First of all recent product introductions have a significant positive effect on enterprises with international involvement. The effect is strongest for enterprises with both export and import activities, but also a significant effect for enterprises that only export can be identified, whereas no significant impact is found for enterprises with only import activities.

Second, the variable for recent process innovations ('recent changes or innovations in internal business processes') has a significant influence on international involvement. Interestingly a significant positive effect exists for enterprises that only import, while the effect is significant negative for enterprises that only export. No significant effect is found for enterprises with both exports and imports.

Furthermore, the variable 'strategic attention for innovation' has a significant positive impact on international involvement. A stronger significant positive effect is found for enterprises that only export than for enterprises with both exports and imports. No significant effect exists for enterprises that only import.

It can also be seen that inter-firm co-operation has a significant positive influence on international involvement. Looking at the other specifications of internationalized enterprises there is only a significant positive effect for enterprises with both exports and imports. Next, the indicator for innovativeness 'use of external networks' has no significant impact on the various measures for international business activities.

Based on the above support is found for hypothesis 1 stating that innovation is positively related to international involvement. Also some support is found for hypothesis 1A as the indicators 'recent product introductions' and 'inter-firm co-operation' have the strongest impact on enterprises that are involved in both exports and imports as compared to other categories of internationalized enterprises.

## **CONCLUSION AND DISCUSSION**

In this study we explored the relationship between innovation and international involvement. It was examined whether innovativeness (the realization of innovations and innovative practices) has an impact on (various measures of) international involvement. International involvement was defined as the extent to which enterprises are importing and/or exporting goods or services. While existing literature on internationalization of enterprises is strongly focused on export and other outward modes of internationalization, we also included inward modes of internationalization (imports) in our analysis. Also,

literature on the relationship between innovation and internationalization has thus far mainly focused on export.

From the results of the analysis it is found that innovation has a significant positive effect on international involvement. More specifically, the results suggest that SMEs that recently realized innovations (in products and/or internal business processes) are more likely to be involved in international trading activities than other SMEs. The effect of recent product innovations is strongest for enterprises with both import and export activities, but also a significant positive effect is found for enterprises with only exports. The effect of recent process innovations is significant positive for enterprises with only imports (and no exports). Remarkably, a significant negative effect was found for enterprises that only export (and do no import goods or services from abroad).

One explanation for the positive effect of recent process innovations on SMEs that only import may be that enterprises that realize process innovations may have a strong focus on internal matters of the firm. Process innovations are often initiated in order to realize cost reductions. One of the most important reasons for SMEs to import is to get access to know how and technology and to buy products at lower prices than would be possible on the national market (Hessels *et al.*, 2005). Thus, imports may provide firms with access to the necessary know how/technology or to (cheap) inputs needed for realizing the required innovations in business processes. A focus on internal processes and cost reduction may also imply that enterprises are not so much concentrating on seeking foreign market expansion, which may explain the negative effect on enterprises that only export. Process innovations, however, may result in product innovations. In accordance with previous studies it is found that product innovations may stimulate enterprises to start exporting. But the results of this study further indicate that product innovations have the strongest impact on enterprises that both export and import, which suggests that enterprises that recently introduced renewals in the products or services they offer are likely to have an outward as well as an inward oriented international focus.

Furthermore, it also found that most of the innovative practices used in the analysis have a positive impact on the likelihood of enterprises to be involved in international markets. Enterprises with strategic attention for innovation and enterprises that are formally co-operating with other firms or institutes to initiate or develop any renewal activities are more likely to be involved in international trading activities than other enterprises. Strategic attention for innovation has a significant positive impact on enterprises with both exports and imports, but the positive effect is strongest on enterprises that only export. Thus, strategic attention for innovation seems to be mainly related to an outward oriented international focus. In general it requires more effort for a firm to export than to import, which is for example illustrated by the fact that enterprises barely face barriers in the import process (Hessels *et al.*, 2005). In order to export their products or services enterprises normally need to develop an export plan and export strategy. It is possible that enterprises with strategic attention for innovation are more ready or capable to devoting strategic attention to and preparing themselves for the export process.

In addition, the results of this study reveal that inter-firm co-operation has a significant positive impact on enterprises with both exports and imports and no significant impact on enterprises that are involved in only one of the modes of internationalization. Finally, the results of the analysis suggest that keeping up regular

contacts with external networks of universities, suppliers and/or knowledge institutes does not have a significant effect on international involvement of SMEs.

Based on the analysis it may be concluded that it is useful to include imports in the analysis when studying the relationship between innovation and internationalization. Furthermore, the results indicate that it may be valuable to make a distinction between enterprises that are solely involved in import or export activities and enterprises with both imports and exports.

More research is needed in order to better understand the complex relationship between inward and outward modes of internationalization and to assess the relationship of these international business activities with innovation. Using an analysis over a longer period of time would provide better insight into the relation between innovation and internationalization behaviour of firms. In the analysis presented above only two modes of internationalization (import and export) are included in the analysis. Future research could also take account of other modes of internationalization such as foreign direct investments and international co-operation.

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Table 1:  
Correlation matrix

|   | 1       | 2                 | 3       | 4       | 5      | 6      | 7      | 8       | 9                  | 10      | 11      | 12      | 13      | 14      | 15     | 16   |
|---|---------|-------------------|---------|---------|--------|--------|--------|---------|--------------------|---------|---------|---------|---------|---------|--------|------|
| 1 International involvement                                       |         |                   |         |         |        |        |        |         |                    |         |         |         |         |         |        |      |
| 2 Exports (and no imports)  | .380**  |                   |         |         |        |        |        |         |                    |         |         |         |         |         |        |      |
| 3 Exports and imports   | .526**  | -.095**           |         |         |        |        |        |         |                    |         |         |         |         |         |        |      |
| 4 Imports (and no exports)  | .590**  | -.106**           | -.147** |         |        |        |        |         |                    |         |         |         |         |         |        |      |
| 5 Recent product introductions:<br>new to firm                    | .237**  | .116**            | .256**  | .000    |        |        |        |         |                    |         |         |         |         |         |        |      |
| 6 Recent changes or innovations<br>in internal business processes | .130**  | .002              | .131**  | .052*   | .230** |        |        |         |                    |         |         |         |         |         |        |      |
| 7 Strategic attention for<br>innovation                           | .169**  | .106**            | .177**  | -.010   | .354** | .381** |        |         |                    |         |         |         |         |         |        |      |
| 8 Use of external networks  | .109**  | .059*             | .107**  | .008    | .217** | .191** | .244** |         |                    |         |         |         |         |         |        |      |
| 9 Inter-firm co-operation   | .165**  | .084**            | .195**  | -.017   | .309** | .218** | .332** | .359**  |                    |         |         |         |         |         |        |      |
| 10 Industry: manufacturing  | .019    | -.022             | .055*   | -.009   | -.051* | -.002  | .011   | -.057*  | -.007              |         |         |         |         |         |        |      |
| 11 Industry: trade  | .230**  | -.064**           | .118**  | .246**  | .040   | -.019  | .016   | -.053*  | -.041 <sup>+</sup> | .362**  |         |         |         |         |        |      |
| 12 Industry: transport  | -.013   | .082**            | -.006   | -.069** | -.039* | .056** | -.017  | -.026   | .014               | .128**  | .158**  |         |         |         |        |      |
| 13 Industry: business services                                    | -.112** | .101**            | -.085** | -.143** | .074** | .003   | .013   | .177**  | .121**             | -.320** | -.395** | -.139** |         |         |        |      |
| 14 Industry: other industries                                     | -.174** | -.067**           | -.108** | -.088** | -.057* | -.013  | -.037  | -.065** | -.094**            | -.230** | -.284** | -.100** | -.251** |         |        |      |
| 15 Firm size  | .101**  | .011              | .149**  | -.009   | .114** | .188** | .151** | .081**  | .092**             | .092*   | -.014   | .041    | -.056*  | -.047   |        |      |
| 16 Gender   | .118**  | .045 <sup>+</sup> | .097**  | .038    | .049*  | .132** | .084** | .093**  | .112**             | .017    | .012    | -.003   | .056*   | -.101** | .085** |      |
| Mean  | 0.32    | 0.06              | 0.12    | 0.14    | 0.34   | 0.59   | 0.56   | 0.46    | 0.35               | 0.23    | 0.31    | 0.05    | 0.26    | 0.15    | 1.10   | 0.82 |
| Standard Deviation  | 0.47    | 0.25              | 0.32    | 0.35    | 0.47   | 0.49   | 0.50   | 0.50    | 0.48               | 0.42    | 0.46    | 0.22    | 0.44    | 0.36    | 0.29   | 0.38 |

\*\* p ≤ 0.01, \* p ≤ 0.05, + p ≤ 0.10

Table 2:  
Presence of new product/process innovations and innovative practices across internationalized enterprises

|   | <i>Total sample</i> | <i>International involvement</i> | <i>Only exports (and no imports)</i> | <i>Exports and Imports</i> | <i>Only imports (and no exports)</i> |
|---|---------------------|----------------------------------|--------------------------------------|----------------------------|--------------------------------------|
| <b>Recent product introductions: new to firm</b>                    | 34%                 | 50%                              | 55%                                  | 67%                        | 34%                                  |
| <b>Recent changes or innovations in internal business processes</b> | 59%                 | 69%                              | 59%                                  | 77%                        | 65%                                  |
| <b>Strategic attention for innovation</b>                           | 56%                 | 68%                              | 76%                                  | 80%                        | 54%                                  |
| <b>Use of external networks</b>                                     | 46%                 | 54%                              | 57%                                  | 61%                        | 47%                                  |
| <b>Inter-firm co-operation</b>                                      | 35%                 | 47%                              | 51%                                  | 61%                        | 33%                                  |

Table 3:  
Binary logistic regression results

|   | Dependent variable        |                         |                               |               |                     |               |                               |               |
|---|---------------------------|-------------------------|-------------------------------|---------------|---------------------|---------------|-------------------------------|---------------|
|   | International involvement |                         | Only exports (and no imports) |               | Exports and Imports |               | Only imports (and no exports) |               |
| <b>Recent product introductions: New to the firm</b>                |                           | <b>0.79**</b>           |                               | <b>0.70**</b> |                     | <b>1.14**</b> |                               | <b>-0.07</b>  |
| <b>Recent changes or innovations in internal business processes</b> |                           | <b>0.21<sup>+</sup></b> |                               | <b>-0.52*</b> |                     | <b>0.28</b>   |                               | <b>0.48**</b> |
| <b>Strategic attention for innovation</b>                           |                           | <b>0.26*</b>            |                               | <b>0.85**</b> |                     | <b>0.46*</b>  |                               | <b>-0.25</b>  |
| <b>Use of external networks</b>                                     |                           | <b>0.20</b>             |                               | <b>0.04</b>   |                     | <b>0.15</b>   |                               | <b>-0.17</b>  |
| <b>Inter-firm co-operation</b>                                      |                           | <b>0.36**</b>           |                               | <b>0.10</b>   |                     | <b>0.73**</b> |                               | <b>-0.11</b>  |
| Constant  | -3.07**                   | -3.35**                 | -4.10**                       | -4.37**       | -5.23**             | -5.94**       | -2.63**                       | -2.70**       |
| Industry: manufacturing <sup>1</sup>                                | 1.14**                    | 1.16**                  | 0.73 <sup>+</sup>             | 0.65          | 1.41**              | 1.37**        | 0.73**                        | 0.76**        |
| Industry: trade   | 1.78**                    | 1.78**                  | 0.45                          | 0.32          | 1.66**              | 1.56**        | 1.58**                        | 1.62**        |
| Industry: transport   | 0.94**                    | 0.95**                  | 1.85**                        | 1.93**        | 1.04*               | 1.00*         | -0.61                         | -0.65         |
| Industry: business services   | 0.65**                    | 0.44*                   | 1.45**                        | 1.28**        | 0.65 <sup>+</sup>   | 0.29          | -0.24                         | -0.24         |
| Firm size   | 0.60**                    | 0.28                    | 0.09                          | -0.09         | 1.04**              | 0.66**        | -0.17                         | -0.25         |
| Gender  | 0.66**                    | 0.52**                  | 0.48                          | 0.43          | 0.93**              | 0.72*         | 0.29                          | 0.24          |
|   |                           |                         |                               |               |                     |               |                               |               |
| Nagelkerke R <sup>2</sup>   | 0.124                     | 0.206                   | 0.055                         | 0.107         | 0.101               | 0.235         | 0.118                         | 0.129         |
| - Δ -2 Log likelihood   | 2124**                    | 2002**                  | 838**                         | 800**         | 1209**              | 1071**        | 1361**                        | 1350**        |
|   |                           |                         |                               |               |                     |               |                               |               |
| Observations  | 601                       | 601                     | 125                           | 125           | 256                 | 256           | 220                           | 220           |

Standardized regression coefficients; \*\* p [two-tailed] ≤ 0.01, \* p [two-tailed] ≤ 0.05;

<sup>+</sup> p [two-tailed] ≤ 0.10

<sup>1</sup> Industry category “other industries” used as base case

**Frontline HR Involvement and Satisfaction in Small and Emerging Firms:  
An Exploratory Analysis**

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## **Frontline HR Involvement and Satisfaction in Small and Emerging Firms: An Exploratory Analysis**

Many times employees in small and emerging firms make the difference between success and failure. In many cases, the owner or manager of a small emerging business handles the human resource functions alone since he or she is usually limited when the firm employs only a few people. Also, even as the firm grows, it may not have the resources to hire a human resource specialist. This practice of informal human resource management may be detrimental to a firm's success. Each year there are a large number of failures in smaller firms in different geographic locations and in different industries. In many cases, the owners report managerial incompetence as the major underlying reason (Dun & Bradstreet, 2001). One specific area of managerial incompetence continually cited is dealing with employee problems that includes recruiting, selection, ineffective or nonexistent training, compensation and benefits, and weak or nonexistent performance appraisal.

There has been a large amount of recent literature devoted to human resource management for larger firms. HRM issues that have been researched include the importance of human capital (Stewart, 1992); the impact on performance and turnover (Arthur, 1994); the impact on financial performance (Huselid, 1995); the impact on organizational performance (Delaney and Huselid, 1996; Huselid, Jackson, and Schuler, 1997); and HRM's effect on competitive advantage (Lado & Wilson, 1994; Barney, 1991; and Kamoche, 1996). An examination of the progress of human resource management's impact on firm's performance as well as its prospects for the future (Becker & Gerhart, 1996) has caused researchers to examine the relationships and configurations within organizations that lead to effective human resource architecture (Lepak & Snell, 1999). On the other hand, research concerning HR practices in

small and emerging organizations is more embryonic. While these businesses make up the majority of firms in the U.S., much less research exists to help us understand the dynamics of effective HR functions in these firms.

### **Recent Literature on the Role HR in Emerging Firms**

In the midst of the recent increase in HRM research, there is still a lack of concentration or applicability to smaller ventures. It should not be assumed that the research results demonstrated from larger firms automatically apply to smaller ventures. In fact, specific research on the HRM practices of smaller ventures has been called for (Purcell, 1993) in order to better assess the needs, concerns, challenges and strategies that will enhance their growth and performance. Marlow & Patton (1993) argued that the effective management of human resources is emerging as a key to survival for smaller ventures.

The practice of effective human resource management is one that has been shown to be an integral part of the success of smaller businesses (Hornsby and Kuratko, 1990; Smith, 1991; Deshpande and Golhar, 1994; Jones, Morris, and Rockmore, 1995; and Wager, 1998). The vast majority of businesses in the U.S. today employ fewer than 100 people (U.S. Small Business Administration, 2000) yet, as illustrated earlier, most research conducted in the HRM field tends to focus on larger firms that employ full-time HRM professionals.

One early study of HRM functions in smaller ventures found that areas of accounting, finance, production, and marketing, all take precedence over human resource management (McEvoy, 1984). In many cases, the owner of a small emerging business handles the human resource functions alone since he or she is usually limited when the firm employs only a few people. This practice of informal human resource management may be detrimental to a firm's success. Each year there are a large number of failures in smaller firms (across different geographic locations and in different industries). Owners report managerial incompetence as the major underlying reason for these failures (Dun & Bradstreet, 2000). One specific area of managerial incompetence continually cited is dealing with employee problems which includes

recruiting, selection, ineffective or nonexistent training, lack of benefits, lack of incentives, inequitable compensation and weak or nonexistent performance appraisal.

A survey conducted by Hess (1987) showed that owners of smaller ventures rank HRM practices as the second most important management activity next to general management work. Amba-Rao and Pendse (1985) surveyed the compensation and maintenance practices of 78 small firms. Their study found that most firms lacked any systematic or rational approach in their compensation practices. Little (1986) examined the HRM functions in 275 small firms employing fewer than 100 employees. This study found that typically the owner of a firm with less than 50 employees handled the HRM function, while 62 percent of the firms with 51 to 100 employees had a full-time human resource manager.

Only a handful of HRM studies on U.S. small ventures were conducted in the 1990s. The empirical research seemed to suggest that smaller firms were progressing in developing HRM practices and policies. Hornsby and Kuratko (1990) studied 247 smaller ventures and found that firms under 50 employees had very little in place regarding formal HRM practices; however, firms with 50 to 100 and 101 to 150 employees had similar HRM practices in place. These firms cited the availability of a quality labor pool as the most critical HRM issue. Another basic finding was that company size did significantly affect the use of formalized HRM practices, especially for job analysis, recruitment, compensation, benefits and incentive plans. However, less than half the firms surveyed employed any formal HRM practices.

In a study of Canadian businesses, Ng and Maki (1993) found a significant difference between large and small firms in their ranking of the importance of HRM functions. Smaller firms rated the retaining, obtaining and identifying functions as most important while large firms rated adjustment, identifying and developing employees as most important. In another Canadian study, Deshpande and Golhar (1994) found that workforce characteristics including firm success, ability to inspect work, worker flexibility, ability to work in groups, and self-discipline were perceived to be more significant to smaller firms. Duberley and Walley (1995) concluded from a

study of sixteen manufacturing firms that there existed a wide variety of practices among firms yet few had developed an integrated set of strategic HRM practices.

Wager (1998) studied the determinants of HRM functions in small Canadian firms and found that less than half of the companies surveyed utilized formal appraisal (50 percent), sexual harassment policies (35 percent), employee pensions (30 percent), TQM (34 percent), employee assistance programs (21 percent), employee attitude surveys (27percent), and employee relations (19 percent). The research also showed that firms which emphasized open communication and employee participation were much more likely to have formal HRM procedures.

The studies cited above found consistent results regarding the limited use of HRM functions in smaller firms. However, after the Hornsby and Kuratko (1990) study, most of the research that investigated the extent of usage of formal HRM activities was conducted outside the U.S. The goal of this study was to investigate the current state of human resource management practices in U.S. smaller ventures as well as the critical HRM issues of small business owners, and compare to the findings in a study ten years ago (Hornsby and Kuratko, 1990).

### **Frontline HR Management**

Since many small and emerging companies do not have a designated human resource person, the responsibility of identifying and developing key personnel often is bestowed on the line managers. In fact, managers actually implement most functions while human resource representatives administer and coordinate these activities. Specifically, managers are usually responsible for interviewing, training, appraising and disciplining their subordinates. In addition, managers play important roles in compensation, safety, job analysis and planning. Therefore, managers will serve as the first-line human resource manager for your company. This is especially the case in smaller firms and growing firms where the existence of a human resource department is less likely. Approximately 99.7 percent of all businesses in the United States have

less than 500 employees and 78.8 percent have less than 10 employees (U. S. Small Business Administration Office of Advocacy (1997)).

While smaller firms espouse to grow into larger firms, focus is needed to provide guidance on effectively dealing with human resource issues as they emerge from a fledgling company to one that must deal the challenges presented by larger employee groups. In support of this argument, a study of young entrepreneurs found that HR topics ranked highest among areas for needed learning (Heneman, Tansky, and Camp, 2000). The purpose of this paper is to examine the use and satisfaction of human resource practices by frontline managers in emerging firms. Specifically, this study examines the extent to which these managers practice effective HR, their satisfaction with these activities, and the amount of training their firms provided.

## **Method**

### **Sample**

Three hundred emerging companies located in the Midwest United States were sent a survey concerning their company's practices regarding frontline HR management. Student research assistants were utilized for survey distribution and data collection. Using surveying methodology similar to McEvoy (1984) and Hornsby and Kuratko (1990), research assistants utilized Chamber of Commerce directories to develop a survey list. These directories were the same data source used in the Hornsby and Kuratko (1990) study. Probable respondents were contacted and asked to participate. Surveys were then distributed and collected by the research assistants. The respondents were further divided into three size categories based on the theory that, in general, a company's human resource practices will become more sophisticated as employment size increases. Specifically, three size categories were utilized. The first category included "smaller" firms with companies having 100 and under employees. The second category consisted of "medium-sized" small firms and included companies that employed between 101

and 500 employees. Finally, the third category consisted of “larger” small firms and included companies that employed between 501 and 1000 employees.

### **Instrumentation**

The data were gathered by means of the 15-item questionnaire. The survey investigated each company’s demographic background (i.e., type of business, size, and revenues) and frontline HRM practices in seven major areas (hiring/selection, HR planning, performance appraisal, training/coaching, wage administration, safety administration, and discipline/employee relations). The respondents were asked to rate, using a five-point Likert scale, their frontline manager’s involvement with these functions and the extent to which these frontline managers are held accountable for these HR responsibilities. In addition, respondents were asked whether or not training is offered to frontline managers and the extent to which the training is offered. Finally, respondents were given a chance to list the most significant challenges facing managers and supervisors.

### **Results**

A total of 110 surveys were returned representing a 36.7 percent response rate. Tables 1 and 2 provide a descriptive summary of the results. Some overall results worth noting are described below.

- On a scale of 1 to 5 with 5 indicating very important, respondents rated the importance of HR activities at 4.7 average.
- On a scale of 1 to 5 with 5 indicating very involved respondents rated overall managerial/supervisory involvement at 3.78. When broken down by HR function the average involvement was rated at 4.43, 2.77, 4.52, 3.69, 3.15, 3.63, and 4.28 for hiring, planning, appraisal, training, wages, safety, and discipline respectively. Further analysis found that overall, firms with 50 to 100 employees have managers most involved in HR practices and firms 101 to 200 have managers least involved.

- On a scale of 1 to 5 with 5 representing most satisfied, respondents were most satisfied with the hiring activities of their frontline managers (mean=3.95) and least satisfied with the planning activities conducted (mean=3.22). Smaller firms with less than 200 employees were more satisfied with the HR practices of their managers.
- Fifty-nine percent of the respondents indicated that they offered some sort of formal training for their managers in the form of in-house seminars, college courses and online programs. Most the training was in the areas of discipline and appraisal.
- The top five challenges facing frontline managers, as cited by the respondents, include keeping up with laws and regulations, employee relations/discipline, consistency and fairness, finding quality employees, and training.

A further breakdown by size category as presented in Table 1. Some interesting size differentials are noted below.

- Firms over 100 employees are twice as likely to have an HR professional.
- The importance of frontline manager responsibilities for administrative HR such as compensation and planning decline as the size category gets larger.
- There appears to be little difference across size categories for the importance of the supervisor's role in the following: performance appraisal, training, safety, and discipline. Also, in all cases, the average rating of importance was above 4.0 signifying the critical role played by the frontline manager in these functions.
- As the size categories increase, satisfaction with how all seven HR functions studied are performed seems to decline.

- Findings for the percentage of firms holding frontline managers accountable for each HR function parallel the findings cited earlier regarding the importance of the supervisor's role in each of the seven HR areas studied.
- Firms larger than 101 employees seem to offer more training, especially in performance appraisal, training, safety, hiring, and discipline. Most of the training seems to be in the areas of performance appraisal and discipline.

### ***Discussion***

The implications of this study are that firms entrust their managers with a high level of employee responsibility but do not provide sufficient training and preparation for these managers to be successful (especially in smaller firms). As firms continue to outsource HR management or downsize HR managers, the role of the line manager in conducting HR practices will continue to grow. This gap in practice and training should be narrowed.

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**Table 1. HR Survey Results by Size Category**

|  | <i>100 and under</i> | <i>101 to 500</i> | <i>over 500</i> |
|--|----------------------|-------------------|-----------------|
| Percent of Sample                                      | 22.5                 | 38.7              | 38.7            |
| Percent of Respondents Role                            |                      |                   |                 |
| <i>HR Professional</i>                                 | 44.0                 | 81.4              | 79.1            |
| <i>Line Managers</i>                                   | 44.0                 | 7.0               | 9.3             |
| <i>Professional Staff</i>                              | 12.0                 | 11.6              | 11.6            |
| Percent in Industry                                    |                      |                   |                 |
| <i>Manufacturing</i>                                   | 24.0                 | 37.2              | 39.5            |
| <i>Service</i>   | 40.0                 | 23.3              | 9.3             |
| <i>Health</i>  | 16.0                 | 18.6              | 4.7             |
| <i>Retail</i>  | 0.0                  | 4.7               | 9.3             |
| <i>Public</i>  | 12.0                 | 14.0              | 34.9            |
| <i>Other</i>   | 4.0                  | 2.3               | 2.3             |
| Average Importance of...                               |                      |                   |                 |
| <i>Supervisor Role in HR</i>                           | 4.58                 | 4.79              | 4.79            |
| <i>Supervisor Involvement in Hiring/Selection</i>      | 4.52                 | 4.51              | 4.26            |
| <i>Supervisor Role in Planning</i>                     | 3.04                 | 2.86              | 2.74            |
| <i>Supervisor Involvement in Performance Appraisal</i> | 4.48                 | 4.53              | 4.42            |
| <i>Supervisor Involvement in Training</i>              | 3.96                 | 3.72              | 3.88            |
| <i>Supervisor Involvement in Wage Increases</i>        | 3.64                 | 3.02              | 2.98            |
| <i>Supervisor Involvement in Safety Administration</i> | 3.76                 | 3.83              | 3.86            |
| <i>Supervisor Involvement in Discipline</i>            | 4.2                  | 4.34              | 4.30            |
| Average Satisfaction with Current...                   |                      |                   |                 |
| <i>Hiring</i>  | 4.33                 | 3.88              | 3.91            |
| <i>Planning</i>  | 3.38                 | 2.83              | 3.14            |
| <i>Performance Appraisal</i>                           | 4.13                 | 3.43              | 3.44            |
| <i>Training</i>  | 3.79                 | 3.10              | 3.16            |
| <i>Wage Administration</i>                             | 3.75                 | 3.15              | 3.38            |
| <i>Safety</i>  | 3.67                 | 3.64              | 3.49            |
| <i>Discipline</i>                                      | 4.00                 | 3.62              | 3.51            |

**Table 1. HR Survey Results by Size Category (continued)**

|   |       |      |      |
|---|-------|------|------|
| Percent of Frontline Managers Held Accountable For... |       |      |      |
| <i>Hiring</i>   | 76.0  | 60.5 | 72.1 |
| <i>Planning</i>                                       | 28.0  | 16.3 | 11.6 |
| <i>Performance Appraisal</i>                          | 88.0  | 76.7 | 90.7 |
| <i>Training</i>                                       | 96.0  | 48.8 | 62.7 |
| <i>Wage Administration</i>                            | 44.0  | 30.2 | 30.2 |
| <i>Safety</i>   | 56.0  | 60.5 | 51.2 |
| <i>Discipline</i>                                     | 80.0  | 79.1 | 90.7 |
| % Formal Training Offered                             |       |      |      |
| <i>Yes</i>  | 48.0  | 88.4 | 88.4 |
| <i>No</i>   | 52.0  | 11.6 | 11.6 |
| % Types of Training Offered*                          |       |      |      |
| <i>In-house</i>                                       | 58.3  | 57.9 | 97.4 |
| <i>Seminars</i>                                       | 100.0 | 76.3 | 78.9 |
| <i>College Courses</i>                                | 16.7  | 36.8 | 44.7 |
| <i>Internet</i>                                       | 25.0  | 36.8 | 39.5 |
| % Training in...*                                     |       |      |      |
| <i>Performance Appraisal</i>                          | 50.0  | 55.3 | 73.7 |
| <i>Training</i>                                       | 8.3   | 63.2 | 55.3 |
| <i>Wage Administration</i>                            | 16.7  | 15.8 | 13.2 |
| <i>Safety</i>   | 33.3  | 60.5 | 42.1 |
| <i>Hiring</i>   | 33.3  | 55.3 | 50.0 |
| <i>Discipline</i>                                     | 41.7  | 78.9 | 73.7 |

\* *Of those who offer formal training*

**Table 2. Major Challenges Facing Frontline Managers**

| <i>Challenges</i>  | <i>Frequency</i> |
|--|------------------|
| Keeping up with and understanding laws and regulations             | 14               |
| Employee relations/discipline                                      | 11               |
| Consistency/fairness   | 8                |
| Finding quality employees  | 8                |
| Training: safety, equality, and efficiency                         | 7                |
| Evaluations, performance appraisals                                | 6                |
| Time management  | 6                |
| Changing workforce, workplace                                      | 6                |
| Coaching employees   | 5                |
| Retention of employees   | 5                |
| Managerial communication   | 5                |
| Assessing management/leadership                                    | 3                |
| Productivity/efficiency  | 3                |
| Save money on labor, health care, etc.                             | 3                |
| Strategic planning   | 3                |
| Communication and confidentiality                                  | 3                |
| Documentation  | 3                |
| Employee motivation  | 3                |
| Outsourcing competition and high turnover                          | 3                |
| Placing people properly  | 2                |
| Absenteeism  | 2                |
| Opinion of HR  | 2                |
| Hiring and accommodating persons with various disabilities         | 1                |
| Managing resources while traveling                                 | 1                |
| Compensation   | 1                |
| Hiring   | 1                |
| Conflict resolution  | 1                |
| Celebrate the successes of staff; don't just focus on bad behavior | 1                |
| Communication of policies/procedures                               | 1                |
| Ethics   | 1                |
| Diversity  | 1                |

# ENTREPRENEURSHIP AND ECONOMIC DEVELOPMENT: A CASE STUDY OF TAIWAN

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## **Abstract**

In the new economic era that features speedy advancement in technology, entrepreneurship has become one important element of economic development. Although recent empirical studies based on data collected mainly in the mature economies have, to some extent, shed light on the interactive roles of entrepreneurship and economic development, they have so far failed to demonstrate detailed chronicle evidences. Furthermore, little evidence has thus far been presented based on experience drawn from newly industrialized economies. Taiwan has long been famous for its abundant entrepreneurial resources and speedy development. This study focusing on Taiwan, has compiled data covering various stages of economic development to clarify the relationship between entrepreneurship and economic development. We use both the rates of self-employment and the shares of SMEs as main indicators of entrepreneurship in this study. The empirical evidence shows the systematic relationship that exists between entrepreneurship and economic growth, with both the time trend of rates of self-employment and that of the SME sector coming hand in hand as the economy developed. We have further demonstrated that as Taiwan reached the more matured stage of development, the rates of self-employment catch the essence of entrepreneurship better than the importance of SMEs. We then show that as the supply of Schumpeterian entrepreneurs in the island is amounting, the rates of self-employment continue to increase, and then we see the subsequent growth of the economy. This study also demonstrates empirically the existence of the hypothesized U shaped trend of entrepreneurship that based on deductions from the experience of industrialized countries realized in Taiwan.

## **Introduction**

In the new economic era that features speedy advancement in technology, entrepreneurship has become one important element of economic development. In the new century, the comparative

advantage of an economy lies in the abundance as well as quality of entrepreneurs in stead of traditional inputs such as labor and capital. Entrepreneurship, though an old concept, has now become an important research topic in the new settings. Many studies launch to decide empirically the relationship between entrepreneurial activity and economic development. These studies have, to some extent, shed light on the interactive roles of entrepreneurship and economic development, with some empirical studies based on evidences drawn from recent experience in well-developed economies, showing that there exists a positive relationship between entrepreneurship and the growth rate of an economy. However, none of these works is based on less-developed sample, and most of them consider only cross sectional data. In order to enrich our understanding of the relationship between entrepreneurship and macroeconomic development, there is a need for an enhanced empirical study aimed at highlighting long-term observation of a fast growing economy, such as Taiwan.

Taiwan, who is famous for her speedy economic development, has been described as a boss's island for its flourishing entrepreneurial resources. Taiwan's SME sector is considered to be a major contributor of the island's economic growth. Even though SME sector can be seen as a vehicle for entrepreneurship, little evidence so far demonstrates directly the linkage between entrepreneurship and Taiwan's economic development. The main purpose of this study is to clarify the relationship between entrepreneurship and economic development with Taiwan, a catching-up economy, as a case study. We will use census data published from 1960s to 2000s to decide the pattern of the long run evolution of Taiwan's entrepreneurial resources as the economy progresses.

The paper is structured as follows. We begin by carrying out a literature review in the next section, followed in the subsequent section by observing the long-term evolution of relevant census data from Taiwan, and examining the hypothesis regarding economic development and entrepreneurial activity. We close by a summary of our findings.

## **Literature Review**

Since SMEs have often been considered to be an indication of entrepreneurship, many works circle around the issue of the relationship between SMEs and economic growth in the late 1990s. Thurik (1996) empirically applies data from twelve European Union member countries to examine whether the growth of small firms has any significantly higher impact on GNP growth than the growth of large firms, and concluded that smaller, and thereby, more flexible, firms are the answer to Europe's problems of unemployment and weak competitiveness. Furthermore, base

on the evidence from thirteen European countries, Carree and Thurik (1998) indicate that in 1990, the increase in the employment share of large firms has a negative effect on output growth. Apart from these works used mainly European cross country data, Acs, *et al.* (1999) base on manufacturing data within US from the early 1990s, and find a negative impact on productivity dynamics from the shares of small businesses. Also in a regional setting, Shaffer (2002) tests the Schumpeterian hypothesis, and suggests small manufacturers and retailers are positively associated with economic growth rates in the US. Based on data covering thirty-seven countries, over the period from the 1960s to the 1990s, Hu and Liu (2003) support empirically the hypothesis that small businesses are beneficial to economic prosperity. Hu and Liu (2003) also draw conclusion that in the pursuit of economic growth, SMEs in the high-income economies will generally exploit entrepreneurship, whilst in the less-developed economies they will tend to drive the job-creation function.

More recently, we find many works address directly the issue of the impact of entrepreneurship. There are studies attempt to test empirically the indication of entrepreneurial activity that lead to economic development. Among them, many use regional data within a country. Audretsch and Fritsch (2003) use regional data from West Germany to link entrepreneurship to growth, and find only the growth in the 1990s were relating to entrepreneurial activity in the 1980s. In another article, Audretsch and Keilbach (2004: 419) also find in Germany, there is a positive linkage between entrepreneurship capital and regional economic performance. Other recent empirical works with regional data suggest similar results. For example, Braunerhjelm and Borgman (2004) with Swedish data, and Berkowitz and DeJong (2005) with Russian data both illustrate the regional entrepreneurial activity is relating to subsequent regional growth.

Two studies consider cross-nation evidences. Salgado-Banda (2002) uses data of 22 OECD countries from 1978 to 1998 and finds different measures of entrepreneurship entail different results on economic growth. Innovation has positive impact on growth, while self-employment reduces growth. Tang and Koveos (2004) test the hypothesis with cross-country data, their results are also mixed. They conclude that the relationship between entrepreneurship and economic growth largely depends on the measures of entrepreneurship as well as the country group with differential income level.

Even though this line of research does draw a lot of attentions, and it does provide many empirical evidences, there is limitation. For example, not much recent cross- nation studies are made. The implications deduced from researches with cross- sectional regional data to test the relationship between growth and entrepreneurship are not quite the same as those from cross

national data. Those works based on nation wise data have tended to draw mainly on the experiences of the industrialized countries.

Further, none of these empirical studies is based on long-run time-series data. With the only exception when Baumol (2004) discusses entrepreneurial enterprises as one of the free-market growth machine. In his attempt to provide indicators, Baumol (2004: 17 and 18) uses long-term growth trend of British per capita GNP and the increasing trend of US private R&D expenditure for last five decades to demonstrate the exploding of both income and R&D activity.

Why only a handful of empirical study draws from long-run observations? The answer lies mainly in the lack of proper sample. While the subject about economic development and entrepreneurship needs to be supported by successful demonstration with some long-term, single-economy observations. Wennekers and Thurik (1999) provide a detailed survey of the literature surrounding entrepreneurship and economic growth. The authors also use historical case studies with East Asian miracle as empirical evidences of the positive relationship between entrepreneurship and economic development. Taiwan is considered to be one of the high-performing Asian economies in their study, and a successful example of an economy with long-term growth (Wennekers and Thurik, 1999: 39).

Now that the focus is on long-term growth of a nation, the angle must shifts from cross sectional observation to time series consideration. When consider the feedbacks from economic development to entrepreneurial activity, Wennekers and Thurik (1999: 48, 49) illustrate a tentative U-shaped trend of self-employment rates over time. As the stage of economic development proceeds, increased income will first decrease self-employment rate, then, as economy matured, the number of Schumpeterians and intrapreneurs will increase. So far, there is no empirical study addresses directly the hypothesis concerning the long-term trend of entrepreneurial activity; we therefore see a need to generalize our empirical study of these issues by taking into account a complete development process of a real economy.

### **Entrepreneurial Activity and Taiwan's Economic Development**

As one of the most dynamic economies in the world, Taiwan is often considered to have the most flourishing entrepreneurial activity. For example, it is well documented that in Taiwan, SMEs involved directly or indirectly in the production process, combining with their larger counterparts to supply output to the markets, form a healthy industrial structure that is beneficial to economic development (Schive and Hu, 2001: 254). Table 1 reports the time trends of data representing

economic development (per capita GNP), and entrepreneurial activity using Taiwan's census data prepared between 1961 and 2001. Three indicators of entrepreneurial activity are used: SME shares in number of firms, employment share of SMEs, and the self-employment rate, which is defined as the ratio of the number of entrepreneur (firm owner or self-employed person) to work force in Taiwan private sector. SMEs are defined here as firms with less than 100 employees.

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Table 1 here

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SMEs have accounted for a large share of total number of companies in almost all economies. In Taiwan, the situation is even more obvious. For example, in 1961, 99.57 percent of private enterprise in Taiwan was SME. This ratio slipped slightly to 98.9 percent in 1976, and then followed by a rising trend (see Table 1). It is evident from these figures how Taiwan earns the reputation of being an island of boss. As another indicator of entrepreneurship, the employment shares of SMEs first decreased then increased. The increasing trend started from 1971, when employment share of SMEs was 52.52 percent, which rose to 57.89 percent in 1986. Then, from 1986 to 1996, the share rose to a new peak of 66.75 percent, an increase of nearly 9% over the ten-year period.

Although the importance of SMEs experienced a recent decrease, they still accounted for more than 60 percent of total employment, and 52 percent through out the sample period. Finally, the last indicator of entrepreneurship in Table 1, the number of firm owner as a share of total work force first decreased from 14.33 percent in 1961 to 10.22 percent in 1976, then increased to 12.15 percent in 2001. These records were documented as the economy progressed. Back in 1961, the per capita GNP of Taiwan was only 154 (USD). Back then, Taiwan was a low income country according to the World Bank categorization. In 1976, Taiwan was already a middle income nation, with a 1,132 (USD) per capita GNP. After 1991, Taiwan proudly graduated into the high income class.

Figure 1 highlights the U shaped, reversing trend of the rates of self-employment. It is also interested to note that the turning point of the trend of the self-employment rates was witnessed in 1976, the same time when the share of SMEs as the number of company rocked bottom. Figure 1 also shows the reversing trend of the employment share of SMEs, and the recent down turn in Taiwan. The trend of the employment share of SMEs first reversed in 1971, a little earlier than that of self-employment rates and number share of SMEs. The second time when the trend of the employment share of SMEs reversed was recorded in 2001, about the same time the economy was

experiencing first and only business downturn during the sample period.

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Figure 1 here

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Today, per capita GNP in Taiwan has reached a record high of 14,032 (USD). Since the most recent statistics reveal that Taiwan has finally regain vitality, while the rates of self-employment have been growing since 1970s, there must be some connection between Taiwan's entrepreneurship and economic development. This result also echoes that of Audretsch and Fritsch (2003). In the discussion of the development and contribution of Taiwan's SMEs, Hu (2003) has contributed the abundance and quality of the pool of entrepreneurship as an important facilitating factor to the nation's economy. Entrepreneurs in Taiwan not only provide competitive edge to enhance free- market growth machine. They are also important job providers. The strong entrepreneurship in Taiwan also stimulates a high rate of technology diffusion (Hu and Schive, 1998). By playing various roles, Taiwanese entrepreneurs have helped directly and indirectly the speedy development of the economy.

Will these heroic entrepreneurs maintain their importance when facing the new challenge in the know-based environment? Will there be enough Schumpeterian entrepreneurs sprout in the economy? Both answers are positive for Taiwan. When looks at the market entry of Taiwan manufacturers, Hu (2004) discovers that the electrical and electronic machinery industry has the highest entry rate among all other 2 – digit manufacturing industries. From 1993 to 1997, the average annual entry rate for electrical and electronic machinery industry in Taiwan is 18.2 percent. Which means a majority of contenders in the market is from the high-tech sector. Since the electrical and electronic machinery industry is considered to be an important sector for innovation, these new comers must fit in the Schumpeterian profile.

### **Concluding Remarks**

Taiwan has long been famous for its abundant entrepreneurial resources. Although recent empirical studies based on data collected mainly in the mature economies have, to some extent, shed light on the interactive roles of entrepreneurship and economic development, they have so far failed to demonstrate detailed chronicle evidences. Furthermore, little evidence has thus far been presented based on empirical data on the newly industrialized, fast growing economies, such as Taiwan. In this study, we have compiled data covering the period from the 1960s to 2000s. These samples represent the status of Taiwan economy and entrepreneurship in various stages of

economic development. The empirical evidence shows the systematic relationship existing between entrepreneurship and economic growth, with both the time trends of the rates of self-employment and that of the SME sector coming hand in hand with economic development.

We have further demonstrated that as Taiwan has become a member of high income nations, the rates of self-employment catch the essence of entrepreneurship better than the importance of SMEs. Both trends now evolve differently. After the long term prosperity over the last five decades, Taiwan economy experienced business downturn in the turn of the century. Giving the fact that the supply of Schumpeterian entrepreneurs is amounting, the rates of self-employment still increase, we see the subsequent growth of the economy after previous set back.

Finally, it is demonstrated in our study, a real life example of the long term relationship between entrepreneurship and economic development depicted by Wennekers and Thurik (1999). Who hypothesized a U shaped trend of entrepreneurship as the economy developed, based on deductions from the experience of industrialized countries. This result not only shows Taiwan's economy has leaned closer toward other more developed counterparts. It also demonstrates the quality of Taiwanese entrepreneurs is fact first class in the world.

Given the limited number of observations, more sophisticated, influential statistical methods are precluded from our study. No definitive conclusions on the relationship between macroeconomic development and entrepreneurial activity can be drawn from these statistics. However, there is sufficient evidence to suggest that Taiwanese entrepreneurs are the 'jewel in the crown' of the island's economy.

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**Table 1** Entrepreneurial Activity and Economic Development in Taiwan, 1961-2001

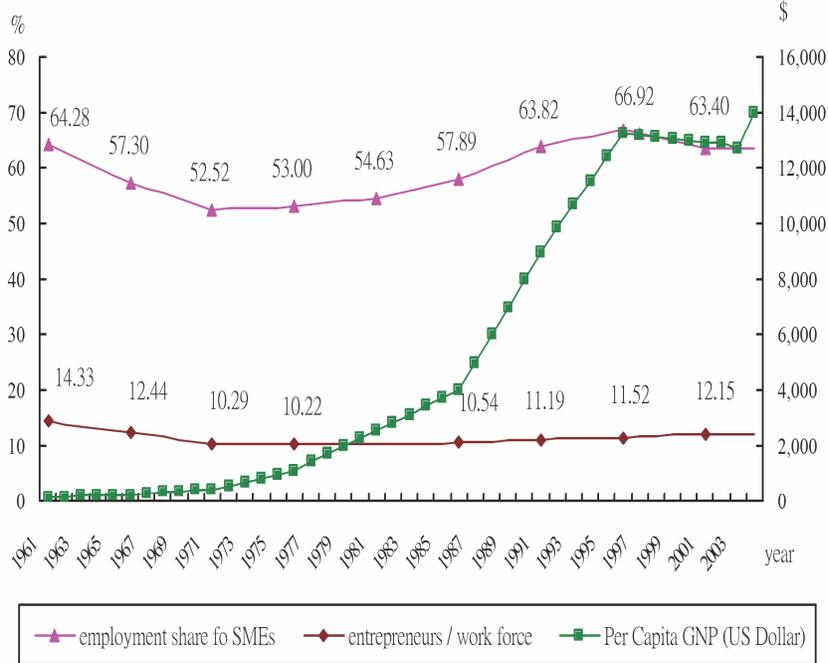
| Year | SMEs (1-99 persons) share (%) |            | Entrepreneurs/Work force (%) | Per Capita GNP (US\$) |
|------|-------------------------------|------------|------------------------------|-----------------------|
|      | No. of Firms                  | Employment |                              |                       |
| 1961 | 99.57                         | 64.28      | 14.33                        | 154 <sup>a</sup>      |
| 1966 | 99.28                         | 57.30      | 12.44                        | 237                   |
| 1971 | 98.96                         | 52.52      | 10.29                        | 443                   |
| 1976 | 98.90                         | 53.00      | 10.22                        | 1,132                 |
| 1986 | 99.00                         | 57.89      | 10.54                        | 3,993                 |
| 1991 | 99.24                         | 63.82      | 11.19                        | 8,982                 |
| 1996 | 99.37                         | 66.75      | 11.52                        | 13,260                |
| 2001 | 99.38                         | 62.29      | 12.15                        | 12,876                |

Note: a) Figure in 1960.

Source: The author compiled from *Industrial and Commercial Census of the Republic of China*, Directorate-General of Budget, Accounting and Statistics, Executive Yuan, R.O.C., and *Taiwan Statistical Data Book*, Council for Economic Planning and Development, R.O.C., various issues.

**Figure 1**

Entrepreneurs and SMEs share and Per Capita GNP in Taiwan: 1961-2004



**E-Mentoring for Entrepreneurial Development: *a review of the largest European E-Mentoring programme for SMEs***

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**ABSTRACT**

Electronic Mentoring or E-Mentoring as it is more commonly termed, although becoming established in some fields, is still relatively new in the area of supporting the development of entrepreneurs; the Small Business Service<sup>1</sup> (SBS) and South East England Development Agency<sup>2</sup> (SEEDA) were the first to test this innovative approach with entrepreneurs. Combining the core principles of mentoring with today's technology enabled E-Mentoring to offer a more cost effective approach for funded business support increasing the availability of mentoring.

This paper seeks to provide a critical review of MentorsByNet, the E-Mentoring programme offered for the development of entrepreneurs by entrepreneurs in the UK. MentorsByNet has now attracted over 500 participants and created over 200 E-Mentoring relationships since its re-launch, following the initial pilot, in October 2003. The pilot programme was originally independently evaluated by Prof David Megginson, (Megginson 2003), similar questions formed the basis for ongoing evaluations throughout the programme, and this paper will review the responses to evaluate the progress achieved.

**Key Words:** Mentoring; E-Mentoring; Business Mentoring; Entrepreneurs Development; Business Support; SME Support; SME Development

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<sup>1</sup> Small Business Service, an agency of the UK Government, Department of Trade & Industry, see [www.sbs.gov.uk](http://www.sbs.gov.uk)

<sup>2</sup> SEEDA is the development agency responsible for the SE of England, see [www.seeda.co.uk](http://www.seeda.co.uk)

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## INTRODUCTION

In January 2003 an E-Mentoring pilot project was established by the SBS South East England Regional Team to test the feasibility of providing business mentoring to entrepreneurs. This was to take the form of non face-to-face communications through electronic means within a structured and formal relationship. The pilot was commenced following extensive research of the subject during 2001/2, (Hunt 2001, Bianco 2002, Bianco & Bianco 2002 and Perren 2002), with funding support from both SBS and SEEDA. The initial pilot involved 40 matched mentees and mentors, was run over a three-month period, with an independent evaluation Megginson, Stokes & Garrett- Harris, (2003). The pilot programme was considered to be successful and the full programme was rolled out in October 2003, since then MentorsByNet established over 300 E-Mentoring relationships and has over 700 participants registered to its programme. This paper will go on to review the results from the ongoing evaluations and those from the pilot programme to understand the effectiveness of this approach for the development of Small & Medium Sized Enterprises (SMEs) entrepreneurs.

There appear to be a significant number of ‘experts’ that believe the only effective method of mentoring is the traditional basis of face-to-face and that the asynchronous and non physical nature of E-Mentoring, (Electronic Mentoring also known as Telementoring, Cyber-Mentoring, Internet Mentoring, etc.), cannot deliver the same level of benefits to the mentee. Whilst this paper will not draw a direct comparison between the two approaches the literature reviewed will draw on both domains for the effectiveness of the E-Mentoring relationship to be evaluated. Dr Bob Garvey, Hunt (2004b:5), introduces e-mentoring as a new and effective approach to mentoring:

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*“E-mentoring is a recent development in the field of mentoring and one which is already showing significant advantages over more traditional forms. E – Communication can be very liberating for both participants and some of the traditional difficulties in face to face mentoring, such as power differences, gender and race issues are simply not present in a virtual environment. It is also clear that the strong benefits of mentoring are present in an e-format. The time factor in e-mentoring can also play an important developmental role, allowing both real time fast communication and time lags for reflection. Another great advantage of e-mentoring is geography is no barrier to participation!”*

For completeness this paper will endeavour to describe some of the key processes and approaches adopted by Circle Squared Europe Limited<sup>3</sup> in the development and ongoing delivery of the MentorsByNet programme. The approach adopted for the MentorsByNet programme was based on the 5Ms framework

### MENTORING

Nandram, (2003) feels that a common definition for mentoring is impossible, as the term has become diffused and used in a large number of different contexts where diverse meanings are applied. Ambrose & Pullin (2004) cites (Hunt & Michael 1983) saying that the word Mentor has its origins in Greek mythology, Odysseus entrusted the education of his son, Telemachus, to a trusted counsellor and friend. This trusted and wise friend, Mentor, reportedly became the counsellor, guide, tutor, coach, sponsor and mentor for his protégé, Telemachus. Indeed many of us can think of examples of where an individual has influenced us in a positive way at some point in our lives.

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<sup>3</sup> [www.circle-squared.com](http://www.circle-squared.com) for more information

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Although we continue to seek a more modern and unified meaning for mentoring, Clawson (1996), none have so far been agreed due to the many different applications in today's environment. Since the late 70's there has been considerable debate around the value of individuals in mentoring relationships where the focus of attention is placed on the quality of the mentoring relationship (Higgins & Kram: 2001). This is emphasised by Eby (1997) who often refers to mentoring as "an intense developmental relationship". Clawson (1996) maintains that mentoring is broader than coaching and results in a more in-depth relationship over a longer period.

Bennis (2004), while discussing his view of the seven stages of leadership, reiterates the importance of having a mentor at various stages of a leader's personal development, from the very first stage through to the mature stage when perhaps, the mentee becomes the mentor! Stokes (2003) discusses the strongly interpersonal relationship between mentee and mentor in which a safe place exists for the mentee to explore and grow. This is further supported by Alred & Garvey (2000:146):

*"A mentor is sensitive to the emotional and intellectual aspects of the mentee's world. Offering empathy is a basis for establishing trust in the mentoring relationship, a condition for learning that goes beyond the routine and the instrumental."*

Murray (1991) defines mentoring as '...the deliberate pairing of a more skilled or experienced person with a lesser skilled or experienced one, with the agreed-upon goal of having the lesser skilled person grow and develop specific competencies....' The mentor acts

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as a confidante and, as Clutterbuck & Megginson (1998) put it; will offer 'help...in making significant transitions in knowledge, work or thinking'. Mentoring relationships can be highly structured or fluid in design allowing the relationship to move in any direction the mentor and mentee agree, but always in support of the mentee's goals. In recent times mentoring has been identified as an important learning activity in a variety of contexts (Hansford, Tennet & Ehrich: 2002), such as businesses and the more traditional learning environments.

As in all aspects of mentoring, more critical questions are now being asked about the quality and effectiveness of mentoring relationships Stokes, Garrett & Hunt (2003). Ragins, Cotton & Miller (2000) draw our attention to the dangers of so-called 'marginal mentors' and McAuley (2003) explores what he refers to as the 'ambivalence' of mentoring, employing psychoanalytic constructs such as transferences and counter transference between mentor and mentee.

In many traditional didactic cases where mentoring programs were reported to have negative outcomes, success appeared to have been jeopardised by lack of time, lack of training; the negative attitudes of others or poor matching of mentors and mentees (Hansford *et al.*:2002). We will explore how some of these problem areas can be alleviated through E-Mentoring.

### E-MENTORING

When the term "mentoring" is used, face-to-face mentoring generally comes to mind first for most people, although with the increased use of electronic communication, e-mentoring is becoming increasingly popular, Hunt (2004). Many of the goals and purposes of face-to-face

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mentoring and e-mentoring are similar as in both forms of mentoring, a more experienced and knowledgeable person provides advice, support, and encouragement to a less experienced person.

With the growth in information technology, e-mentoring is now providing opportunities for mentoring not possible with some face-to-face mentoring programmes and it has only been in the last few years that electronic communications have reached the levels of reliability and capability for vibrant relationships to flourish. The convenience of this style of communication allows for, regular, informal discourse between individuals in disparate locations. It appears that one of the greatest advantages of e-mentoring is that it provides a very flexible communication environment independent of time and space, allowing for asynchronous exchanges, thus making them an ideal medium for mentoring

While there has been a veritable explosion of online mentoring websites and opportunities within a wide variety of professions, very few academic articles to date have addressed this phenomenon Ensher, Heun & Blanchard (2003). Stokes *et.al*, (2003) also identified that as yet, there is relatively little empirical evidence to constitute a thorough exploration of what e-mentoring is and whether it works or not.

Perren (2002), in a piece of research commissioned by the authors during the development phase of MentorsByNet programme, identified a limited number of published articles, supporting the view that few academics have sought to address this area of research to date. This looked primarily at the research of e-mentoring and its relevance to entrepreneurs.

To date any research on E-Mentoring immediately runs into a barrier over the definition: Kasprisin, Single, Single & Muller (2003) point out that, e-mentoring “...has also been

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popularly termed telementoring, cyber mentoring and on-line mentoring...". Perren's (2002) review identifies use of the internet, using email and list servers and non face to face methods of interaction as being key aspects of e-mentoring. Although the literature in this area is relatively sparse, some definitions are offered for e-mentoring. For example, Single & Muller (2001) define e-mentoring as:

*"A relationship that is established between a more senior individual (mentor) and a lesser skilled or experienced individual (protégé), primarily using electronic communications, that is intended to develop and grow the skills, knowledge, confidence, and cultural understanding of the protégé to help him or her succeed, whilst also assisting in the development of the mentor".*

This is useful as a starting point but is, arguably, not hugely differentiated from many definitions of traditional mentoring: the same could be said of others offered in Perren's (2002) review. Gibb (1994) argued that mentoring cannot be explained through a single universal definition, an argument that can equally be applied to E-Mentoring.

After an extensive literature search Perren (2002) identified 20 papers that initially looked to be relevant to both E-Mentoring and Entrepreneurs, however further analyses reduced this to three core papers, a brief summary of each follows:

- Evans and Volery (2001) - this article looks at providing "business development services, such as training... and networking" through the internet by asking 'experts' "from around the world." Three success factors are found: 1. Internet communication is perceived as "second-best" to face-to-face; 2. So face-to-face contact is needed as a

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primary form of communication, internet provision is not a substitute; 3. The management of the internet site and program is a key factor".

- Stokes (2001) - this article is one of the most focused on the topic of the review as it looked at the feasibility of introducing a UK on-line tele-mentoring advisory scheme based on the Distance Learning Advisory Service in the Netherlands. Focus Groups were used to ask owner-managers what they thought about the idea. Owner – managers saw computers as a vital part of their businesses, but there was a wide range of application of computers and levels of confidence varied. Issues of trust, flexibility of delivery of support and time were repeating themes. Owner-managers also thought that face-to-face tutorship and networking with peers was important and they liked the idea of directed tutorship/mentoring rather than just brainstorming.
  
- Sullivan and Duffy (2000) - this article builds on Sullivan (2000) and reports some of the same issues. This summary will concentrate on the additional features of the article that look specifically at e-mentoring. A range of e-tools are suggested that could support entrepreneurs and facilitate e-mentoring including: email, email with attachments, asynchronous electronic discussion forums (not in real time) and synchronous teleconferencing (in real time). Discussion forums could allow entrepreneurs to share and discuss concerns and mentors could make contributions. Teleconferences are normally arranged at a pre-arranged time, it is suggested that the "role of the mentor is to assist focusing the group on a topic of discussion and ensuring that all participants have the opportunity to contribute". A teleconference could also be used for a "problem clinic" where mentees bring forward their live problems for consultation either with their mentor alone or with other mentees.

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Stokes *et. al.* (2003) are critical of Perren's review and the contributions that existing research makes to e-mentoring. The emerging view is that current research falls short of a robust evaluation of the area, largely due to the lack of data. Those who have published on the subject have tended to balance low cost and flexibility of e-mentoring schemes against the limitations that e-mentoring has when dealing with more complex interpersonal issues. As a result, there have been calls for e-mentoring to be seen as a supplement to, but not a substitute for face to face mentoring. However, the paucity of research limits the extent to which this can be claimed with confidence.

Beech & Brockbank (1999) offer another perspective when considering the issue of power and how the imbalance of power may be overcome through e-mentoring. They consider how face-to-face interactions may be distracted by visual clues, and issues related to setting, context, and atmosphere may hamper communication. They conclude that as e-mail and text based messaging are leaner communication channels that allow for more direct information transfer, it could remove contextual issues.

Stokes *et.al.* (2003), raise a number of questions, specifically about e-mentoring. Firstly, can e-mentoring - as an alternative mode of mentoring – enable mentoring relationships of sufficient depth and quality so that benefits can be gained? Related to that question, we can also ask whether e-mentoring can overcome some of the difficulties experienced in traditional didactic mentoring relationships. If the answer to both questions is 'yes' then e-mentoring has a great deal to offer to the field of mentoring and coaching.

However Stokes *et. al.* (2003) conclude that e-mentoring, due to the 'leanness' of text based communication, might compel the participants to focus more on the substance of the

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message than on the style, status etc of the person delivering it. This therefore adds an additional research question to those already contributed: can e-mentoring offer additional benefits which go beyond those offered by traditional mentoring? Stokes *et. al.* (2003) cites Hawkrigde's, 2003 article, which is based on his eighteen years experience with the Open University, offers some additional ways in which text based communication might hold sway over face-to-face interaction. These advantages seem to stem from the recordable nature of the text which, unless special effort is made to record face to face sessions, is not usually used in those sorts of interactions. As the text is available, this enables all parties to make sense of the contributions by "synthesising and summarising, drawing threads together, watching for and correcting conversational drift, spotting good ideas" and so on. Bierema and Merriam (2002) point out, in the case of mentoring, "successful mentoring involves frequent and regular interaction" but that "all sorts of barriers such as time, work responsibilities, geographical distance and lack of trust often reduce if not halt interaction" (p214). E-Mentoring merges the approach of the traditional mentoring relationship with technology, and is increasingly used as the preferred choice of communication, Realm (2002)

It has become apparent from the literature that many authors believe E-Mentoring is a suitable means of support for the traditional physical mentoring relationships, rather than a relationship that exists solely through the use of technology. The definitions offered earlier also appear to be inappropriate, this one offered by Hunt, (2004a) starts to narrow it down:

*"E-Mentoring uses technology to facilitate the development of a supportive relationship for experimentation & personal development in a safe, convenient & timely environment; helping both mentee & mentor to grow"*

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Hunt (2005) has gone on to provide a tighter definition, which is widely used for the MentorsByNet programme and other programs that he has been involved with:

*“Utilizing technology, E-Mentoring is the process by which two people assist each other to grow and learn in a safe and supportive relationship”.*

For the future, Clutterbuck (2004) believes we are likely to use a blend of methods and technologies to improve the mentoring process.

*‘As technology becomes more sophisticated it is reasonable to assume there will be much broader and more intelligent use of technologies. There will, in particular, be much more use of videoconferencing, through desktop PCs and web cameras. In the future, it seems likely that the majority of mentoring relationships will be hybrids of face-to-face in person, synchronous face-to-face remote and asynchronous textual exchanges. The evidence suggests that this has great potential to enrich the dialogue between mentor and mentee. Mentoring scheme co-ordinators will have to include the effective use of these technologies as an integral part of mentor and mentee training.’*

It is already possible to see some of the features that a face-to-face and e-mentoring relationships share, such as:

- A caring relationship
- Fostering of the person's skills by a more experienced person
- Ongoing, regular communication

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- Trust, warmth and support
- Clear boundaries of the parameters of the mentoring relationship
- Administration by an organization that oversees the mentoring relationships

However we can also begin to see where e-mentoring differs from traditional face-to-face mentoring in a number of ways:

- Location is not an issue
- A record of the discussion will exist (saved emails) facilitating reflection
- Communication occurs mostly through e-mail
- Relationships are often time-limited
- Mentors can often engage in e-mentoring during their work day or when it is convenient.
- E-mentoring offers the convenience of communicating online
- A large number of communication methods can be utilised:
  - Telephone
  - Desk top video conferencing
  - Email
  - Discussion rooms
  - Instant relay chat
  - Etc.

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## EVALUATION APPROACH

The data used for this evaluation comes from two distinct stages, pilot programme and full programme.

### Evaluation Approach – Pilot Programme

The evaluation was carried out in two phases - in the form of pre- and post-programme e-mailed questionnaires. The questionnaires were based on the one sent out by APESMA<sup>4</sup> (Australia), for comparative purposes, as well as covering additional aspects that were of interest to the sponsors of MentorsByNet and the researchers. On both occasions the questionnaires were sent out to mentees and to mentors in parallel, but worded differently.

The decision to send out both a pre- and post-questionnaire, for the pilot, instead of just a post-programme one was founded on the desire to evaluate and compare pre-programme expectations with post-programme views grounded in their experience.

A preliminary analysis of the pre-programme questionnaires was undertaken using the industry standard computer package for analysing data called SPSS. A preliminary report was then produced. The data was analysed looking at both frequency of response as well as any significant correlations using the Spearman rho method.

### Evaluation Approach – Full Programme

Pre programme expectation data is now captured routinely as part of the registration process that both mentors and mentees undertake. This data is then held within the database for subsequent use and investigation.

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<sup>4</sup> Association of Professional Engineers, Scientists & Managers, Australia

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MentorsByNet now secure information from participants through electronic questionnaires based on the 'post programme' one used for the pilot stage to ensure comparability, at two distinct stages. The first questionnaire is circulated about 4 weeks after the mentor and mentee have been notified of their e-mentoring relationship. The second questionnaire is post programme participation and is circulated at the end of the 6 months.

The data from both these questionnaires and the registration process is evaluated in line with the processes adopted for the pilot programme.

## OVERVIEW OF MENTORSBYNET

MentorsByNet programme was designed by the author around the 5M's principles shown below :

| <b>The 5M's of E-Mentoring</b>                             |   |  |
|--|---|--|
| <b>5 M's</b>   | <b>Objective</b>  | <b>Outcome</b>   |
| <b>M</b> arketing<br><b>P</b> rocess                       | Clearly understand the marketing implications to enable the programme to gain sufficient number of relevant Mentors and participant Mentees. These will differ from programme to programme.   | Sufficient Numbers in Scheme                                       |
| <b>M</b> atching<br><b>P</b> rocess                        | The matching process starts when designing the data capture as part of the registration process. The registration process must answer the key questions, for example: Identification of the skills of the mentor and the Mentees requirements. This allows a primary match on Skills, but secondary data will also be required such as: Background, Gender, Age, Education, Learning Styles, and Mentors Capabilities etc. With sufficient data we can perform an effective match | High Success Rate in Matching and Outcomes from the E-Relationship |
| <b>M</b> anaged<br><b>R</b> elationship<br><b>P</b> rocess | An E-Mentoring relationship will require a degree of facilitation for it to go through the 4 stages of the Mentoring Cycle. Sufficient information and knowledge will be required to facilitate these relationships from frequency of contact, feedback on the relationship, the training provided, expectations managed, etc.  | Relationship is Sustained  |

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|   |   |  |
|---|---|--|
| <b>M</b> erging<br><b>S</b> kills &<br><b>K</b> nowledge<br><b>T</b> ransfer<br><b>P</b> rocess | Mentor / Mentee effectively merging the relationship process to transfer knowledge and skills. This will help both the Mentor & Mentee to develop | Skills & Knowledge Transfer Effective                |
| <b>M</b> easuring the<br><b>O</b> utcomes   | Effective MI process development to ensure outcomes can be measured   | Benefits Identified That Demonstrate Value for Money |

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MentorsByNet has now developed into a very sophisticated model from the early days, far too complex to describe fully here, but some of the key elements of the processes are listed below:

- It works with and through established business support organisations.
  
- All participants register online
  - Core data
  - Freeform data for expectations
  - Skills matrix for matching
  
- Mentors undertake an Online Self Assessment against 7 core competencies<sup>5</sup>
  
- Mentors & Mentee undertake online training against the 7 core competencies<sup>6</sup>
  
- Mentors & Mentees are matched using a range of data provided during registration and updated by the participant during the training:
  - Primary data for the matching comes from the skills matrix and identified needs for development

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<sup>5</sup> The online Mentor Self Assessment programme was developed by Kevin Hunt & Dr Robert Garvey of Sheffield Hallam University, Mentoring & Coaching Unit UK.

<sup>6</sup> The online Training programme originally developed by Prof. David Clutterbuck of Clutterbuck Associates and was redeveloped by Kevin Hunt & Dr Robert Garvey of Sheffield Hallam University, Mentoring & Coaching Unit UK to address the 7 core competencies that they identified were needed in the mentoring relationship.

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- The early stages of the relationship is monitored through email activity as initial contacts use a @mentorsbynet email address to route through the secure server. This stage is facilitated through email interaction with the programme delivery team.
- The relationship is planned to last about 6 months and will go through the 4 stages of the mentoring relationship.
- During the developing stage of the relationship participants are offered a ‘no fault divorce’ if it is felt that the match is not working as well as it could.
- Facilitation is then evident at the closing stages of the relationship to help manage the final stage and to provide information for further support.

The MentorsByNet programme is actively managed and relationships facilitated throughout the programme, evaluation material and feedback is secured at key points within the process which has led directly to many of the enhancements that the programme now benefits from.

## **RESULTS & DISCUSSION**

### Profile of Participants

At the time of the evaluation MentorsByNet had attracted a total of 517 participants. As *Table 1*, shows the gender split between mentees were 37% women and 63% men, whilst the mentors were 19% women and 81% men.

| MENTEES |       | MENTORS |       | TOTAL |
|---------|-------|---------|-------|-------|
| Men     | Women | Men     | Women |       |
| 205     | 120   | 154     | 38    | 517   |

Table 1: Gender Profile of Participants

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Whilst this presents a balanced picture for mentors in relation to the business ownership with the UK demonstrating around 17% of SMEs are owned or led by women, SBS (2004), Carter, Anderson & Shaw (2003). However it does show that the programme has been more successful in attracting women mentees to participate, 37%, although the programme was not gender orientated in its marketing approach.

The research also took into account the location of the participants, splitting this between urban based locations and rural based locations. Whilst there is a natural tenancy for the programme to attract participants from urban locations due to the higher density, we can see from *Table 2*, that 64% of mentees and 59% of mentors were urban based.

| MENTEES |       | MENTORS |       | TOTAL |
|---------|-------|---------|-------|-------|
| Urban   | Rural | Urban   | Rural |       |
| 208     | 117   | 114     | 78    | 517   |

Table 2: Location of Participants

It has been argued the E-Mentoring is more suited to participants based in rural and isolated locations, often quoting distance as a reason Hunt (2004b & 2004c), but this programme appears to demonstrate that E-Mentoring is equally as popular with urban based entrepreneurs, if not more so.

This demonstrates a need for further research to look at the motivation for the decision to participate in this type of programme.

| MENTEES |       |       |       |       |       |     |            |
|---------|-------|-------|-------|-------|-------|-----|------------|
|         | 16-19 | 20-29 | 30-39 | 40-49 | 50-59 | 60+ | Not Stated |
| Women   | 0%    | 7%    | 30%   | 36%   | 19%   | 2%  | 7%         |
| Men     | 1%    | 10%   | 26%   | 36%   | 15%   | 6%  | 7%         |

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| MENTORS |       |       |       |       |       |     |            |
|---------|-------|-------|-------|-------|-------|-----|------------|
|         | 16-19 | 20-29 | 30-39 | 40-49 | 50-59 | 60+ | Not Stated |
| Women   | 0%    | 3%    | 30%   | 32%   | 24%   | 5%  | 5%         |
| Men     | 0%    | 1%    | 8%    | 27%   | 42%   | 20% | 3%         |

Table 3: Age Profile of Participants in Years

It can be seen from Table 3, that the age profile for the mentees is broadly similar with over 50% of the participants falling between the ages of 30 and 49 years, irrespective of gender. However the age profile for mentors shows 65% of women mentors are under 50 years of age whilst only 36% of the men fall into the same age bracket. This could be for a number of reasons, such as men tend to volunteer as they near retirement, a higher percentage of women are now becoming self employed at a younger age etc. but the responses to the questionnaires did not provide an insight into this question.

MentorsByNet is a voluntary programme where mentees were not charged and mentors received no income or expenses. It was an objective of the programme to secure volunteer mentors who were still actively engaged in running their business, to this end 78% of the mentors described themselves as owners of an SME. The balance was a mix between retired owners and active managers in larger organisations. All mentees were either owners of SMEs or were in the pre-start stages of their business.

### Summary of Key Findings

Before moving on to the key findings the following general point should be noted. Whilst there was a 'reasonable' return rate (approximately 45%) of evaluation questionnaires, compared with a typical response rate of 30%, it should nevertheless be pointed out that a significant number of scheme participants did not return their evaluation forms. Thus it is

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difficult to tell what that means in terms of the views of the scheme as this set of participants have not articulated their views, thus tempering any general conclusions that can be drawn.

Post participation evaluation questionnaires are sent out to all participants at the conclusion of their e-mentoring relationship; this involved some 248 of which 45% returned usable data. This was split 60 mentees, 51 mentors and all figures subsequent quoted in this paper are as a percentage of the respondents to the survey.

One significant factor appears to be the use of facilitator's messaging to participants was used to prompt and direct the activities of participants and to 'keep them on track'. This approach has both strengths and weaknesses. On the one hand, it appears to have the effect of ensuring that mentees get the 'advice' they were seeking, on the other hand, many writers in the area (e.g. Garvey, 1995, Clutterbuck & Megginson, 1998) have emphasised the importance of voluntarism and uniqueness in mentoring relationships and have cautioned against being too prescriptive and standard-driven about the advice given. However, it is beyond the scope of this current study to examine the longer term effect of these different orientations.

The following are some of the key points:

- Over 90% of respondents felt that the programme was beneficial and stated they would recommend it to colleagues. In broad terms, the benefits gained conformed to what the mentees had expected in terms of being able to bounce ideas off a neutral party.

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- 88.3% of respondents felt that the frequency of contact, which varied greatly, met, or totally met, their needs.
- 83.3% of responding mentees felt they had achieved their objectives. Where the objectives were not achieved, the duration of the relationship and 'my objectives changed during the relationship' were the most cited reasons.
- Contrastingly only 60.8% of the mentors felt that their mentees had achieved their objectives. This raises the question of perception and clarity of goals that would need to be investigated further.
- 100% of the mentees felt that the 6 month time limit on the programme was correct, whilst only 72.5% of mentors would agree.
- Over 50% of mentees said they would like continue in the e-mentoring relationship. Contrary to the previous point in which the participants felt 6 months was sufficient, this indicates that a longer period may have been required.
- Over 90% of mentees rated their mentor as good or very good in terms of both their skills and experience, and their overall performance during the e-mentoring relationship
- There was an increased willingness from both mentees (22% increase to 96%) and mentors (11% increase to 79%) to recommend the scheme to colleagues and peers post-programme.
- Generally participants felt that e-mentoring enabled integration of the programme into the mentees day-to-day activity, which would assist in their development and learning

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- 91% of mentors and 82% of mentees indicated a substantial satisfaction rating with the respective mentoring partner
- 100% of mentees pre-programme expected to develop a good relationship with their mentors; post-programme 96% reported they had. Pre-programme 90% of mentors had the same expectation; post-programme this had decreased to 79%.
- In the pre-programme questionnaire 84% of mentees affirmed that the fact that MentorsByNet was an email-based programme encouraged them to participate. Post-programme mentee response had slightly increased to 90%.

The programme is still in progress so the foregoing results should be considered as interim. Irrespective there is now sufficient evidence that suggests MentorsByNet is successful and meeting its overall objectives. But there are still a number of questions that remain unanswered such as:

- What are the views of the 55% of non responses?
- Why the programme appears more successful, than traditional business support programmes, at attracting women mentees?
- What are the motivations for participation?

None of these are likely to detract from the results presented here, but do remain considerations for the future.

Based on the results reported MentorsByNet e-mentoring programme appears to be able to deliver benefits for participants that are directly comparable to the more traditional face-to-face approach. In addition a number of other benefits have emerged, such as:

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- Allows for the propagation of mentoring in the small business sector, which is widely seen as effective, as valuable sources of on-going management development.
- It appears that the absence of visual cues remove some potential barriers e.g. gender or status and permits concentration on key issues.
- E-Mentoring allows for remote meetings that are time and space independent
- There appears to be no loss of relationship between communications
- Asynchronous communication encourages reflection, allowing mentee and mentor to record, focus on, and to return to issues and to spend more time on them
- Email based mentoring appears to be good for communication of information, ideas and developing an analytical and questioning approach
- Mentor and mentee able to communicate whenever is convenient.
- E-mentoring may suit those for whom face to face meetings produce anxiety.
- Based on satisfaction levels the approach taken by MentorsByNet demonstrates a higher tendency for mentors and mentees to be paired correctly and less extraction complications.
- MentorsByNet has shown that it is able to recruit mentors who are still working vs. retired.

### CONCLUSIONS

Whilst there remains much debate over the true value of face-to-face mentoring versus E-Mentoring there is now growing evidence to suggest that, as a minimum, the same levels of

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benefits for the mentee are possible through E-Mentoring alone. There is further evidence to suggest that additional benefits are being recognised by E-Mentoring participants, not least issues like convenience, timely, peer pressure reduction to name a few. There is emerging evidence that suggests certain groups of the business population find this approach more appropriate, such as women. There is little to suggest that E-Mentoring does not work.

It appears, as with any other mentoring programme, the benefits for the participants are enhanced by the quality of the overall programme. MentorsByNet is well run and has been developed to aid the quality of the programme with feature such as the On-Line Self Assessment, 7 Core Modules of Training, the matching matrix and facilitation of relationship etc. The quality of the key features and the professional delivery of the programme contribute greatly to the results achieved, thus it would not be fair to conclude that all e-mentoring programmes can offer the same or greater benefits over the more traditionally recognised approach. But it is possible to conclude that were these factors are present and combine then E-Mentoring is an effective approach to mentoring in today's business world.

This paper has also high lighted some areas that could benefit from further research, areas such as the motivation factors affecting the decision of the participants to join an e-mentoring programme over a face-to-face, such as gender differences or rural versus urban participation. The following are a few of the comments received from the evaluation questionnaires from the participants that appear to support, in general, these conclusions:

*"E-mentoring has definitely improved the quality of my business management processes as it has allowed me to tap a collective pool of knowledge that has been built up over dozens of years". (Mentee)*

*"E-mentoring is not a process which lends itself to infrequent lengthy meetings, with formal agendas. It's more about providing a sounding board or a shoulder to lean on. When these*

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*things are needed, they're needed virtually as the thought arises and not in a week's time. That's the beauty of E-mentoring". (Mentor)*

*"Discussing issues with our mentor has given us self belief and encouragement, plus a great network of people to discuss various aspects of the business with". (Mentee)*

*"I have found the Mentoring role causes me to question the way I do/view things and to that extent it is potentially as beneficial to me as to the mentees" B.L. Mentor*

*"It has given me more confidence and improved my skills" R.R. Mentee*

*"As mine is a fairly new business and it is certainly expanding, it has been a great help to me to be able to discuss the business with someone. It has helped me to solve some problems and avoid possible pitfalls." J.A. Mentee*

*"Very useful for both myself as a mentor and hopefully the mentee, can we continue" S.B. Mentor*

*"A great system, thank you very much" J.H. Mentee*

*"It has been so valuable to take time out and evaluate where I am up to and what next." D.C. Mentee*

*"The business is growing in turnover and profitability, some of which can be attributed to the mentoring. The key benefit has been with regard to the longer term potential of the company, the results of which will not be evident for some time." B.R. Mentee*

*"We have worked well together as I was able to bring relevant experience to the party" J.R. Mentor*

*"As a start-up outside the commercial sector it was useful to have an experienced commercial manager giving a perspective... Thanks to you for such a good and organized programme." P.J. Mentee*

*"It provided me with an experienced sounding board and some good business tactics." P.D. Mentee*

*"It has given me personal satisfaction to be able to help two people who felt the need for objective, independent support from someone with no 'agenda'." A.J. Mentor*

*"I have now realised how beneficial a mentor could be if the mentee approaches the relationship with commitment." D. W. Mentee*

*"A very worthwhile relationship & thank you for your assistance." A. G. Mentee*

Whilst recognising that the author is not totally independent, this has been a robust investigation with input from Sheffield Hallam University (UK) Coaching & Mentoring Unit

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amongst other independent bodies, the information presented in this paper is factual and representative of the findings.

[END]

### Note:

The author would welcome discussions on the subject and may be contacted by email at:

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## **SUPERSERVICES ONLY FOR SUPERSTARS! – WHICH FIRMS BENEFIT MOST FROM THE INCUBATORS?**

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### **ABSTRACT**

The firms that locate within the incubators (incubatees) are not a homogeneous group but they differ in age, size, industry, phase of development and firm strategy. After the years of investing in the premises and walls, the Finnish incubators are currently focusing on the development of their services. Simultaneously, they should consider which firms benefit most from these services. The incubators should be able to segment the firms in order to provide the right services for the right firms. In addition, they should also be aware what types of services are beneficial for the different firms at the different phases of development. In Scandinavia and in Europe the incubators are in most cases a policy-measure financed by the public sector. Hence, from the policy perspective it is important to make sure that the most 'promising' firms will benefit from the incubator. Our results suggest that younger firms that have developed fast and not prolonged their stay in the incubator benefit most from the incubators. Hence, alternative tools for traditional life-cycle based models in firm the development are needed to provide better benefits for the “superstars” and to activate the other customer segments in the incubator.

### **INTRODUCTION**

Promoting entrepreneurship and growth of companies is one of the most important aims for the industrial and entrepreneurship policies in Finland and in Europe. There are several instruments that aim at fostering entrepreneurship and growth. In this paper we will focus on the technology incubators<sup>1</sup>. Technology incubators have become common in all of the Western countries but also lately, for example, in Asia. The term incubator can be used to refer to several different types of organisations that aim at assisting entrepreneurs or aspiring entrepreneurs to commercialise their idea and to set up a company. In its broadest sense the incubators include science parks, business and innovation centres and organisations that coordinate services without physical presence ('incubators without walls'). According to a narrower definition:

*'A business incubator is an organisation that accelerates and systematises the process of creating successful enterprises by providing them with a comprehensive and integrated range of support, including: Incubator space, business support services, and clustering and networking services'. (European Commission 2002, 9.)*

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<sup>1</sup>For further discussion on the typologies refer to Grimaldi – Grandi 2005, Chan – Lau 2005, Surlemont et al 2002.

In this study we use the term incubator to refer to organisations that provide *business services to new technology-based firms* (NTBFs). These services are produced by the incubator management or purchased from the incubator network service providers. The incubatees can either locate in the incubator premises or in other premises. The incubators that do not offer premises for their incubatees are called ‘virtual incubators’. (Tilburg et al 2002, also Nowak – Grantham 2000) In this paper, we will focus technology incubators and their role in promoting new technology based firms (NTBFs).

The technology incubators request their incubatees to have a high technology level and they provide high-level management support for the companies. Currently, there is a strong focus to develop these services and support for the firms to achieve the best possible effectiveness. The purpose of this study is, firstly, *to find out what companies seem to benefit most from their location in the incubator*. Secondly, we investigate *if the firms that should benefit most from the incubator - the ‘superstars’ - are actually able to claim these benefits*.

## **SERVICES PROVIDED BY THE INCUBATOR**

The task for the incubators is to complement the existing resources of the incubatees: human resources (by developing the existing resources through training or by assisting in recruiting), social resources (by facilitating access to networks within the incubator/science park or to external networks), financial resources (information about and contacts to financiers), physical resources (premises, machines, etc.), technological resources (access to technology) and organisational resources (counselling, consulting and mentoring). (Sijde, 2002).

Based on the study by Chan and Lau (2004) the main reasons for the incubatees to locate themselves in an incubator are connected to costs, especially for the firms active in the R&D process. Furthermore, the joint staff development and training and marketing events were important reasons to stay in the incubator. Furthermore, sharing of joint resources (e.g. the premises, library) were also important perceived benefits for most of the firms in the different phases of development. The firms also needed to develop their business competences and expressed a need for related consulting. The unwillingness to share information was hampering the full use of the services. R&D consulting was not a main motivator for the firms due to expertise in their own areas. The firms did not perceive to benefit much from the networking or clustering services. Similarly, the image benefits connected to the location in the science park or incubator were also not recognised. In the study it was also emphasised that the expected benefits from the incubator change over time as a consequence of the phase of development of the firm. (Chan & Lau 2004, also Ferguson 1999)

## **DATA, METHODOLOGY AND ANALYSIS**

### **Data and Measures**

The research question was operationalised by investigating if firm age, size, industry, phase of development, growth of the firm or the length of the incubating period

(=independent variables) are connected with the use of the incubator services, needs for the incubator, satisfaction with the incubator, expectations for the incubator and the perceived effects of the incubator (=dependent variables). (See Appendix 2). In order to catch a general view on the firms' perceptions of benefits from the incubator and in order to find out which factors should be taken into a closer consideration in the future, we used a series of logistic regression analysis. We are aware that this is a quite unusual method as normally only one or in maximum a few logistic regression models are developed in a study. However, in this phase when we have a very rich body of data and the phenomena is quite unexplored we found it very useful. With this explorative analysis we aim at contributing to the development of measures for the effectiveness of incubators<sup>2</sup>. A logistic regression analysis was conducted firstly by including the independent continuous variables in the model as such and by including alternative variables (variables that had a high correlation) one by one in the model in order to eliminate the problems of multi-collinearity. Then the independent variables were classified and the same analyses were conducted in order to see, whether there are also non-linear correlations between the dependent and independent variables. In general, the independent variables explained the dependent variables better when classified (which suggests that the correlations in our data are in many cases non-linear) and we ended up using a model with classified independent variables. The final analysis was conducted by including all the variables in the model simultaneously (Enter method) and also by applying Forward Wald method. In the interpretation we have applied both the analyses in order to find as many explanations for the above issues as possible.

The firms' basic characteristics are presented in the table below.

**Table 1 Presentation of the incubatees investigated, N = 131**

| <b>Characteristic</b>                          | <b>Average</b>  | <b>Mode</b> | <b>Min</b> | <b>Max</b>    |
|--|---|-------------|------------|---------------|
| <i>Age</i>                                     | 3,08 years  | 2 years     | 0 years    | 40 years      |
| <i>Activity with the current business idea</i> | 1,99 years  | 2 years     | 0 years    | 7 years       |
| <i>Duration of the incubation period</i>       | 20 months   | 9,00 months | 2 months   | 86 months     |
| <i>Number of entrepreneurs 2004</i>            | 2,6 persons   | 3 persons   | 0 persons  | 10 persons    |
| <i>Number of employees 2004</i>                | 3,1 persons   | 0 persons   | 0 persons  | 40,75 persons |
| <i>Turnover 2004</i>                           | 308 252 €   | 100 000 €   | 0 €        | 3 000 000 €   |
| <b>Industry</b>                                |   |             |            |               |
| <i>Industry</i>                                | Information technology 47 %; life sciences 9 %; other technology 21 %; high-tech services or services for the high-tech firms 22 %. |             |            |               |
| <b>Firm classification</b>                     |   |             |            |               |
| <i>Firm classification</i>                     | A-class 15 %; B-class 47 %; C-class 38 %.   |             |            |               |
| <b>Growth</b>                                  |   |             |            |               |
| <i>Growth</i>                                  | Employee growth by minimum of 2 employees between 2002-2004: 7%;<br>Turnover growth by min of 150 000 € between 2002-2004: 4 %.     |             |            |               |

## Results of the study

<sup>2</sup> Refer to for further discussion on the measures of incubator success (Hackett – Dilts 2004).

In order to find out what firms seem to benefit most from their location in the incubator we studied the incubatees' use of services and perceptions of the benefits induced by the incubator. In general, the most frequently used services are premises, office services and related services, business development services and consultation, juridical services, and financial services and consultation. Recruitment services, mentoring and other senior advisory services, as well as internationalization services and consultation are services used most infrequently. The incubatees are in general fairly satisfied with the incubator and the incubator management. The business development services are an important motive for the firms for their location in the incubator and the firms perceive to benefit mostly from the business development services, especially from the start-up services and financial guidance and counselling as well as from financing. Furthermore, the firms' expectations for the future are also most frequently targeted at the business development services.

The use of certain services is connected to the firm *age*. The use of R&D, patenting and licensing services as well as mentoring, board members and other services is most typical for the firms that are between 2–3 years. The most satisfied customers are the firms under 3 years of age. Satisfaction with the business development services is more likely among firms that are under 4 years, and firms that are under 2 years mention these services as an important value added of the incubator more likely than older firms. The firms that are 3 years or more are less likely to hold that the relation with the incubator would generate any value added for the firm. The *length of the incubating period* is connected to the needs for the incubator and satisfaction with the incubator. The firms that have operated in the incubator under a year emphasise networks and contacts as a reason for their connection with the incubator. Especially the firms that have operated 2–3 years in the incubator are eager to criticise the practices, characteristics or skills of the incubator staff. Furthermore, the satisfaction with the incubator decreases along the stay in the incubator. We have also noted elsewhere that the prolonged stay in the incubator decreases the likelihood for employment growth among the new technology based firms. (Mäki – Hytti 2005)

Firm *size* did not explain the ability to benefit from the incubator in the same way than the firm age. Mentoring and other senior advisory services seems to be more typical for the firms employing under 2 persons and business development services and consultation for the firms employing 2–5 persons. The firms that employ 2 or more persons are less likely to hold that their connection with the incubator would generate any value added for the firm. This result suggests that the incubators contribute more for the development of the smallest firms.

In most cases the *industry* did not explain any differences. However, the use of R&D, patenting and licensing services is more typical for firms operating in life sciences sector and other technology sectors (than in ICT and life sciences). The firms operating in life sciences and other technology sectors also have more often expectations for the premises and related services. As there were no differences in the satisfaction with the incubator among the firms in the different industries we may conclude that the incubators are able

to answer to the needs of the incubatees despite their industry. Hence, our results do not support the need for strong industry-based specialisation of the incubators.

To sum up, it seems that the younger firms (basically three years of age at maximum) that have not extended their stay in the incubator for over two or three years perceive to benefit most from the incubator. The firm size and industry did not remarkably distinguish the perceptions of the firms.

Secondly, we were interested if the most 'promising' firms actually perceive to benefit the most from the incubator as is expected by the policy-makers. This was done by asking the incubator managers to classify the firms into classes A, B and C based on their assessment of e.g. growth, internationalisation and venture capital investment potential of the firm. This classification was validated by cross-tabulating the three-class variable with the basic characteristics of the firm. The analysis confirmed that the A-class firms were the most developed firms, B-class firms came second and C-class firms third. The classification correlated with the firm size (number of entrepreneurs as well as employees), industry, internationalization, growth-orientation and funding patterns of the firm. Thus, although the indicator aims at measuring merely the potential of the firm, the analysis indicates that it might actually predict quite well the actual development of the firm. In addition, we were also interested to investigate the already proven success of the firms. Although it is suggested elsewhere that the incubatees grow only after they graduate from the incubator (Ferguson 2004), we have identified different growth firms already in the clientele of the incubators. Elsewhere (Mäki & Hytti 2005), we have developed growth indicators suitable for examining the growth of incubatees or new technology based firms in general<sup>3</sup>. The firms that had an annual growth of 2 employees or turnover growth of 150.000 euros annually were classified as growth firms. There was no correlation between the growth of the firm and the ABC -classification.

The analysis shows that the most promising firms (A-class firms) use certain services more often than the B- and C-class firms. These services include R&D services, juridical services, marketing and sales consultation and services, internationalisation consultation and services, recruitment, mentoring and other senior advisory services. In order to serve better the A-class firms the incubators should put a stronger emphasis on these services, especially because of these services juridical services, internationalisation services, recruitment services as well as mentoring and senior advisory services were given worse grades than the other services by the firms. (Hytti – Mäki – Akola 2004). From the perspective of the incubator staff this is particularly challenging as many of these services (incl. internationalization services and consultation; recruitment, mentoring and other

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<sup>3</sup> The use of proportional growth indicators is problematic because in the beginning the turnover and employment is often 0. Another problem with proportional indicators is that they favour the smallest companies. Our analysis suggests that in the analysis of growth of new technology based firms absolute growth indicators might be more useful than proportional growth figures. Overall the age structure of the firms hampers the growth analyses. Firstly, it may not be possible to have actual and reliable growth figures from three consecutive years because the firms are young. Secondly, the business operations often start gradually by the efforts of the entrepreneur and growth in some scale is considered necessary anyway to even achieve the breakeven point. (For this reason it would be necessary to investigate growth by taking into account profitability in the start-up companies.)

senior advisory services) are also used quite infrequently in general. The infrequent use – and hence, also supply – of these services could also be the reason for the worse grades: lack of practice, routines and knowledge may cause distortions in the service process. Similarly to the “A-class firms”, the *firms that had grown* by employment also use more often mentoring and senior advisory services (see above). These growth firms had typically joined the incubator to take advantage of the start-up services and less often to get funding. The growth firms also put less emphasis on the premises and the related services as a particular value added created by the incubator and they also have fewer expectations for the premises and the related services. The results suggest that the premises are more important for the firms growing slowly than for the growth firms.

To sum up, the most successful and promising firms were as satisfied with the incubator as the other incubatees. Thus, we cannot in this sense conclude that the incubators should focus more on satisfying these clients in general. On the other hand, it is necessary to understand that both the satisfaction and dissatisfaction of these firms would be difficult to interpret from the point of view of the incubators. Even if the firms were satisfied, we would not know whether this is due to the activities of the incubator or their own success. The dissatisfaction, on the other hand, could be interpreted as higher demands and better ability to judge the incubator activities. More importantly, however, on the basis of the analysis we can conclude that if the incubators are supposed to provide the best possible services to the most successful or promising firms they should pay more attention to the services that these firms use.

## **Conclusions**

In the literature it is possible to identify different incubator profiles (Grimaldi – Grandi 2005, Chan – Lau 2005, Surlemont et al 2002). In this paper we have focused on technology incubators that request their incubatees to have a high technology level and in return are committed to providing intensive business development services for the firms. Nevertheless, the incubatees residing in the technology incubators are not a homogeneous group but they differ in age, size, industry, phase of development and firm strategy. In this paper we have analysed, firstly, which characteristics really distinguish the incubator firms and which firms benefit most from their location in the incubator. Secondly, we have analysed if the firms that should benefit most from the incubator, i.e. the already successful firms as well as the most promising firms, can actually claim these benefits.

Based on our findings, the firm size and industry did not distinguish the perceptions of the firms. It is the relative young firms (under 3 years of age) that seem to benefit most from their location in the incubator. The firms that have an incubating period of less than two years seem to benefit most from the incubator. Furthermore, as the firms that have stayed in the incubator longer are not likely to grow their number of employees (Mäki – Hytti 2005), we may conclude that prolonging the incubating period would not be recommendable. As a result, it is suggested that continuous attention is given to the optimisation of the incubating periods. We suggest that instead of fixed incubating periods (generally from 1-3 years in Finland) the incubators would develop ‘graduation criterion’ for the firms as the heterogeneity of the firms might also be reflected in the

optimal incubation periods for each firm. The graduation criterion should also include incentives for the firms. It is suggested that continuous effort is placed on the early stages of the firm, for example, by supporting strongly early-growth of the firms. This could be done by underlining the growth perspective already in the first business planning and strategy formation phase of the firm. The entrepreneurs with a background in a university or an R&D department are strongly motivated to developing the technology. Hence, the important task for the incubator is to underline continuously the need to reflect the market and customer side of the business. Based on our earlier study, the entrepreneurial teams are also more likely to develop and grow the firm than sole entrepreneurs (Mäki – Hytti 2005). Hence, team entrepreneurship might be an efficient way to increase the growth potential of the incubatees. By shortening and intensifying the incubating periods and by creating landmarks for the early and fast graduation it might be possible to increase the number of incubatees in the incubators over time, and consequently also the graduates and new technology-based firms, which is also the aim for the current Finnish policy.

The most successful firms or most promising firms were as satisfied with the incubators as the other incubatees. However, the A-class firms and the growth firms use business development services more than the other firms (Chan – Lau 2004). These services include R&D services; juridical services; marketing and sales consultation and services; internationalization consultation and services; recruitment, mentoring and senior advisory services. Based on the ratings given by the firms for these services, it seems that there remains some improvement possibilities in the quality of these services (e.g., juridical services, internationalisation services, recruitment as well as mentoring services and other senior advisory services). However, many of these services are used quite infrequently in general and, therefore, the challenge for the incubators lies in creating and developing the services processes. As the number of A-class firms requesting these services per an incubator is limited this might be problematic if the incubators do not intensify their co-operation and provide mutually organised services for the firms.

Therefore, our results confirm the earlier studies that business services need to be focused strongly in the incubator (Massey 1992, Phillimore 1999). Especially for the most successful and promising firms the business development services and consultation are the most important benefits that they can gain from the incubator. The premises and funding are also necessary and the incubatees willingly accept also these benefits but it is the business development services that make the difference.

*Limitations of the study:* As this study is based on cross-sectional data which does not include graduates from the incubators, the results are preliminary. If the graduates would have been included in the sample we might expect to have received an even more positive picture, and also more differences between the firms. A follow-up study will be conducted to investigate the firm development.

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## **Appendix 1 List of groups of dependent variables**

### *Use of incubator services*

“What services of science park, incubator or some other service provider does your firm use?” Different services: Premises and related services; Office services; Firm founding related services and consultation; Firm development related services and consultation; R&D, patenting, licensing; Juridical services; Marketing and sales related services and consultation; Funding related services and consultation; Internationalization related services and consultation; Recruitment services; Mentoring and other use of senior advisors; Networking services/Structured question: “Uses continuously”; “Uses every now and then”; “Uses seldom” vs. “Does not use”.

### *Needs for incubator*

“Please mention three most important reasons for operating in the incubator”/Open ended question, classified: Networks and contacts/Premises and related services/Support services/Business development services/Location/Atmosphere and image/Practices, characteristics, skills/Other/None, does not know.

### *Satisfaction with incubator*

-“When considering incubator’s activities as a whole, what grade describes it best?”/Structured question, compressed: A vs. other grades.

-“Please mention three especially successful factors in the incubator”/Open ended question, classified: Networks and contacts/Premises and related services/Support services/Business development services/Location/Atmosphere and image/ Practices, characteristics, skills/Other/None, does not know.

-“Please mention three especially unsuccessful factors in the incubator”/Open ended question, classified: Networks and contacts/Premises and related services/Support services/Business development services/Location/Atmosphere and image/ Practices, characteristics, skills/Other/None, does not know.

### *Expectations for incubator*

“What kind of services and activities do you expect from the incubator in the future?”/Open ended question, classified: Networks and contacts/Premises and related services/Support services/Business development services/Location/Atmosphere and image/ Practices, characteristics, skills/Other/None, does not know.

### *Perspectives on effects of incubator*

-“What is the value added the incubator gives for the firm that the firm can not get anywhere else?”/Open ended question, classified: Networks and contacts/Premises and related services/Support services/Business development services/Location/Atmosphere and image/ Practices, characteristics, skills/Other/None, does not know.

-“If the incubator did not exist, would your firm be founded in any case?”/Structured question: “Probably yes”; “Probably no”; “No” vs. “Yes”.

-“How would you consider the following statement: “The incubator has accelerated the development of the firm”/Structured:question: “Yes, remarkably” vs. “Yes, to some extent”; “Yes, a little”; “No”.

## Appendix 2 Compressed results of the series of logistic regression analysis

|  | Groups of dependent variables   |                     |  |   |   |
|--|---|---------------------|--|---|---|
| Independent variables  | Use of incubator services   | Needs for incubator | Satisfaction with incubator  | Expectations for incubator  | Perspectives on effects of incubator  |
| Age in years <ul style="list-style-type: none"> <li>• 0–1 (reference class)</li> <li>• 2</li> <li>• 3</li> <li>• 4–</li> </ul>   | -Firm founding related services and consultation (likelihood decreases among firms that are 4– years)<br>-R&D, patenting, licensing (likelihood increases among firms that are 2–3)<br>-Mentoring and other use of senior advisors (likelihood increases among firms that are 2–3)                                    | –                   | -Satisfaction with Business development services (likelihood increases among firms that are under 4 years) | –   | -Business development services as value added (likelihood decreases among firms that are 3– years)<br>-Does not recognize any value added the incubator gives for the firm (likelihood increases among firms that are 3– years) |
| Number of employees <ul style="list-style-type: none"> <li>• 0 (reference class)</li> <li>• 0,25–1,75</li> <li>• 2–4,75</li> <li>• 5–</li> </ul>                           | -Firm development related services and consultation (likelihood increases among firms that employ 2–5)<br>-Mentoring and other use of senior advisors (likelihood decreases among firms that employ 2–)   | –                   | –  | –   | -Does not recognize any value added the incubator gives for the firm (likelihood increases among firms that employ 2–)  |
| Industry <ul style="list-style-type: none"> <li>• IT (reference class)</li> <li>• Life-sciences</li> <li>• Other technology</li> <li>• High technology services</li> </ul> | -R&D, patenting, licensing (likelihood increases among firms that operate in Life-sciences and Other technology sectors)  | –                   | –  | -Premises and related services<br>-Support services (likelihood increases among firms that operate in Life-sciences and Other technology sectors) | –   |
| Incubator customer class <ul style="list-style-type: none"> <li>• A (reference class)</li> <li>• B</li> <li>• C</li> </ul>   | -R&D, patenting, licensing<br>-Juridical services;<br>-Marketing and sales related services and consultation;<br>-Internationalization related services and consultation; -<br>Recruitment services;<br>-Mentoring and other use of senior advisors (likelihood increases among firms that are classified as A-firms) | –                   | –  |   | –   |

|   |  |   |   |  |  |
|---|--|---|---|--|--|
| Employment growth (min. 2 employees annually in 2002–2004) (dummy)  | -Mentoring and other use of senior advisors (likelihood increases among firms that have grown) | -Business development services; especially firm creation and establishment related services (likelihood increases among firms that have grown)<br>-However: Business development services; especially funding related services (likelihood decreases among firms that have grown) | –   | -Premises and related services<br>-Support services (likelihood decreases among firms that have grown) | -Premises and related services as value added (likelihood decreases among firms that have grown) |
| Turnover growth (min. 150 000 € annually in 2002–2004) (dummy)  | –  | –   | -Satisfaction with Business development services especially funding related services (likelihood decreases among firms that have grown)                         | -Premises and related services<br>-Support services (likelihood decreases among firms that have grown) | -Premises and related services as value added (likelihood decreases among firms that have grown) |
| Operating time in incubator in months <ul style="list-style-type: none"> <li>• 0–12 (reference class)</li> <li>• 13–24</li> <li>• 25–36</li> <li>• 37–</li> </ul> | –  | -Networks and contacts (likelihood decreases among firms that have operated in incubator 13–36 months)  | -Dissatisfaction with Practices, characteristics, skills of the incubator staff (likelihood increases among firms that have operated in incubator 25–36 months) | –  | –  |

# **ENTREPRENEURIAL INTENTIONS OF UNIVERSITY STUDENTS AND GRADUATES – A FINNISH PERSPECTIVE**

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## **ABSTRACT**

The Finnish universities have not focused on developing new entrepreneurs. University graduates have been underrepresented in the entrepreneur population in Finland. However, the group of university graduates is heterogeneous calling for investigations of the different sub-groups. The paper confirms earlier studies that the male persons at their prime-age (31-45 years) continue to be the most active group in terms of entrepreneurship and that the role of entrepreneurial role models in the family has a positive effect on the perceptions and intentions. Despite the risks attached to the dual-entrepreneur families, the role of the spouse is underlined in this study to have a positive influence on the personal desirability, feasibility and intent to start a firm. The university students find entrepreneurship both personally and generally desirable, which suggests that the entrepreneurial career in the future might become more typical for the university graduates. However, training and skill-development programmes might be necessary to increase the personal capabilities. Interestingly people with the background in business have more positive attitudes towards entrepreneurship than people with a background in engineering. Similarly, inter-disciplinary courses to include engineering and business students might be necessary to promote the entrepreneurial attitudes of the engineering students in order to promote more new technology-based start-ups. The paper suggests that there should be a continuous effort to promote female entrepreneurship. Furthermore, the third-age persons with the necessary social and financial capital could be targeted specifically to promote the positive attitudes and entrepreneurial intent, which would also support the current employment policies.

## **INTRODUCTION**

Traditionally Finnish universities have educated individuals for the public sector and large enterprises and the role of the Finnish universities has not been important in terms of developing future or current entrepreneurs. It is only recently that this role for the universities has been emphasised by the society due to the structural changes both at the private and public sector (flattening organisations, downsizing of the public sector). Nevertheless, there is still some controversy within the university sector of this role (see Paasio et al 2005). The university graduates are also underrepresented in the entrepreneurial population: There is a negative correlation between education and entrepreneurship in Finland: The more educated a person, the less likely she or he is to act as an entrepreneur albeit the positive attitudes towards entrepreneurship in general.

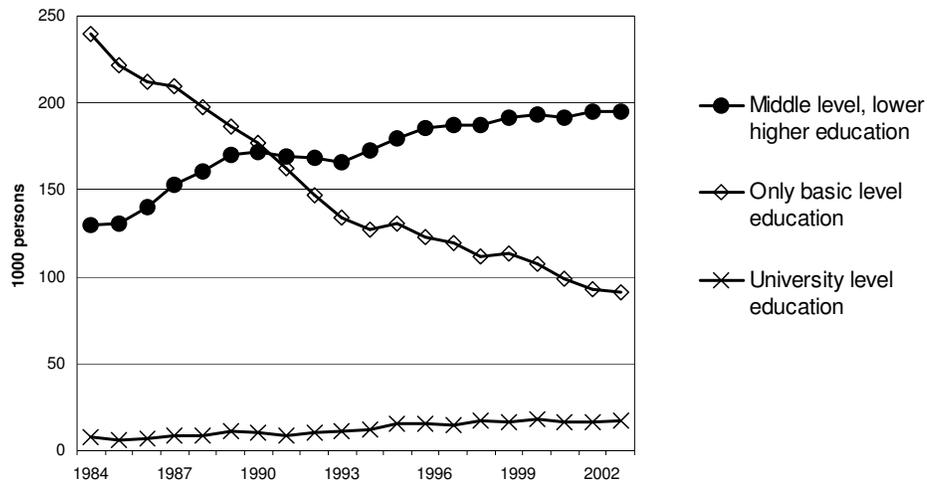
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In this study, we are interested in how people with an academic degree perceive entrepreneurship as a personal career alternative. Nevertheless, we must acknowledge that the group of academic graduates is a highly heterogeneous one. In order to grasp these differences, we have selected the respondents from different groups in the study. First, we analyse how people that have graduated the university at different times perceive the alternative. Second, it is also interesting to examine how the future graduates that are currently studying at a university perceive entrepreneurship. Our expectation is that they should be more positive about the option than the older generations as the option is increasingly put forward as an alternative for people with an academic degree. Thirdly, there is currently a strong emphasis on the doctoral studies in Finland. The annual number of PhDs has doubled in the 1990s. For example, in 1995 there were about 800 PhDs which had grown into 1400 PhDs in 2004. At the same time it is assumed that the universities will not be able to absorb the growing number of PhDs into an academic career but they will increasingly need to seek other career options. For this reasons we are also investigating not only the basic degree students (M.Sc., B.Sc.) but also doctoral students and their perceptions of entrepreneurship. Fourthly, it is assumed that the different university disciplines will provide the students with different capabilities with regard to entrepreneurship. The respondents also represent different educational backgrounds: commercial, technical and natural sciences. As a result, we investigate how the background education will affect the entrepreneurial intentions of the respondents.

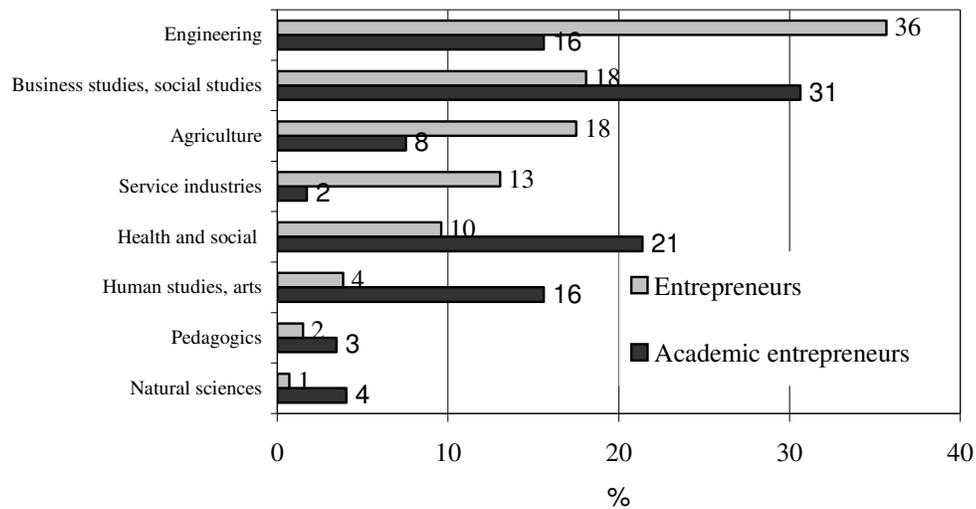
### **ENTREPRENEURSHIP AS A CAREER CHOICE FOR THE UNIVERSITY GRADUATE**

Recent research results suggest that Finnish people have very positive attitudes towards entrepreneurship in general but only few people have actual plans of setting up a firm (Arenius – Autio 2000, Arenius et al 2004). More particularly it is university graduates that are not interested of the entrepreneurial career. In fact, there is a negative correlation between education and entrepreneurship in Finland: The more educated a person, the less likely she or he is to act as an entrepreneur (see Figure 1). About 1/5 of the working population with a basic degree act as entrepreneur, while the share for the university graduates is only about 10% (Statistics Finland 2004).



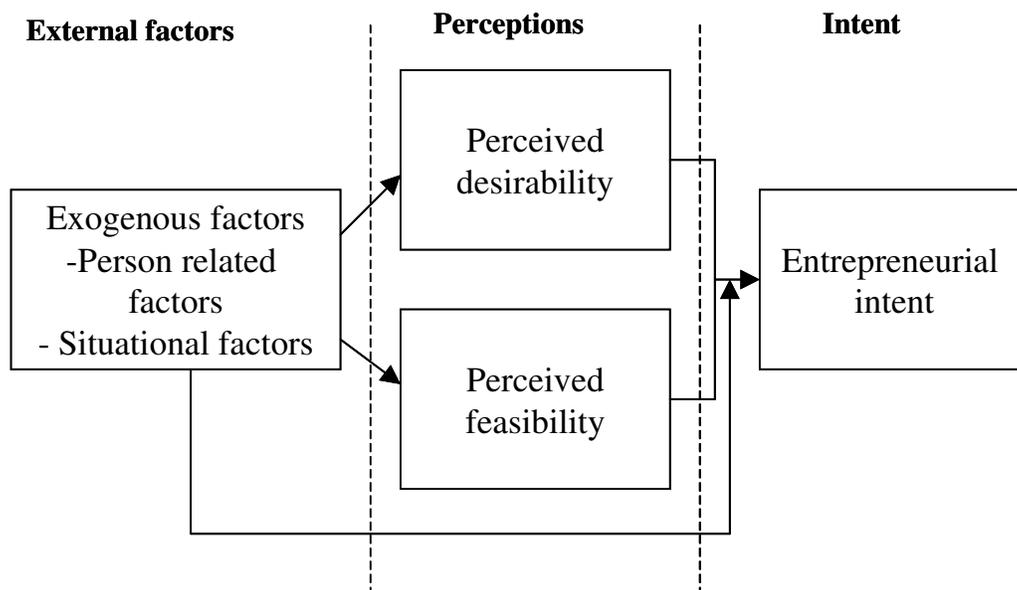
**Figure 1 The development of the number of entrepreneurs by level of education 1984-2004 (1000 persons), (Statistics Finland 2004, Paasio – Pukkinen 2005)**

There are also important variations between the different disciplines with regard to entrepreneurship. On average only about 1,3% of the students act as entrepreneurs after one year from graduation. However, in certain disciplines the average is much higher (20% of the dentists, 11,5% of the veterinaries). (Statistics Finland 2004, Paasio – Pukkinen 2005) It seems also that in certain disciplines the entrepreneurial activity is based on the level of education (Figure 2). For example, the entrepreneurial option is fairly usual for the people with a lower engineering degree while for the engineers with a university degree the option is less frequent. Within the business and social studies the trend seems to be opposite: the more educated persons act as entrepreneurs more frequently than the persons with a lower degree. The trend is similar for the natural sciences although with a much smaller proportion of entrepreneurs.



**Figure 2 Entrepreneurs and entrepreneurs with an academic degree by education, 2003, %**

The basis for the study is that becoming an entrepreneur is intentional, planned behaviour (Shapero – Sokol 1982, Krueger et al 2000, Rouvinen – Väänänen 2004, Grundstén 2004, Kolvereid 1996). Based on the theory the intent and behaviour are dependent on one hand on the perceived personal desirability and on the other hand on the perceived personal feasibility of the endeavour. These personal attitudes are affected by the personal and situational factors (Krueger 2000) such as educational background and working history. The framework for the study is presented in the figure 2.



**Figure 3 The process of model of entrepreneurship (adapted from Krueger 2000, Paasio – Pukkinen 2005)**

The aim of our study is to investigate how university students and graduates perceive entrepreneurship as a personal career alternative.

## METHODOLOGY AND ANALYSIS

### Data Gathering

For the purposes of this study a dataset was formed to include respondents from the following groups:

- Bachelor or Master’s degree students
  - Turku School of Economics and Business Administration (Finnish speaking business university in Turku), N=188
  - Åbo Akademi (Swedish-speaking university in Turku), N=76
- Doctoral students at the University of Turku
  - Participants at an Entrepreneurship Programme, N=56
- University graduates that work as employees
  - Members of the Finnish association of Graduates in Economics and Business Administration (SEFE), N=471
  - Members of The Finnish Association of Graduate Engineers (TEK), N= 374

### Data and Measures

#### *The dependent variables*

Entrepreneurial intent: How probable is it that you will start a firm within 5 years (scale 0-100)

Perceived personal desirability: How attractive would it be for you to start a firm? (scale 0-100)

Perceived personal feasibility: How easy would it be for you to start a firm? (scale 0-100)

[Perceived general desirability: How attractive is it for people in general to start a firm? (scale 0-100)]

[Perceived general feasibility: How feasible is it for people in general to start a firm? (scale 0-100)]

The independent variables:

- Sex (1=male)
- Age (1=under 30 years, 2=31-45 years, 3=over 46 years)
- Entrepreneurs in the family (grand-parents) (1=yes)
- Entrepreneurs in the family (parents) (1=yes)
- Entrepreneurs in the family (sisters, brothers) (1=yes)
- Entrepreneurs in the family (spouse) (1=yes)
- Entrepreneurs in the close networks (friends) (1=yes)
- Status (1=Student (M.Sc., B.Sc.), 2=Doctoral student, 3=Employee)
- Education (1=Business studies, 2=Engineering, 3=Natural sciences)

**Table 1 Presentation of the data**

| Sex   | n   | Age            | n   | Status          | n   | Education  | n   |
|-------|-----|----------------|-----|-----------------|-----|------------|-----|
| women | 529 | under 30 years | 446 | basic degree    | 260 | commercial | 659 |
| men   | 621 | 31-45 years    | 311 | doctoral degree | 56  | technical  | 446 |

|         |      |                  |      |              |      |                  |      |
|---------|------|------------------|------|--------------|------|------------------|------|
|         |      | 46 years of more | 400  | working life | 845  | natural sciences | 56   |
| missing | 11   | missing          | 4    | missing      | 0    | missing          | 0    |
| N       | 1161 |                  | 1161 |              | 1161 |                  | 1161 |

## Analysis

We conducted a logistic regression analysis on the relation of gender, age, entrepreneurial role models, status of the respondent (student, doctoral student or already in working life) and educational background towards perceived personal desirability, perceived personal feasibility and entrepreneurial intent. In addition, we conducted a logistic regression analysis on the relation of the above independent variables towards perceived general desirability and feasibility of entrepreneurship.

The relations were first analysed with SPSS Logistic Regression Enter method that includes all the variables in the model. We then iterated the model with Forward Wald method that excludes the variables not explaining the dependent variables. The stepwise analysis excluded some of the variables that appeared as statistically significant in the first phase but included also some new variables that were not statistically significant in case all the variables were included in the models. In the results we have chosen to apply the results from the Forward Wald method.

## RESULTS

The variables explaining the positive attitude towards perceived personal desirability and feasibility and entrepreneurial intent are listed in the table below.

**TABLE Logistic regression on positive attitudes towards perceived personal desirability and feasibility and entrepreneurial intent**

| N = 1161                                     | Perceived personal desirability |             | Perceived personal feasibility |             | Entrepreneurial intent |             |
|--|---------------------------------|-------------|--------------------------------|-------------|------------------------|-------------|
|  | <i>Exp (B)</i>                  | <i>Sig.</i> | <i>Exp (B)</i>                 | <i>Sig.</i> | <i>Exp (B)</i>         | <i>Sig.</i> |
| Male   | 2,648                           | 0,000       | 2,434                          | 0,000       | 2,436                  | 0,000       |
| Young (under 30 yrs)                         | 1,682                           | 0,017       | --                             | --          | --                     | --          |
| Prime age (31-45 yrs)                        | 2,407                           | 0,000       | --                             | --          | 2,139                  | 0,001       |
| Entrepreneurs in the family (parent)         | --                              | --          | 1,601                          | 0,003       | 1,629                  | 0,008       |
| Entrepreneurs in the family (sister/brother) | --                              | --          | --                             | --          | 1,759                  | 0,014       |
| Entrepreneurs in the family (spouse)         | 2,050                           | 0,004       | 2,133                          | 0,005       | 2,635                  | 0,000       |
| Engineering studies                          | --                              | --          | --                             | --          | 0,412                  | 0,036       |
| Management studies                           | 1,511                           | 0,020       | 1,911                          | 0,055       | --                     | --          |
| Student (B.Sc, M.Sc.)                        | 2,636                           | 0,000       | --                             | --          | --                     | --          |
| Doctoral Student                             | 2,372                           | 0,019       | --                             | --          | --                     | --          |

| N = 1161<br><i>Variable</i>                                     | Perceived personal desirability                         |             | Perceived personal feasibility                          |             | Entrepreneurial intent                                  |             |
|---|---|-------------|---|-------------|---|-------------|
|   | <i>Exp (B)</i>  | <i>Sig.</i> | <i>Exp (B)</i>  | <i>Sig.</i> | <i>Exp (B)</i>  | <i>Sig.</i> |
| Male  | 2,648   | 0,000       | 2,434   | 0,000       | 2,436   | 0,000       |
| Young (under 30 yrs)  | 1,682   | 0,017       | --  | --          | --  | --          |
| Prime age (31-45 yrs)   | 2,407   | 0,000       | --  | --          | 2,139   | 0,001       |
| Entrepreneurs in the family (parent)                            | --  | --          | 1,601   | 0,003       | 1,629   | 0,008       |
| Entrepreneurs in the family (sister/brother)                    | --  | --          | --  | --          | 1,759   | 0,014       |
| Entrepreneurs in the family (spouse)                            | 2,050   | 0,004       | 2,133   | 0,005       | 2,635   | 0,000       |
| Engineering studies   | --  | --          | --  | --          | 0,412   | 0,036       |
| Management studies  | 1,511   | 0,020       | 1,911   | 0,055       | --  | --          |
| Student (B.Sc, M.Sc.)   | 2,636   | 0,000       | --  | --          | --  | --          |
| Doctoral Student  | 2,372   | 0,019       | --  | --          | --  | --          |
| Model summary   | N=1161; Model Sig. < 0,000; Nagelkerke R Square = 0,150 |             | N=1161; Model Sig. < 0,000; Nagelkerke R Square = 0,095 |             | N=1161; Model Sig. < 0,000; Nagelkerke R Square = 0,111 |             |
| Method of analysis:<br>Binary Logistic Regression: Forward Wald |   |             |   |             |   |             |

The variable explaining the positive attitude towards perceived general desirability and feasibility are presented in the table below.

**TABLE Logistic regression on positive attitudes towards perceived general desirability and feasibility**

| N = 1161, Model Sig. = 0,000<br><i>Variable</i>                 | Perceived general desirability                          |             | Perceived general feasibility                           |             |
|---|---|-------------|---|-------------|
|   | <i>Exp (B)</i>  | <i>Sig.</i> | <i>Exp (B)</i>  | <i>Sig.</i> |
| Student (B.Sc, M.Sc.)   | 2,870   | 0,000       | 2,399   | 0,000       |
| Model summary   | N=1161; Model Sig. < 0,000; Nagelkerke R Square = 0,054 |             | N=1161; Model Sig. < 0,000; Nagelkerke R Square = 0,038 |             |
| Method of Analysis:<br>Binary Logistic Regression: Forward Wald |   |             |   |             |

Our results confirm earlier findings that entrepreneurship is predominantly a male activity. Men are about 2,5 times more likely to perceive entrepreneurship as personally desirable as well as feasible and similarly 2,5 times more like to start a firm in the next 5 years than women. The age of the respondents also explains the perceptions regarding entrepreneurship. The likelihood for finding entrepreneurship personally desirable increases for the young people (under 30 years) and prime-age people (31-45 years) compared to middle-aged and older people (over 45 years of

age). As expected, the likelihood for setting up a firm also increases for the prime-agers. People in this prime age group are two times more likely to start a firm within the next five years than the older generations in the study. Hence, the older generation (over 45 years of age) seem to be a 'lost case' in terms of entrepreneurship in Finland although from the point of view of social and financial capital needed for the venture they might be an interesting group (Blackburn – Hart 2004).

Similarly to previous studies the role of entrepreneurial role models (entrepreneurs in the family: parents, sisters and brothers) increases the likelihood for the entrepreneurial intent. More particularly the role of the spouse is underlined in the study: the spouse as an entrepreneur more than doubles the likelihood for the perceived personal desirability, feasibility and intent to set up the firm.

It also seems that the university study background effects the entrepreneurial intent: the students or graduates with an engineering background are less likely to set up a firm compared to students/graduates with a background in management or natural sciences. This is a surprising finding as one might expect that the engineering students and graduates to possess many technology- or knowledge-based ideas that could be the basis for a new venture. Management studies also increase the likelihood for the perceived feasibility which makes sense: they believe to be able to make business plans, manage employees, take care of the finances and all the other things considered necessary for running of the business. Interestingly, management studies also increase the likelihood for the perceived desirability of the entrepreneurial career.

Students (B.Sc., M.Sc., doctoral students) find entrepreneurship more desirable for themselves than people active in the working life. More importantly students also consider it to be a desirable and feasible career option for people in general. In this sense the students seem to consider entrepreneurship very positively. This might be the consequence of the strong emphasis of entrepreneurship in the studies currently and of the current policy debate in the society more generally. It is quite expected that the students do not yet have strong intentions of starting up the firm within the five next years as they presumably lack the necessary skills and experience. However, if the positive perceptions are sustained over the years we might be able to see more entrepreneurs with an academic degree in the future, which is an encouraging finding.

### **Limitations of the study**

For the purposes of this study we have combined a dataset where the respondents represent different groups in order to understand university graduates as a heterogeneous, rather than a homogeneous group. However, there are some problems with the dataset. The groups “natural sciences” and “doctoral students” are identical, hence, we do not have doctoral students in our sample to represent the other educational backgrounds and we do not have basic degree students or people in the working life that would have a background in natural sciences. In the future, we aim to form a more balanced dataset. Furthermore, the engineering students are all enrolled in one university and the business students in another university. Hence, the university per se might have an effect on their perceptions and intent and not only the discipline to be studied. This problem can be corrected by including also the management students in the first university in the sample to verify if there are differences between the disciplines. However, as the second university has a single

discipline (business studies), it is not possible to include engineering students from the other university in the sample. In this sense the group of graduates that includes graduates from all the universities in Finland is the most representative of the samples in our study.

## DISCUSSION

This study reinforces the earlier studies that entrepreneurship is predominantly a male activity. Men are more likely to set up a firm in the near future, perceive their own capabilities to be better in setting up the firm and perceive it to be personally a more desirable career alternative than women in our study. This message gives a clear indication to put a continuous effort on encouraging female entrepreneurship. Since based on an earlier study this finding holds true also when only students are targeted (Mäki – Korvela 2002), we believe that the universities have an important role to play in this regard. The possibilities provided by entrepreneurship to reach management position without the fear of reaching the ‘glass ceiling’ and to combine work and family life in a flexible manner might be the messages that the female students might find compelling. At the moment the image of the female students with regard to entrepreneurship might be biased towards ‘slave work and long hours’ that cannot be combined easily with a family.

Based on our study the persons in the younger or prime-age group are motivated by the entrepreneurial endeavour. In contrast, the older generation (over 45 years of age) seem a 'lost case' in terms of entrepreneurship, which raises some concern. Currently, there is an effort increase the number of employed persons by for example prolonging the working period (until 68 years of age). The Western population matures and more and more people represent the third age. These people are still fit and healthy, have generated wealth and experience during their careers and possibly find it too early to retire completely and need something interesting to do. Hence, the third age citizens are also increasingly considered as an important and interesting source for potential entrepreneurs. Not least because the shift in the age profile of the population has major implications for the ability of the state and the corporate sector to continue to pay pensions to retiring employees. (Blackburn – Hart 2004) Based on our study, however, the third agers do not seem motivated by the entrepreneurial career but on the contrary they perceive the option less desirable and are less likely to set up a business in the near future than the persons in the other age categories. This might reflect also the policy development where the youth entrepreneurship has been on the agenda for many years but the idea of the third-age entrepreneurship is a new-comer. Hence, more emphasis should be placed on promoting entrepreneurship, for example, part-time entrepreneurship for the third-age people. In this way, they could more flexibly integrate free time and work-life.

As expected the role of entrepreneurial role models in the family (parents, sisters and brothers) increases the likelihood for setting up the firm. Interestingly, however, the role models do not have an effect on all of the dependent variables. For example, the parents as entrepreneurs increase the intent and the feasibility of the entrepreneurial career but not the personal desirability. This might result that the entrepreneurial are not only positive: If the parents have had limited amount of free-time and not enough time and energy for the family, this might be decrease the desirability of the career although it is considered personally feasible. Especially the role of the spouse is underlined in the study: the spouse as an entrepreneur more than doubles the

perceived personal desirability, feasibility and intent to set up the firm. On one hand this makes sense as the respondent is able to consider that if her or his spouse is doing well as an entrepreneur and enjoying the life, why could not she or he as well? The positive attitudes might also be connected to the intent of joining the spouse's firm later on. On the other hand, we could have expected also a contrary result from the study. The respondents might consider the risks of dual-entrepreneur households and be less likely to start up the firm than the persons with spouses in wage-work. In general, the other family members (parents, sisters etc.) do no longer live in the same household so the economic consequences of their failures do not affect the respondents. In this sense, this is an interesting finding from our study. This is also an area that is rarely discussed in the media or in the policies. Based on our study it might be interesting to provide entrepreneurship training courses directed to the spouses of entrepreneurs.

It also seems that the university study background effects the entrepreneurial intent: The students or graduates with an engineering background are less likely to set up a firm compared to students/graduates with a background in management or natural sciences. Management studies also increase the likelihood for the perceived feasibility. In order to promote the birth of new technology-based firms it might be an interesting option to promote entrepreneurship more heavily for the engineering students and graduates. For example, forming inter-disciplinary teams in the university might help to develop teams with both the technological and business knowledge.

With regard to the future of entrepreneurship in Finland, it seems promising that the students in the study find entrepreneurship more desirable as a personal career alternative than people participating already the working life. The students also consider it to be a generally desirable and feasible career option for other people which might increase their willingness to promote the alternative for other people (friends, relatives). However, they might need further training and skills to increase their perceived personal feasibility and actual behaviour. It is important not to lose this positive attitude over the years at paid work. Hence, it is important the universities and professional associations develop entrepreneurship awareness raising campaigns and training also for the people already at work, not just for students.

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**WOMEN AT THE HELM:  
MANAGEMENT SUCCESSION WHEN CRISIS HITS**

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**ABSTRACT**

An exploratory study was conducted to investigate the experience of widows who succeeded their deceased spouse in a privately-held business. The purpose of this study was to identify factors which affect the business performance when the widow is at the helm of the company. There is no previous research on women in this role.

Using qualitative methods, this study describes the experiences of 16 widows who took over their deceased spouse's business. In each case, the husband died unexpectedly and the woman was left with the decision to continue the family business. The organization's performance before and after the takeover, and factors affecting the business's performance when the widow succeeded her husband as leader are investigated.

Performance increased in 14 out of the 16 organizations after the widow took over the company, one had no change, and one had a slight (2.75%) decrease. The increases in average annual sales ranged from 3.13% to 225% with an average of 44.2% . To explain the results, the study describes several characteristics of the women in the sample. Number of years of widowhood, age, and financial knowledge were among the variables investigated in relation to performance. The study concludes by offering recommendations for future research. While this study does not provide causality, it suggests important facts and relationships to provide assistance for all business owners and their families.

## INTRODUCTION

Sixty to 70 percent of U.S. Small businesses define themselves as family owned, according to recent surveys by Arthur Andersen Enterprise Group and National Small Business United. Nearly 40 percent of small-business owners hire a spouse, while 37 percent have their children on the payroll. Family businesses are the backbone of the American economy, making up more than 90 percent of over 15 million businesses. Most are small to mid-sized, but they range throughout the business spectrum. Even among the Fortune 500, more than one third are family controlled.

Statistics indicate that, following War World II, the formation of small businesses was on the increase. Now, forty years later, there is an emerging problem in the leadership of these businesses. The predominately male owners are approaching retirement age, and most have not planned for leadership succession. This may be for a variety of reasons. Occasionally, the owner/founder is the roadblock due to his or her anxiety over death. Some act as though death were something that happens to everyone else except themselves. Owners may also fear losing their identity by turning over the company, or they may simply hate losing their power base (Kets de Vries, 1981). In other cases it may be the family that represents the roadblock. Not only can family members be hampered by the death anxiety already mentioned, but they may also suffer from the fear of sibling rivalry or a change in their position or status.

Another reason for the lack of succession planning is that the owner usually is the business. In the field of entrepreneurship, researchers have argued that the firm becomes an extension of the founder's self and plays an integral role in forming his or her sense of identity (Kets de Vries, 1981). The individual's personality and talent make the business what it is. If the owner was removed from the picture, the business might be unable to continue. Additionally, this individual may not want to be removed. So, if the owner begins to have health problems or is unable to manage effectively, the individual may still hang on to the business. Furthermore, entrepreneurs often are unable to find someone with their talents. Potential successors lack the creativity and innovativeness of the founder and this can be particularly important (cf. Kuratko & Hodgetts, 1989).

Additionally, there is the common problem of considering one's children to be too young to take over, regardless of their chronological age. If a father brings up succession planning, his wife thinks he's suffering chest pains. If the children bring it up, both parents may think they're greedy.

Family management succession poses one of the greatest challenges for these business owners. This undoubtedly helps account for the fact that only one third of all enterprises prosper through a second generation and only one tenth through the third generation. Upon initial examination, succession does not seem as if it should be a major problem. All the owners have to do is designate which heirs will inherit the operation or, better yet, train one (or more) of them to take over the business during the founders' lifetime (Kuratko & Hodgetts 1989). However, in reality, one problem that most family businesses experience is planning how to pass control of the

business onto that next generation.

In fact, most family-owned businesses never even formulate succession plans. Transferring management/ownership of a family business is always difficult and often emotional; it affects family members, bankers, employees, managers, competitors, lawyers, spouses, and friends. The only sure thing is that failing to plan will make a transfer more difficult and painful.

Traditionally, the wife of the family-business owner stayed home and raised the children while he dedicated his life to building the business. Although the business had a profound influence on her life, all too often the traditional wife knew little about it. Given that men statistically have shorter life spans than women, these men often die before their wives, and the leadership and management-succession roles are left to his wife by default. If the owner died unexpectedly, his widow often found herself unprepared for the responsibility of a business that had lost one of its most valuable assets: its leader. Sometimes, by necessity, she stepped into the business and assumed control (Benson, Crego & Drucker, 1990).

When a widow finds herself with the unanticipated dilemma of suddenly owning her spouse's business when her husband dies unexpectedly, there is often a lack of guidance for her. The widow is faced with the responsibility of selling the business, operating the business, or hiring someone to run it. Sometimes, the widow has never worked in the business or, if she has, it has not been within a leadership position.

The literature on women in family business is still gestating. Serious papers on the subject total 5 or fewer (Gersick & Salganicoff, 1990). This is an exploratory study undertaken to investigate the frequent crisis situation which occurs when a widow succeeds her husband as leader of his business. The purpose of this study is to examine the business's performance at the time of the husband's death compared to when the widow is at the helm of the company. The need for studying this group is based, in part, on the increasing number of women who are experiencing this situation. However, no specific literature has been found which focuses on the widow's role in the business after her husband's death (McKinley, 1984). Therefore, there is a need for more research on the effects this situation has on the widowed woman and her family.

## **METHODOLOGY**

Most studies of family-owned businesses have focused on the male entrepreneur or on his wife (McKinley, 1984). A case study method of descriptive research, which is exploratory in nature, was chosen as the appropriate methodology for this study of an aspect of family-owned business. Fowlkes (1980), describing her research on wives of those in medicine and academe, stated that the advantage of the personal interview as a data-gathering technique is that it can *combine* structure and standardization with open-endedness and flexibility. The case study is ideal for this purpose as it is an examination of a specific phenomenon (Merriam, 1988) in a bounded population (Marshall & Rossman, 1989). Utilizing this approach then allows the researcher to focus particularly on the phenomenon of interest, obtain rich descriptions of the phenomena, illuminate our understanding of the phenomenon, and draw general inferences from the specific

subjects. In using this method, the desire is to generate findings that indicate an in-depth understanding of the management performance of the widows while providing breadth in terms of research implications for future studies.

Prospective subjects were identified through networking (friends recruiting subjects who are not known by the interviewer), insurance agents, accountants, attorneys and other professional advisors. In addition, referrals were supplied through the U.S. Small Business Administration, the Service Corps of Retired Executives (SCORE), Small Business Development Center at the University of Pittsburgh, Internet Government Census, and the Family Firm Institute. Eighteen widows were identified who met the following criteria: a widow who has taken over the leadership of her husband's business as a result of his death; between thirty-five and eighty-five years of age; business (formerly her husband's) had a sales volume of \$1 million when she assumed leadership of it; business is located within the mid-Atlantic region of the U.S.

The first criterion was developed to directly address the research population. The second criterion allows a broad enough age group to span the experience of several generations. The third criterion was included because it deals with the increased number of problems in a larger volume business. Finally, the fourth criterion restricting location was included so that the subjects would be within an area easily accessible to the researchers. Of 18 subjects contacted, 16 agreed to participate, and the 2 subjects who declined did not offer a reason for their refusals.

Before the interviewing process, subjects were informed of the full intent and requirements for the study. Confidentiality was assured through elimination of identifying data, and a written release of information, including permission to use direct quotes, was signed by each subject before interviewing.

In-depth descriptions of the experiences, along with biographical and business data, of the 16 widows who have succeeded their deceased spouses in business were collected. The interviews were tape recorded and transcribed for the purpose of content analysis. A pilot study was conducted to familiarize the researcher with the sample, the procedure, and to refine the instruments of research and analysis procedure for this study. As a result of the responses to questions in the first interview, the questions were redesigned to elicit greater depth in the subjects' answers. After completion of the interviews, the audio tapes were transcribed verbatim. The data were then analyzed.

In literature, business performance is usually measured from the economic perspectives of growth in sales or employees and by the increase in profits (Barr, Box, & White, 1993; Chandler & Hank, 1994; Covin & Covin, 1990;). Women-owned businesses tend to be smaller and slower to grow, and they often appear less successful if measured by economic criteria. Gattaker and Larwood (1989) suggest that women may seek outcomes other than business growth as measures of their success. Women have a stronger preference for businesses which offer opportunities that are more closely related to personal satisfaction, like professional growth and challenge, while men prefer businesses that offer higher sales and income (Bigoness, 1988; Buttner & Moore,

1997). Therefore, in this study, management performance was measured by change in annual sales and satisfaction of each woman in her new role.

## RESULTS

Of the sixteen subjects who participated in this study, five of their husbands had a succession plan in place at the time of his death. These five subjects were all operating second-generation businesses, and they and their spouses were very knowledgeable concerning the advantages of having a succession plan in place at the time of death. The other 11 subjects were knowledgeable of a succession plan and had previously discussed the concept, but for various reasons a plan was not put in place.

At the time of the husband's death, the sales in the companies examined ranged from \$500K to almost \$50 million. The time since the husband's death ranged from less than one year to approximately 30 years with an average lapse of 12.63 years. Although all of the subjects were lacking in the knowledge of finance prior to their husbands' deaths, of the sixteen organizations studied, sales performance since widowhood increased in fourteen, decreased (2.75%) in one, and had no change in one. Sales performance increases ranged from 3.13% to 225% with an average increase of 44.18%. Total increases in sales ranged from 30% to over 1000% (see Table 1).

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TABLE 1 ABOUT HERE  
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The youngest subject was widowed at the age of forty and the oldest at 68 with an average age at widowhood of fifty two. All sixteen subjects graduated from high school and several took additional business courses. Two had Bachelor's Degrees, two had Masters Degrees, one had a Ph.D., and one had a Nursing Degree. In the number of years the subjects were widows in relation to the average annual increase of sales, the average annual percentage increase in 1-to-10 years of widowhood (n=6) was 78.5%. In the 10-to-20 year category (n=6), the average percentage increase was 8.16 percent and in the 20-to-30 year category (n=4), the average percentage increase was 23.99 percent (see Table 2).

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TABLE 2 ABOUT HERE  
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When comparing the widows' ages with their companies' average annual increase in sales, more interesting patterns emerged. The group of those widows in their 60s had an average increase of 75.02 percent, which may be accounted for by the fact that this group also has the businesses with the longest periods of operation ( $\bar{x}$ =54.5 years, run by the widow an average of 15.17 years). In the 70s age group, there was an annual average increase of 23.13 percent, and the lowest

average increase was shown in the 50s age group with 9.99 percent (see Table 2).

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TABLE 3 ABOUT HERE  
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### DISCUSSION

The purpose of this study was to explore the effect on business performance when a widow succeeds her husband as president of a privately-held firm. This is significant because women often have to take over the family business upon a husband's death and there is little guidance for women in this situation.

All but two of the businesses demonstrated an increase in sales when taken over by the widow. It appears that the first 10 years of widowhood produced the greatest amount of annual sales increases. That the greatest increases were shown during the 1-to-10 year period might be because the subjects were more energetic and enthusiastic during this initial period than later. It could be because they were younger, had younger children, and needed more income. They also could have been more knowledgeable. In this category, the subjects had more formal education: one subject held a Ph.D., one held a Master's degree, two held Bachelors' degrees, and two had high school diplomas.

The highest increase in sales in the 60s age group could be attributed to the fact that the children who are presently in the business are college educated and have more skill in marketing than those in the first generation. Since the takeover, 14 of the subjects described an annual increase in sales and profit. Several have moved to new locations that were on the drawing board at the time of the takeover, and several planned these new locations on their own. Only one subject did not have an increase in sales since the takeover, although she has added a new division to the business. She attributes this to the economy and several other factors. This subject also stated that her husband was a great risk take while she is not. This could be one of the reasons for the decrease in sales.

This research provided answers to questions but also revealed new ideas for further investigation. While the results are very strong, more research is necessary to obtain results that are statistically significant. Today, women-owned businesses are no longer a new phenomenon, and an increasing number of women have become business owners by default when the husband has died unexpectedly. Before 1970, women owned only 5 percent of all U.S. businesses, but currently they own approximately 30 percent. These women entrepreneurs have changed history by undertaking great risk, facing great personal difficulties, legal barriers, discrimination, ridicule, and danger in order to pursue their dreams.

Further research is necessary to reveal how the husband's and wife's management style affect

organizational performance. Are these organizations more successful because the women take on nurturing and caring management styles? Is this true internationally? Also, the sample in this study was restricted by age. Future research should broaden the age groups investigated to reveal whether the age of the woman or even the ages of her children affect the success of the organization. It is possible that younger women with younger children are even more driven to make these companies succeed in order to support their families. Finally, the success of widows should be compared to the success of men who find themselves in the same situation, and to other women entrepreneurs. Although more rare, comparing widows and widowers might reveal that anyone who takes over a spouse's business is driven to make that company succeed, perhaps out of love for the one who was lost, or just plain determination to make the company a success in memory of the lost spouse.

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**Table 1  
Business Data**

| Subject | Year Business Started | \$\$ Sales at Takeover in Millions | Current \$\$ Sales in Millions | Subject's Age at Widowhood | Subject's Current Age | Type of Business           |
|---------|-----------------------|------------------------------------|--------------------------------|----------------------------|-----------------------|----------------------------|
| S-1     | 1924                  | 1.5                                | 15.0                           | 60                         | 66                    | Electrical Contractors     |
| S-2     | 1963                  | 4.0                                | 5-6                            | 61                         | 77                    | Industrial Sales           |
| S-3     | 1978                  | 1.5                                | 1.0                            | 33                         | 53                    | Meat Packing/Cater         |
| S-4     | 1941                  | 15-50                              | 500                            | 62                         | 66                    | Publishing                 |
| S-5     | 1969                  | 3.0                                | 5.0                            | 39                         | 52                    | Well Drilling              |
| S-6     | 1940                  | 1.0                                | 5.0                            | 33                         | 63                    | Construction Utilities     |
| S-7     | 1920                  | 5-15                               | 15-30                          | 60                         | 68                    | Automobile Dealership      |
| S-8     | 1956                  | 1-5                                | 5-15                           | 42                         | 54                    | Manufacturing/Air Curtains |
| S-9     | 1944                  | 5.0                                | 15-50                          | 44                         | 71                    | Automobile/Dealership      |
| S-10    | 1959                  | 1.5                                | 6-7                            | 42                         | 63                    | Advertising/Publishing     |
| S-11    | 1968                  | 1.2                                | 1.6                            | 56                         | 58                    | Manufacturing/Plastic      |
| S-12    | 1945                  | 2.0                                | 5.0                            | 59                         | 71                    | Publishing                 |
| S-13    | 1946                  | 1-5                                | 1-5                            | 68                         | 68                    | Burial Vaults              |
| S-14    | 1971                  | .5                                 | 4.0                            | 40                         | 62                    | Promotional Products       |
| S-15    | 1968                  | 1-5                                | 5-15                           | 72                         | 75                    | Leasing                    |
| S-16    | 1972                  | 1.0                                | 3.0                            | 43                         | 57                    | Wholesaler/Apparel         |

**Table 2  
Years of Widowhood and annual Sales Percentage Fluctuation**

| <b>1 to 10 Years of Widowhood</b> | <b>10 to 20 Years of Widowhood</b> | <b>20 to 30 Years of Widowhood</b> |
|-----------------------------------|------------------------------------|------------------------------------|
| 1 year; 0%                        | 12 years; -2.75%                   | 21 years; 17.46%                   |
| 2 years; 16.67%                   | 12 years; 12.50%                   | 22 years; 31.81%                   |
| 3 years; 66.67%                   | 12 years; 16.67%                   | 27 years; 33.34%                   |
| 4 years; 225%                     | 13 years; 5.13%                    | 30 years; 13.33%                   |
| 6 years; 150%                     | 14 years; 14.29%                   |                                    |
| 8 years; 12.50%                   | 16 years; 3.13%                    |                                    |

**Table 3**  
**Age Group in Relation to Average Annual Sales Fluctuation**

| <b>50s Age Group</b> | <b>60s Age Group</b> | <b>70s Age Group</b> |
|----------------------|----------------------|----------------------|
| S-3: -2.75%          | S-1: 150%            | S-13: 0%             |
| S-5: 5.13%           | S-4: 225%            | S-2: 3.13%           |
| S-8: 16.67%          | S-6: 13.33%          | S-9: 33.34%          |
| S-11: 16.67%         | S-7: 12.50%          | S-12: 12.5%          |
| S-16: 14.29%         | S-10: 17.46%         | S-15: 66.67%         |
|                      | S-14: 31.81%         |                      |

**ANALYSIS OF PRE-REQUISITES FOR AN ENTREPRENEURIAL CAREER  
VIS-À-VIS PARENTAL WORK PROFILE: INDIAN EXPERIENCE**

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**ABSTRACT**

This paper attempts to study the effect of parental work profile on the career paths taken by their offsprings. The study brings to light the various determinants of choice based on parental work profile which can help us comprehend the basis on which entrepreneurship can be promoted in developing countries. Also, it will help an aspiring entrepreneur realize and evaluate his resources and thus decide the course of his career.

Entrepreneurship exhibits innovation as well as acts as a major new job creator in an economy, with cost-effective strategies for economic development. Through our knowledge-based perspective we perceive it to possess the capacity to boost the economy in developing nations.

The choice-theoretic framework of the study focuses on determination of the factors that lead to different career choices for the offsprings depending on their parents' work profile. In developing countries like India, the economic and societal environment makes the involvement of parents in the lives of their offsprings inevitable.

Through a survey, we have analyzed the plausible parental factors that influence the career choice of offsprings: (a) emotional support of parents towards the chosen career choice, (b) job satisfaction of parents about their work profile, (c) job satisfaction of parents about their

earnings/perks, (d) available financial support from parents, (e) networking of parents, (f) professional guidance available from parents in the chosen career choice.

## INTRODUCTION

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In a developing country like India, the economic and societal environment makes the involvement of parents in the lives of their offspring inevitable. This paper attempts to comprehend the manner in which the parental work profile influences the career path taken by an offspring.

Entrepreneurship is commonly defined as the pursuit of opportunity, whether for a profit or non-profit venture, without relying exclusively on resources currently in one's control. That is, entrepreneurs see opportunities, often where others only see obstacles, and they pursue these opportunities by finding ways to mobilize needed resources (Melissa A. Taylor, 1997). Entrepreneurship therefore has the capacity to become the driving force in any economy. It exhibits innovation as well as acts as a major new job creator in an economy with cost-effective strategies for economic development.

In India, there has been substantial growth in the higher educational system and it generates over 3 million graduates every year. However, the employment generation system is not in a position to absorb the graduates passing out from the universities, leading to an increase in educated unemployed, year after year. India envisions to be developed by the year 2020 and factors like these necessitate the promotion of entrepreneurship in India.

The path to entrepreneurship taken by a person depends on numerous factors. These factors range from something as localized as personal conditions to something as large as the global economy. Some of these factors are direct and can be studied in terms of monetary indicators. However, other factors, which at times are more influential than the economic factors are environmental factors. These environmental factors govern the will that goes behind making a successful entrepreneur.

The study concentrates on the career decisions of the students from the engineering discipline which involves a large fraction of students. India significantly differs from the developed countries in terms of the influence parents exert on the career choices of their offsprings. The effect of parents on a child has innumerable dimensions. Factors like parents' educational profile, work profile and experiences exert a crucial and sustained influence on the children during the forming years of their lives. India's societal norms accord primacy to attributes such as a steady and stable individual career path, reduction in the levels of uncertainty and ambiguity, an aversion to failure, and the desire to 'fit' within a certain 'mould'. This leads to weaning away the youth from entrepreneurship. Also, there is immense financial dependence of children on their parents since India, being a developing economy, still has a long way to go in providing funding and support to nurture entrepreneurs.

A wrong career decision often shelters many other problems which emerge with the progress of time. Activities like job dissatisfaction, reduced efficiency, job hopping and other psychological problems come as by products of the faulty decision.

Realizing the importance of entrepreneurship in India's developing economy, this paper attempts to determine and weigh the plausible factors based on parental work profile that influence the career path of the offspring. Such an analysis will help the policy makers encourage entrepreneurship, and also help people in evaluating their career options on the basis of the analysis.

## LITERATURE REVIEW

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In an attempt to realize the various parental work factors that influence the career decisions of the offsprings, we began the study by analyzing the previous research done in this sphere. Much research has been done to examine the influence that parents exert on their offsprings' career decisions. However, almost none was specific to the work profile of parents.

Research indicates that parents have an important influence, perhaps the single most important influence, on the career and job choices their children make (Kotrlík & Harrison, 1989; McCracken & Odell, 1988; Otto & Call, 1985; Splete & Freeman George, 1985). The major family determinants of children's career development can be categorized as follows: geographic location, genetic inheritance, family background, socio-economic status, family composition, parenting style and parental attitudes toward work (Splete & Freeman-George, 1985). Authorities in psychology and career development believe that parents are the most crucial factor in the formation of children's personalities and self-concept, and that career choices can be regarded as the "implementation" of these qualities (McDaniels & Hummel, 1984). As children make self-assessments and receive feedback from significant others, they form educational aspirations. These in turn are a primary influence on educational achievement, the level of which is the single most important determinant of eventual occupational achievement (Otto, 1984).

However, research also indicates that to be effective in vocational guidance, parents need knowledge of career paths and development (Schergens, 1980). Schergens separates the role from the parents in two shutters: that of guide (nobody-resource) and that of provider of information and experiments for the child. In other words, the parents must assist the child by developing on their premises good attitudes vis-à-vis with work (respect, direction of the responsibilities, motivation, etc).

Although parents have the most vital influence on the youth, they may be restrained by factors beyond their control such as culture and economics. Middleton and Loughead, in 1993, presented three categories to describe types of parental involvement in adolescents' career development: (1) positive involvement, (2) non-involvement, and (3) negative involvement. The greatest anxiety adolescents feel about their career decisions or exploration, quite understandably, is in response to parents' negative involvement. Parents in the "negative involvement" category are often controlling and domineering in their interactions with their children. The children of such parents often pursue the careers selected by their parents rather than those they desire so as not to disappoint their parents or go against their wishes (Middleton and Loughead, 1993).

One family variable that has been shown to influence career aspirations includes the parents' occupation (Trice, 1991). The father's occupational status is highly correlated with his son's occupation (Blau, 1992; Blau and Duncan, 1967; Conroy, 1997).

## THEORY CHOICES

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### Figure 1

Using our knowledge-based perspective, we realized that the following factors (see figure 1) are crucial in influencing the career paths of the offspring: emotional and financial support available from parents in the chosen career path, professional guidance available from parents in the chosen career path, job satisfaction of parents in their jobs as well as in terms of their earnings/perks, and the networking of parents.

## METHODOLOGY

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### Data Collection

Since we were interested in studying the effects of work profile of parents on the career choices of their offsprings, it became vital to select students who had enough knowledge and awareness about different possible career options ahead of them as well as the Indian economic scenario. Thus, we went ahead to study the students pursuing engineering in one of India's finest engineering institute – the Indian Institute of Technology Delhi ( IIT Delhi). IIT Delhi has had a tradition of making successful entrepreneurs as well as employees who have gained prestige and power in all corners of the world. The atmosphere in this institute promotes an overall and sound development of students. Since IIT Delhi has students from all sections of the society and all parts of the country pursuing their engineering here, the sample has a wide database. IIT Delhi offers different types of courses at the undergraduate level. We have sampled students pursuing their Bachelor of Technology (B.Tech) degree in different fields of engineering. The survey was conducted on 200 students.

The study included the following steps:

- (1) Developing the choice-theoretic model (figure 1) that correlates the various factors based on parental work profiles that influence the choice of an entrepreneurial or non-entrepreneurial career for the offsprings
- (2) Completion of the survey of students through a structured questionnaire
- (3) Data analysis using analytical techniques and interpretation
- (4) Testing and validating the hypothesis of the model
- (5) Deriving the implications of the model

A structured questionnaire was prepared that was distributed amongst the sample and explained to them. To gather more information about the reason for their responses, some of the sample was also spoken to in person.

### Variables

The different career options for students based on our understanding of the trends being followed in IIT over the last decade were found to be (1) Low Scale Entrepreneurship, (2) Medium Scale Entrepreneurship, (3) High Scale Entrepreneurship and (4) Service/Salaried Job.

The factors depending on parental work profile that were assumed and later verified to be affecting the career choices of an offspring were:

- 1) Need for financial support from parents
- 2) Need for emotional support from parents
- 3) Need for networking of parents
- 4) Need for professional guidance available from parents
- 5) Job satisfaction of parents about their work profile
- 6) Job satisfaction of parents about their earnings/perks.

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## **RESULTS AND DISCUSSIONS**

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Table 1, Figure 2, Figure 3, Figure 4, Figure 5

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Table 1 shows the relative effect of factors (on a 10 point scale) regarding parental work profile that affect the career choice of the offspring. Figures 2, 3 and 4 show the relation between parental work profile and the various career choices of a student.

Results show that the need for financial support from parents is minimum for a salaried job and maximum for high scale entrepreneurship. Finance is a major milestone that needs to be crossed to start a business venture. Thus financial support from parents becomes crucial. This clearly shows that due to lack of enough finance, a lot of students are made to take up a salaried job for some time and after earning for some years and after gaining enough financial backing, they switch to entrepreneurship. This not only adds to dissatisfaction in one's jobs but also makes them lose precious years of their youth in an occupation they don't desire.

Results indicate that the need for emotional support is minimum for a salaried job and maximum for high scale entrepreneurship. This need was found to be more dominant than money because of the fact that Indian parents are deeply involved in the upbringing of their child. They often guide their child into taking a particular career choice, often influenced by their expectations from them. Children also wish to live up to the expectations of their parents and their career choices are thus dependent on the emotional support that their parents provide them within their careers.

As shown by results the need for networking is minimum for a salaried job and maximum for high scale entrepreneurship. Networking is extremely benefiting in an entrepreneurial career.. Thus students expect enough help in terms of the contacts that their parents have made in their working life. Lack of this, as the results show, make a student feel discouraged for entrepreneurship and he/she thus prefers to go in for a salaried job which requires minimal networking from parents.

Need for professional guidance was found to be minimum for a salaried job and maximum for high scale entrepreneurship. Professional guidance from parents is an important factor in choosing an entrepreneurial career. Any crucial decision is based on a lot of advice. And since again, the environment in India makes the parental involvement inevitable, offsprings have a natural inclination to look up to their parents for guidance. Service/salaried job on the other hand requires much less professional guidance from the parents.

The response of parents towards their job in terms of work profile, salary and perks is often the key to what the offsprings perceive and how they weigh that career as an option for themselves. Also, a parent dissatisfied with his/her job will try and persuade the offspring not to go for the same career. Similarly a satisfied parent will persuade his/her child for the same occupation.

### **IMPLICATIONS OF THE STUDY**

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The results indicate that the effect of need for financial support from parents, need for emotional support from parents, need for networking of parents and need for professional guidance available from parents increase as one moved from salaried job to low entrepreneurship to medium entrepreneurship to high entrepreneurship as a career option. Thus due to lack of financial support, emotional support, networking of parents and professional guidance from parents, a large percentage of country's youth is inclined to go into options other than entrepreneurship (service/ salaried job). Such a practice has many disadvantages which tend to emerge over a period of time. It decreases the offsprings' productivity in the company where he/she is reluctantly employed; it results in job hopping and many other such problems.

Considering all this, it becomes essential that we frame policies that help and assist students in overcoming the negative effect exerted by lack of enough support for entrepreneurship from their parents. These policies could be in terms of entrepreneurship awareness camps for students as well as for parents that would help parents realize the positives of entrepreneurship so as to help and encourage their children in going for the same. Policies could be in terms of improving financial support in terms of banking and other financial benefits for entrepreneurs. These policies would promote entrepreneurship and speed up the process of economic development in the country.

The study would also make students realize that the effect that is exerted on them by their parents consciously or unconsciously, is to be taken into account and only after considerations of all such factors should a right career be chosen. This would lead to greater job satisfaction for the student as well as satisfaction for the parents.

The study, although conducted on engineering students of IIT Delhi, has a lot of attributes which are common to many developing countries which see a large involvement of parents in their offsprings' life. Such a study opens the doors to extensive research that is required in this field to point out the ways in which parents influence the career choices of their children. This is essential since without this, attempts to promote entrepreneurship will not be as successful as they can be.

A similar study also needs to be done for students who do not have bright career options, as our sample. This is essential as in a country like India, employment is difficult to find. A study on them would help present a deeper analysis of this issue.

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Table 1

Relative influence of factors based on parental work profile on the career choice of offspring (on a 10 point scale)

| Factors Based On Parental Work Profile That | Possible Career Choice |
|---|------------------------|
|---|------------------------|

| Influencing Career Choice Of Students                         | Entrepreneurship |        |      | Service/ Salaried Job |
|---|------------------|--------|------|-----------------------|
|   | Low              | Medium | High |                       |
| Need For Financial Support From Parents                       | 3.61             | 5.32   | 7.52 | 1.61                  |
| Need For Emotional Support From Parents                       | 7                | 7.58   | 8.42 | 6.88                  |
| Need For Networking Of Parents                                | 4.31             | 5.81   | 7.33 | 3.35                  |
| Need For Professional Guidance From Parents                   | 6.50             | 6.8    | 7.50 | 5.5                   |
| Job Satisfaction Of One’s Parents About Their Work Profile    | 6.50             | 7.17   | 7.73 | 7.7                   |
| Job Satisfaction of One’s Parents About Their Earnings /Perks | 6.33             | 6.64   | 7.21 | 7.26                  |

Figure 1

Choice Theoretic Framework: Relation between parental work profile and career choice of offsprings

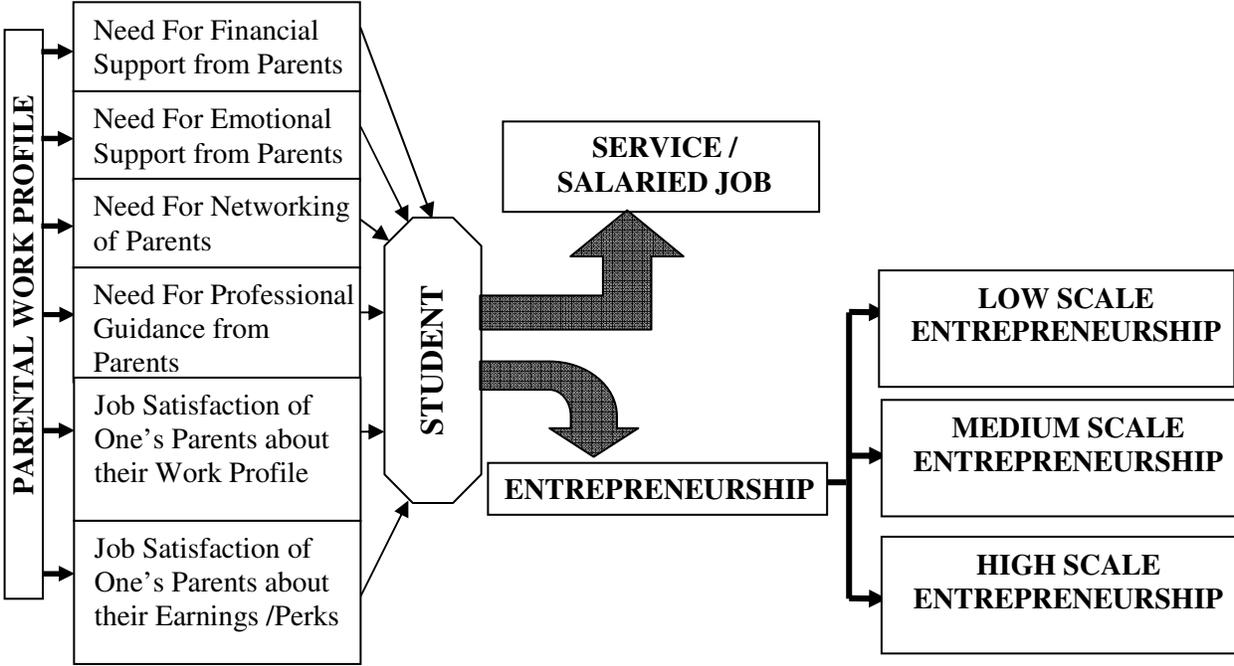


Figure 2

Relation between parental work profile and service/salaried job as career choice of offsprings. (Numerical values indicated are influence of the factors based on parental work profile on a 10 point scale)

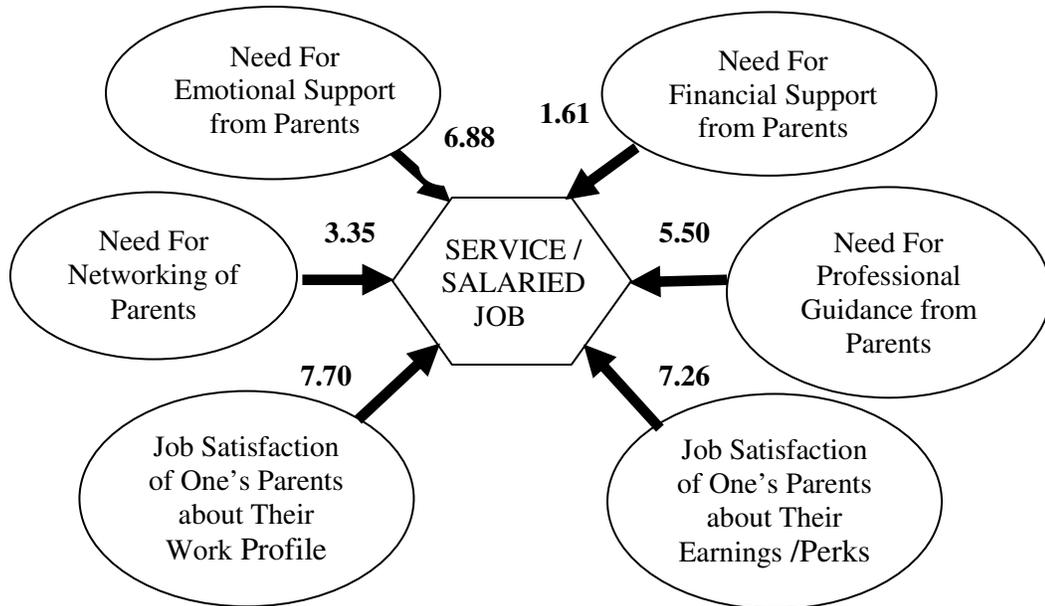


Figure 3

Relation between parental work profile and low scale entrepreneurship as career choice of offsprings. (Numerical values indicated are influence of the factors based on parental work profile on a 10 point scale)

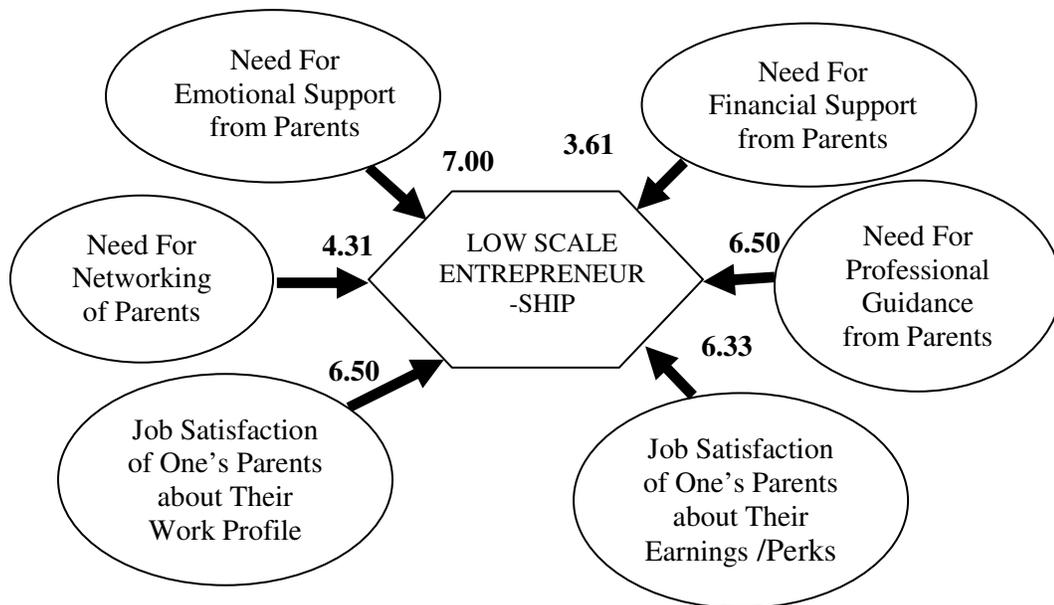


Figure 4

Relation between parental work profile and medium scale entrepreneurship as career choice of offsprings. (Numerical values indicated are influence of the factors based on parental work profile on a 10 point scale)

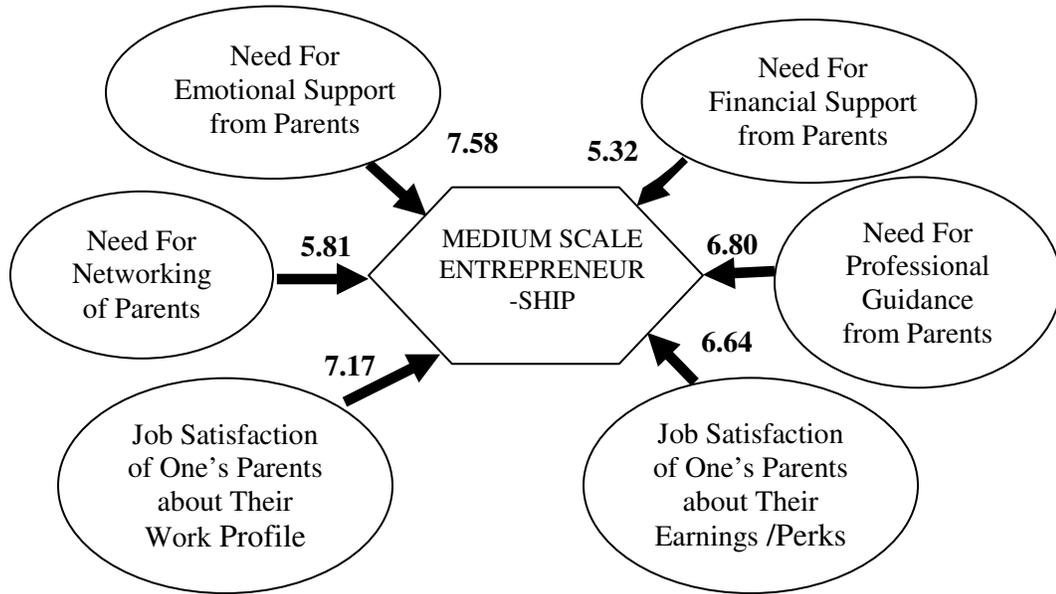
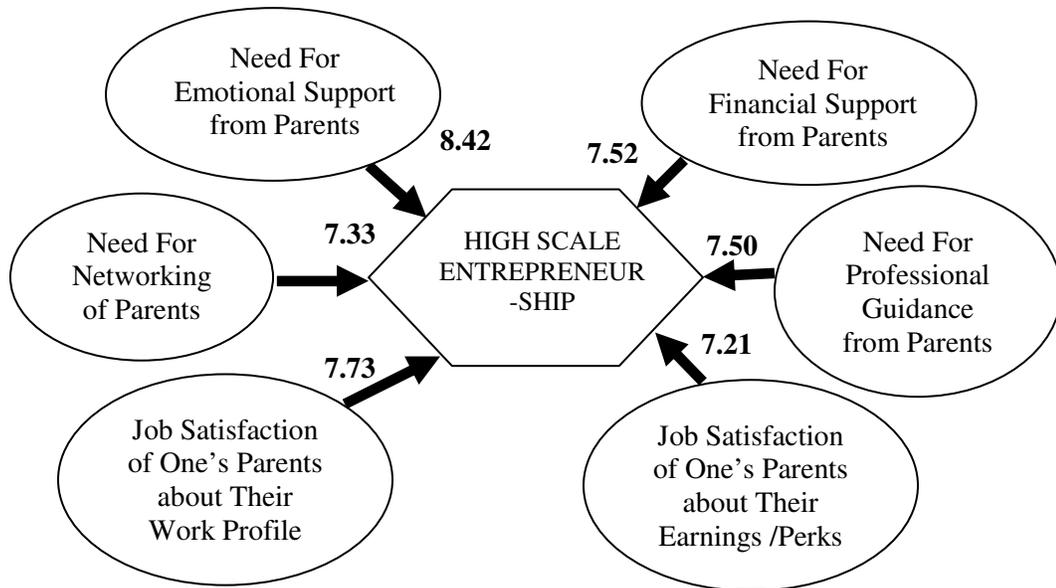


Figure 5

Relation between parental work profile and high scale entrepreneurship as career choice of offsprings. (Numerical values indicated are influence of the factors based on parental work profile on a 10 point scale)



## **WOMEN AND THE ECONOMY: A DECADE OF ENTREPRENEURSHIP**

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### **Abstract**

The last decade has seen significant changes in the business environment for small firms and individual entrepreneurs. This paper considers the business environment for women in 1995, based on findings of a large-scale survey for the 4<sup>th</sup> UN conference on Women held in Beijing, and key issues facing them at that time.

The 50th ICSB World Conference provides a “golden opportunity” to revisit the original survey and consider whether conditions for women running their own businesses have changed significantly since then. The original survey questions are used as the basis for a follow-on survey (2005), with some amendments/additions to broaden the scope, in order to identify practical concerns of women in business, whether these have changed significantly, and their views on further changes that are needed.

Where possible, respondents from Survey 1 will complete Survey 2, to identify areas of change since 1995. In addition, new groups of respondents will take part in the survey to give a broader base of knowledge and to reflect a greater social/ cultural/ ethnic/ demographic mix.

Initial responses to survey 2 will be analysed, with on-going distribution and analysis of survey questionnaires during 2005 to continue the research on a larger scale. Clearly this is a major piece of research work that is only partly completed, and results from the first group of respondents will be analysed and presented to delegates at Conference in Washington DC in June 2005.

### **Introduction**

At the United Nations 4<sup>th</sup> World Conference on Women, held in Beijing ten years ago, the author presented a paper that considered the contribution of women entrepreneurs to the world economy[1]. This was based on findings from a comprehensive survey of over 2000 women entrepreneurs in the UK that considered problems and issues they faced when setting up or running their own business[App 1].

The number of women entrepreneurs has risen throughout the last decade, and this 50th ICSB World Conference does indeed provide a “golden opportunity” to revisit the original survey and consider whether conditions for women running their own businesses have changed significantly.

This paper considers the business environment for women in 1995, the findings of the original survey [2], and key issues affecting women entrepreneurs then and now. The original survey questions are used as the basis for the current survey (2005) with some amendments/additions to broaden the scope [App2].

Clearly this is a major piece of research work that is only partly completed, and results from the first group of respondents will be analysed and presented to delegates at Conference in Washington DC in June 2005.

### **The business environment a decade ago**

The picture for entrepreneurs in the UK in 1995 was one of growing awareness of the impact of small firms on the economy generally, and the contribution of women entrepreneurs in particular.

Around 90% of firms in the private sector employed fewer than 50 people with the majority of workers in large, public-sector organisations. Small firms were defined as those with “up to 250 employees”, although this was considered by many commentators at the time to be inappropriate given the type of organisational structure required to support so many staff. The later EU definition of a micro firm employing up to 10 people and a small firm up to 50, reflects a more realistic picture of organisational structures at this level.

Rates for business failures within the first 18 months of trading were around 2/3 with approximately 30% of businesses being started by women [2]. The use of computers and hi-tech equipment was very limited at the time, with many service-sector businesses still operating in traditional ways to serve their customers.

The Federation of Small Businesses (FSB) was the largest small firms representative group in the UK, established in 1975 and growing rapidly to around 70,000 members by 1995. The breakdown of membership was primarily 50% employing up to 10-15 people - 35% as self-employed individuals - 15% employing up to 50 people.

### **The business environment for Women Entrepreneurs a decade ago**

Several preparatory meetings were held around the world prior to the UN conference in Beijing in order to identify issues and concerns facing women, whether in a social, personal or business context. At the preparatory conference in Amsterdam [3], the author presented a paper that identified the following issues for women entrepreneurs:

- the contribution of women to the economy is largely ignored or undervalued unless related directly to paid employment;
- there had been some recognition of the value of work in the home, but as a nominal value if you had to pay someone else to carry out these tasks rather than a contribution to the economy generally;
- women were more likely to work in the voluntary sector, again with their contribution recognised as a value to the individual organisation rather than the national economy;
- there were problems associated with recognising work of equal value/ equal pay with that of men;
- women themselves often saw their contribution in a negative way;
- self-employment should be seen as an “equivalent” option for employment rather than as a last resort;
- self-employment can provide flexibility to combine with family and domestic responsibilities, although that often just means more workload during a day.

At the time, there were many barriers to self-employment identified, including:

- working for yourself often viewed more negatively than working for a large employer; work often seen as a social value rather than a financial one;
- many self-employed women are not working full-time or do not register with the relevant authorities so do not necessarily appear in national data as “economically active”;
- there is little or no recognition of the wide range of management and organisational skills women already possess in a different context from work;
- training programmes need to focus on recognising and transferring existing skills; other groups such as funding or government bodies also need to recognise these transferable skills;
- access to relevant training – better programmes available at the time were usually time-consuming and expensive, and not easy to define in “outcome” terms. They were therefore more likely to be government or EU funded so not equally available to all;
- attitudes of family and others are important – without family support it can be extremely difficult to establish a business (though not impossible of course);
- access to funds – banks at this time agreed that women were more likely to produce better business plans/ succeed once business started/ be better payers of loans than men BUT often had to provide more collateral/ were more likely to be refused funding/ given lower sums than asked for;
- trading activity is often flexible or intermittent so “profit” not necessarily the best measure of “success”;
- the value to the economy may be in diversity of product or service for customers, and the income generated reduces dependence on the state or family.

At the UN World Conference in Beijing, feedback from representatives from around the world suggested that these problems were similar for women wherever they lived. The incidence of entrepreneurship broadly reflected economic recession and levels of poverty, with businesses primarily in the informal and/or service sectors.

Common issues identified were:

- barriers to success as noted above, including attitudes of others and cultural factors, need to be addressed;
- there needs to be better access to relevant, affordable training in skill areas that will support the business;
- the value of women’s entrepreneurial activity for the local economy must be recognised; better measures are needed to reflect their contribution;
- there needs to be better access to smaller amounts of funding, credit, other financial support specifically targeted at women entrepreneurs.

These issues were reflected consistently in research on women entrepreneurs during the last decade, whether by banks directly [4] or by organisations representing the concerns of women [5;6].

However, there have been changes during the last decade for all small businesses, including those established by women entrepreneurs.

- Financial institutions have made significant steps to try and redress the balance of unfair access to funds.
- Self-employment is more likely to be seen as a realistic option for those with family or other responsibilities who want more flexible working choices.

- Access to IT and communication facilities has grown substantially around the world reducing barriers to entry for small businesses to wider production options.

Self-employment is a real option for many women to gain financial independence and, just as importantly, to gain access to decision-makers through networking. It would be encouraging to think that substantial changes have been made to the business environment for women entrepreneurs since the global commitment of governments in Beijing 10 years ago. Anecdotal evidence suggests that these changes may not be as broad as we would have hoped, so this paper provides an opportunity to revisit original concerns and consider the extent to which they have been met.

## **The 1995 Survey of FSB Women Members**

### **Methodology:**

To avoid bias, 11,000 women members of the FSB were sent a comprehensive questionnaire by mail, with a covering letter explaining its purpose and the importance of the results to our UK representation in Beijing. The survey was supported by Lloyds Bank (now Lloyds TSB) and FSB funds through the national Policy Committee. [Appendix 1: survey one questions]

More than 2000 responses were received, 18%, which exceeded expectations. Given the volume of responses, the bank at the time was only able to carry out a raw data analysis of findings [2]. However, this still yielded a comprehensive picture of issues and concerns facing women members at that time.

### **Summary of findings:**

#### **Profile of respondents:**

- 86% were married
- 45% were aged 41-50
- 80% were based in England; 14% Scotland; 6% Wales

#### **Business details:**

- 34% were service sector; 27% retail & catering; 11% manufacturing
- 3% agriculture; 3% transport; 4% construction;
- 28% business had been running for less than 5 years; 21% more than 20 years
- 60% had fewer than 5 employees.

#### **Difficulties experienced as a woman in business:**

- 22% said they believed they experienced difficulties as a direct result of being a woman, mainly related to juggling home and family;
- difficulties included not being taken seriously, customers or others preferring to deal with a man rather than a women, and assumptions that they were the secretary rather than the owner of the business;
- 34% said they had experienced problems at start-up stage and once established. Finance was the most commonly stated problem, 28% saying this related to the amount of funding needed.

#### **Support needed to help overcome problems:**

- 36% gave one or more areas of lack of skills that presented problems for them;

- training was a key issue, with 14% stating time as a problem and 13% cost;
- several respondents referred to lack of provision in their locality, difficulties in finding relevant training courses, and of fitting it in with other responsibilities.
- Cited changes required at macro level included the need to reduce legislative burdens; better provision of childcare and some form of subsidy or tax concessions to reduce the cost of childcare.

### **Conclusions of the survey**

The range of issues identified was diverse with many not specifically gender-related. However, there are clear areas where respondents felt that they experienced additional problems simply because they were women rather than “entrepreneurs”.

Critical questions emerged from this analysis, and the follow-on survey for 2005 will incorporate these. Where possible, respondents from the first survey will be asked to complete Survey 2, to consider whether conditions have changed and if so in what areas. In addition, several new groups of respondents will take part in the survey in order to give a broader base of knowledge and to reflect a greater social/ cultural/ ethnic/ demographic mix.

### **The revised Survey 2005**

Why review now? After 10 years, this would seem to be an ideal time to review progress for women entrepreneurs and to consider whether there have indeed been improvements in the business environment. Banks in particular are keen to suggest that they have made considerable improvements in the way they deal with women business customers, and support bodies such as Business Link/Chamber of Commerce also emphasise their support for women through various networking events.

The last 10 years has seen many EU Directives introduced into national law, some intended to improve conditions for women in the workplace. In particular, the question of work-life balance has been of major concern while technological advancements have provided significant opportunities not previously available to small firms.

### **Survey structure and analysis:**

The majority of questions from the 1995 questionnaire will remain in order to maintain continuity, with additional emphasis on work-life issues [see Appendix 2 for revised questions].

The questionnaire will be distributed to FSB women members in UK, including some who have been members for more than 10 years and who completed the original survey. A hard-copy and an on-line version will be available.

As well as this sector, other groups of women entrepreneurs will be asked to take part, including Business Women’s Forum, Partners for Business clients who have used their business advise & support service, Prince’s Trust, and others in UK and EU countries. An initial analysis of responses will be carried out and results presented at the ICSB 50<sup>th</sup> Conference in Washington DC in June 2005, with on-going distribution and analysis of survey questionnaires during 2005 to continue the research on a larger scale.

## Conclusions

The last 10 years has seen some significant changes in the business environment for small firms and individual entrepreneurs. Clearly this is an ideal opportunity to look more closely at the practical concerns of women in business, whether they feel these have changed significantly, and indeed their own views on further changes that are needed.

### APPENDIX 1:

Survey 1 1995: FSB/Lloyds Bank

#### FSB "WOMEN IN BUSINESS" MEMBERSHIP QUESTIONNAIRE

PLEASE TICK APPROPRIATE BOX

##### 1. FSB Membership Status

Full Member  Joint Member  Associate Member

##### 2. Marital Status

Single  Married  Divorced  Widowed

##### 3. Age

Years

##### 4. Do you have children?

Yes  No

##### 5. If Yes,

How many?  What are their ages?

##### 6. What is your main business activity?

Agriculture  Manufacturing  Transport  Construction   
Wholesale  Retail and Catering  Services  Other

##### 7. Where is your business located?

North  Midlands  East Anglia  South West   
South East  Wales  Scotland  Northern Ireland

##### 8. How long has your business been in operation

Years

##### 9. Number of employees?

Nil 0-5 5-15 15-50 50+

##### 10. Do you operate as:

Sole Trader Partnership Limited Company PLC Co-operative

##### 11. As a woman, are there any aspects of running your business that present difficulties?

##### 12. If yes, please describe briefly:

**13. Have you experienced any difficulties? (Tick as many as possible)**

At start-up stage? Yes No

Once Business established? Yes No

When you want/wanted to expand the business? Yes No

**14. If you answered no to any part of Question 13, was there any person or organisation that was particularly helpful or supportive? If YES, please give brief details**

**15. If you answered YES to any part of Question 13 please identify the area(s) of difficulty, when you experienced them and give brief details:**

**Finance:**

Amounts of Funding

Sources of Funding

Terms and Conditions

Other

**Legislation:**

**Resources:**

Premises

Equipment

Supplies/materials

Other

**Staff:**

Recruiting Staff

Retaining Staff

Other

**Childcare:**

Cost

Availability

Changing need over time

Other

**Attitudes of:**

Customers

Suppliers

Family

Others

**16. Have you experienced any difficulties in the following areas (Please tick which ones and give brief details)**

|                              |                          |                          |
|------------------------------|--------------------------|--------------------------|
| Technical/production skills  | <input type="checkbox"/> | <input type="checkbox"/> |
| Organisation skills          | <input type="checkbox"/> | <input type="checkbox"/> |
| Finding appropriate training | <input type="checkbox"/> | <input type="checkbox"/> |
| Financial skills             | <input type="checkbox"/> | <input type="checkbox"/> |
| Cost of training             | <input type="checkbox"/> | <input type="checkbox"/> |
| Sales/marketing skills       | <input type="checkbox"/> | <input type="checkbox"/> |
| Confidence                   | <input type="checkbox"/> | <input type="checkbox"/> |
| Time involved in training    | <input type="checkbox"/> | <input type="checkbox"/> |
| IT Skills                    | <input type="checkbox"/> | <input type="checkbox"/> |

**17. Are there any changes that could be made at national/international level that would make it easier for you to run your business?**

**18. As we are frequently asked for comments on issues specifically concerning female members, do you think the FSB should have a women's section**

Yes  No

Thank you for completing this questionnaire. You can be assured that your individual comments will be treated in the *strictest confidence*. If you are willing to take part in other surveys related to women in business, please complete your name, address and telephone number below.

PLEASE RETURN TO: JACQUELINE JEYNES, FSB, 140 LOWER MARSH, WESTMINSTER BRIDGE, LONDON SE1  
7AE BY MONDAY 10TH JULY 1995

### **Covering letter to go with Questionnaire:**

Monday 19th June 1995

Dear Member,

I need your help with a major survey the Federation is carrying out on women in business. The survey is being carried out with the help of Lloyds Bank plc. The feedback with your concerns will help when we attend the United Nations 4th World Conference on Women in Beijing in September 1995.

For me to fully represent these concerns, it is vital that you have an opportunity to inform me about them. As there are 15,000 Individual, Joint and Associate women members, it will be too difficult to collate your responses without some sort of structure, so please spare the time to answer the enclosed questionnaire, even if you have experienced no difficulties as a woman in business.

I would be most grateful if the questionnaires could be returned to me, via the FSB, at the above address by Monday 10th July 1995. Thank you for your help.

Yours Faithfully,

Jacqueline Jeynes (Employment Affairs Chairman)

## APPENDIX 2

### Survey 2 2005: Women in Business

Questions follow the same structure as Survey 1 above and cover the following areas (please note this is not the final structure of the actual questionnaire):

1. Omit this as not a major issue with wider set of respondents
2. Marital status and include section for ethnic background
3. Age
4. Do you have children
5. If yes, what are their ages
- 5.a) Do you have any other dependents, if so how many?
6. What is your main business activity
7. Where is your business located
8. How long has the business been in operation
9. Number of employees
10. Legal trading status
11. Have you experienced any difficulties with the business at start-up/ once established/ expanding the business stages? Yes or No
12. Do you believe you have had particular problems as a woman (tick all that apply) sourcing finance/ dealing with customers/ managing staff/ achieving acceptable work-life balance/ sourcing affordable childcare provision?
13. Have you personally faced problems related to – deciding to have children/ organising childcare/ paying for childcare/ maternity cover/ accessing suitable training/ finding suitable premises
14. Has any person or organisation been particularly helpful when starting or running your business? If yes, please give brief details (eg accountant/ bank/ friends etc)
15. As a woman entrepreneur, do you experience problems with attitudes of any of the following – customers/ suppliers/ family/ banks/ others
16. Omit original question 16.
17. Any changes you think should be made at national or international level to make it easier to run your business
18. What business support groups or associations do you belong to – please list.

### References:

- [1]Jeynes J *Report to FSB Policy Committee on 4<sup>th</sup> UN Conference on Women* 1995
- [2]Lloyds Bank: *Federation of Small Businesses – “Women in Business” Survey Research Summary* 1996
- [3]Jeynes J *The Contribution of Women Entrepreneurs to the Economy* 1995 Conference paper for Women 2000 Preparatory Meeting, Amsterdam
- [4]Barclays Bank Review: *Women in Business* 1996
- [5]First Voice: Michael Harrison *Women in Business* Pages 18-19 & 34 Feb/March 1999
- [6]Scottish Enterprise *Women starting Businesses – Making it happen* 1994

**COLOMBO, HOLMES, MAIGRET, WILLIAM OF BASKERVILLE  
AND REGIONAL ENTREPRENEURSHIP**

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# COLOMBO, HOLMES, MAIGRET, WILLIAM OF BASKERVILLE AND REGIONAL ENTREPRENEURSHIP

Pierre-André Julien and Richard Lachance

## ABSTRACT

In criminal matters, if, like Colombo, one is able to recognize the direct causes of an isolated crime, when criminality increases in a community, or various forms of gangsterisms occur, this somewhat simple approach proves inadequate. Even the perspicacity of Sherlock Holmes and the intuition of Maigret, are no longer sufficient. We must be able to reflect in the same way as William of Baskerville who “In the Name of the Rose” understood that the crimes committed by the monks of the Melk Monastery were related to a power struggle between the Pope and the Emperor and ultimately to a search for the truth.

Using this metaphor based on the detective novel<sup>1</sup>, in this paper we reassert that regional entrepreneurship cannot be understood by limiting the analysis to the behaviour of a few entrepreneurs and their enterprises, according to a first level approach, however dynamic these may be. In particular, we cannot explain why in many regions which do not have important natural resources or strategic locations, businesses multiply and innovate while in other regions new businesses are few and change sporadic. Then, we must look to the role of the milieu and to the social capital generated by it to facilitate change and opportunity sizing. To this second level, we must analyse rich information and networks which select this information, adapt and transmit it, as well as diffuse innovation to sustain competitiveness or business and regional distinctiveness. Finally, to a third level approach, we must take into account conventions which sustain entrepreneurial culture and then the regional dynamism.

## INTRODUCTION

It is this third level that, firstly, we will try to reach in this communication in order to better understand entrepreneurship, both in theory and in practice, starting from the three most important players of development to get out with the three factors favouring the enterprise and region differentiation and recalling that that entrepreneurship is an eminently collective process. Secondly, we will attempt an initial application of this way of seeing things by studying the very different entrepreneurial dynamism of two small adjacent regions in Quebec (Canada) having the same origins and environments. Finally, in conclusion, we will return to the metaphor of the detective novel, a particularly useful approach to better grasp complexity (Morgan, 1980; Grant and Sick, 1996) by showing in particular how the novels of Conan Doyle or of Simenon apply Marshall's theory, which alone can finally explain the genius of Sherlock Holmes or of Maigret.

### 1. THREE MAIN PLAYERS AND THREE FACTORS WHICH EXPLAIN WHY REGIONAL ENTREPRENEURSHIP IS A COLLECTIVE PROCESS

The first player in entrepreneurship is evidently the *entrepreneur*. To understand it, one must know his antecedents, what some call his inborn, acquired and constructed development (Erickson, 1959). These antecedents include various aptitudes occasioned by his family

environment, by his acquaintances and by the acquisition of knowledge, whether in school or in his contacts with his work environment. It is there that he will find the models that are discussed at the table or at family reunions, or again his work experiences during his free time and which will provide him with various openings to start up and manage his enterprise later. We find in this development three types of influence, positive or negative : the affective, the symbolic, and the sociological, which cannot be other than social, as in the example of even isolated crimes. In this last case, it is fair enough for the lawyer to refer to a difficult family life or again to regrettable associations, hoping the jury will find in them mitigating circumstances favourable to the accused.

The second player is the *organization* (or the enterprise), constituting first of all the extension of the entrepreneur and his capacity to marshal resources, and then the implementation of his effort at appropriating market space. The organization parts from these gradually<sup>2</sup> as the internal and external stakeholders, if not the external proprietors (stockholders), take on more significance. The organization becomes a system of social relations, or even a field of interest, but especially a combination of “rare and inimitable” resources and skills such as interdisciplinary personnel of the enterprise and other complementary resources provided by upstream or downstream firms with which it negotiates and which, by particular combination, ensures its distinctiveness and hence its competitiveness with respect to the market (Barney, 1991; Brown and Eisenhardt, 1998). Evidently, these resources and skills must be systematically upgraded and expanded in order to maintain the organization’s advantages through technological change and through training and information, since technology, the market, and competitiveness are constantly evolving. In the underworld, organization (are we not speaking of *organized crime*?) is a guarantee of coherence and especially of discipline; it is also a management system, often with very complex ramifications that allow for the diversification of sources of revenue and a lessening of detection by the police, if not the buying of protection.

There are all sorts of enterprises. Most are very small and do no more than fill the needs of consumers. Many disappear in their first year and nearly 50% close before their fifth year of existence (Phillips and Kirchhoff, 1989; OECD, 2002a). Only a small fraction, generally fewer than ten percent, referred to as the *gazelles*, grow rapidly; they have a major effect not only on job creation, but on the regional dynamic in requiring the resources and advanced services that in turn act as a stimulant for a good number of other enterprises.

The third actor is the *milieu* which plays a special role in supplying relatively easily, basic resources such as specialized workers, truckers and distributors, financial sources and research centres (Camagni, 1995; Maillat, 1995). The milieu also helps to develop personal, business and information networks with strong or weak ties (Granoveter, 1973) connecting entrepreneurs with lower transaction costs to resources, market opportunities and ideas for innovation and technological change. Finally, the milieu supplies information which serves to reduce uncertainty, risks and the informational ambiguity which limits the entrepreneurial commitment, as well as information which increases the collective learning process and stimulates the innovative activity of firms, mainly that of *gazelles*. As in detective stories the underworld<sup>3</sup> gives coherence and orientation and supplies resources to diversify black-market income sources and to elude the police.

The milieu generates the social capital which facilitates the acquisition of resources such as angel capital but also trust, reputation, and cooperation all of which accelerate transactions and synergy elements thus increasing creation and innovation (Lin, 1999). Social capital develops explicit and implicit rules for legal, political and economic systems, norms and conventions and even ideology thus stimulating the regional dynamism or the entrepreneurial culture, creating what North (1990) calls the informal or the contrary to formal institutions. On the other hand it can also be a system of conformism that limits initiatives and dynamism, even forcing better entrepreneurs out of the region. These rules and conventions can be measured in relation to criminality by observing the level of permissiveness or of social delinquency which they limit or facilitate, for example corruption systems which retard entrepreneurship in developing countries.

Of the three factors which help to distinguish and stimulate a region, the first is *rich information* (Daft and Lengel, 1986), e.g. complex, cumulative and more often tacit information (Leonard and Sensiper, 1998), obtained through inter-personal relations which can be transformed into opportunity and innovation. Rich information is the essential element in transforming organizations (Weick, 1979; Choo, 1998). It allow up to stay up to date on change, and even to get ahead of it through innovation.

The second factor is the sharing of information facilitated by *networking*. Networks are like meshed nets formed by a great number of direct and indirect associates more or less close that are relative knowledgeable of the needs of the interlocutor and this make it possible to grasp and retain this rich information, letting pass current information of little or no interest. This information serves not only to know more rapidly and more easily about various resources, but in seizing opportunities before the others (Ucbasaran, *et al.*, 2001). Eisenhardt (1990) explains why, because of the accelerating changes in the economy, one must turn to real-time information (that is, information as it is created), share it with the greatest number of people in the network and in the organization to finally transform it into insight and actions integrated with the other decisions and tactics. A dynamic milieu with strong social capital stimulates the exchange of information through the multiplication and enrichment of its networks (Allen, 1997), particularly if they are linked to other weak-signal networks, often outside the region, and sources of more radical innovation (Julien, *et al.*, 2002).

The third factor is *innovation*, above all if it is diffuse, modifies most of the enterprise's value chain and it's products thus helping to distinguish the business, it affects the external value chain in the production system (commodities and equipment suppliers, sub-contractors, sellers, testing institution, etc.), and finally gives very important comparative advantages (Dyer and Singh, 1998) which sustain the enterprises' and the regions' competitiveness.

## **2. AN APPLICATION TO TWO SMALL REGIONS OF QUÉBEC (CANADA)**

To apply this analysis somewhat, we have selected to two small closely situated regions in Québec Canada (Centre-du-Québec with 220000 inhabitants and Mauricie with 263000) with relatively the same industrial history. Both were in decline from 1960 to 1990 at the end of the second industrial revolution. But in the last decade, the first has renewed faster than the second because the social capital is stronger, the networking is more complex and technological, giving

richer information and thus more innovative firms and finally because the entrepreneurial culture is greater.

An example of the development difference can be seen on Table 1 for the 1990-2001 period. The data show that if the rate of regional creation (when compared to existing enterprises) is greater in the Mauricie than in the Centre-du-Québec, the portion of fast growth SMEs (having at least doubled the number of their employees during this time) is close to twice as great in this last region, i.e., 21% vs. 13%. In particular, the Regional County Municipalities (MRC)<sup>4</sup> of Drummondville, the most important city in the Centre-du-Québec, has 27% of its manufacturing firms experiencing fast growth while its Maurician counterpart, the MRC de Francheville, where we find the most important city of the north region, Trois-Rivières, is made up of but 10% fast growth firms. As we said, the fast growth firms are particularly responsible for job creation (OCDE, 2002b), it is then not surprising that the unemployment rate for the last few years in the Centre-du-Québec has been consistently inferior (on average 8.7% from 2002 to 2004) to the rate in Quebec (9% in general) while just the opposite was true for the Mauricie (10.5%).

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Table 1 about here

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Since it is difficult to directly measure the impact of the milieu, and thus of the social capital, on these differences in dynamism, we have limited our study to evaluating the impact of complex networks on the development of manufacturing SMEs having between 5 and 500 employees in a single survey in each of the regions. The survey in the Mauricie region was conducted through the mail, that for the Centre-du-Québec was done by telephone (20 minutes). The questionnaire was made up of 11 questions concerning the entrepreneur's networking activities with some data on the evolution of profits and sales and on exports. In particular, we asked the entrepreneur the number of different persons with whom he had discussed the development of his enterprise during the past six months, their status (client, supplier, friend, consultant, etc.), the average number of hours per week devoted to this networking, and if this effort was profitable for his enterprise, on a scale of little, enough, or a great deal. Moreover, the entrepreneur had to specify if these persons were new to him and if contact with them was maintained. The questionnaire was taken from a study in Sweden (Johannisson, 2000) and was adapted and vetted using ten enterprises to ensure clarity for the respondents.

The enterprise populations of the regions were taken from a financial evaluation company's repertoire of firms. For the Mauricie, we mailed 540 questionnaires to finally received 87 completed. For the Centre-du-Québec, we started with a possibility of 840 manufacturing enterprises to finish with 137 completed questionnaires. As the length of this paper is limited, we cannot show tables of these data. We must say that the samples representativeness is relatively good, particularly for regional repartition. According to size, we notice that the response rate decreased relatively with size in the Centre-du-Québec region while this rate remained fixed in the Mauricie resulting in a more conservative view because the small business networking is generally less developed than larger firms.

Table 2 shows the results of a typological analysis undertaken separately in each region. A typological analysis is a method that seeks to identify types of behaviour within a population. It involves first establishing a classification and then counting the number of matching firms. Or, as

we did, the classification variables can be used in a statistical process (Sharma,1996). We performed a hierarchical typological analysis using SPSS software (Wald's method using Euclidian distances). We retained a three-group classification.

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Table 2 about here

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The enterprises of the first group seek information from a variety of sources, both business sources (clients, suppliers, other entrepreneurs and competitors) and sources more informational, generally weak-signal (consultants, industrial associations, financial institutions and government bodies, including colleges and universities). Enterprises in the second group concentrate their search for information on less traditional sources; business people, financial institutions, government bodies, as well as consultants and former colleagues ( in the case of the Centre-du-Québec). Lastly, firms in the third group have no ultimate preference and appear somewhat introverted, seeking little information. A comparison between the two regions gives some advantages to the Mauricie over the Centre-du-Québec; 34% compared to 23% of the firms in this region are in the first group and 32% compared to 21% are in the second.

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Table 3 about here

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Table 3, however, brings a nuance to this first result. It shows that the firms in the first two groups from the Centre-du-Québec discuss the development of their enterprises with more people and take greater advantage of these contacts in proportion to “the efforts invested in the maintenance and development of their networks”. Firms in Group 1 export more. Finally, according the study's data, these firms continue to maintain new contacts which contributes to the renewal of their networks thus illustrating informational dynamism. 76% of the enterprises in the Mauricie and 72% of those in the Centre-du-Québec have less than 15% of new contacts among the people with whom they have spoken of development. However, 76% of the firms in the Centre-du-Québec stayed in contact with more than half of their new sources (28% with all their new contacts) while only 48% of the firms in the Mauricie maintained this contact (5% with all).

Another clue can help us understand the difference in regional dynamism. A telephone survey of the regional management of six venture capital firms allowed us to see that angel capital was at least twice as dynamic in the Centre-du-Québec than in the Mauricie to the point where these firms had difficulty financing projects in Drummondville, for example. The entrepreneurs of the Southern region could fairly easily meet their needs with angel capital without having recourse to official capital. Moreover, we have witnessed this capital operating in a particularly effective manner in the first region on several occasions.<sup>5</sup>

In short, the differences between the two regions cannot be understood other than by a different collective entrepreneurship, thus by an “industrial atmosphere” or an “entrepreneurial culture” not having the same dynamism.

## CONCLUSION

This with short applications, because the limited length of this paper, shows that by taking into account the quality of the milieu and the social capital and by introducing rules, norms and conventions or an entrepreneurial culture which stimulate a rich information exchange, we use more than an interpretive approach (Strauss and Corbin, 1998). The values shared in the region generate dynamic complicities or what Alfred Marshall called over one hundred years ago an “industrial atmosphere” particularly innovative for enterprises and regions.

By applying rich information, networking and innovation, we can go further with a constructionist approach to explain how enterprises structure and regional players stimulate change and sustain distinctiveness to create a virtual cycle for development. As in the detective story, we thus reach a third level of explanation as Baskerville does. This is illustrated in table 4.

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Table 4 about here

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Thus we demonstrate that entrepreneurship is fundamentally a deep collective phenomenon which cannot be understood without a complex approach similarly to the crime story metaphor in the Umberto Eco novel. It is like Conan Doyle who demonstrates indirectly that the success and the genius of Sherlock Holmes, as a brilliant entrepreneur, cannot be explained without considering the dynamic entrepreneurial atmosphere of England in the late 19th century, an atmosphere which allowed Holmes and his friend, Dr. Watson, after receiving a tearful widow from a distant country, to easily send several telegrams, to place two or three advertisements in newspapers published that very afternoon, to procure two tickets for a train which left on schedule, to hire a good carriage upon arriving at the country station and finally to get a room in a comfortable inn after an excellent meal.

Similarly, seen from a different angle, Maigret explains in his *Mémoires*<sup>6</sup> that in a real investigation officers from the neighbourhood police station, who visit thousands of households, are most often added to his inspectors from the Quai des Orfèvres, who interrogate hundreds of witnesses,. This does not take into account officers in terminals “scrupulously scanning faces,” at times the national police force on the look-out for various clues, and the role of informers and the public who contribute various pieces of information, some of which could be crucial. As Simenon says, these thousands of participants and these hundreds of events could not be described in detail in a novel without confusing the reader. But in the case of the success of an enterprise, we know that it does not depend solely on the entrepreneur, but rather on: the members of its organization, the complementary enterprises upstream and downstream, the information system, and the many players both within and outside the region, not to mention the economic climate and good fortune.

In short, a good detective story is often a pretext for discussing the good and bad sides of people and the quality of the structures and institutions that surround them. Similarly, as with all processes of development, entrepreneurship is quite simply the collective history of people each looking for his own identity, to better know himself and to be recognized for his work (the noble

result of his work through creation and innovation). Entrepreneurship is then a shared experience. For, every individual story or every success or failure of enterprises also belongs to others who endorse it and gives its value or its limits, such as recognition beyond any monetary value for what really constitutes humanity and gives it the power to change things.

**Table 1. Creation of manufacturing enterprises and of fast growth, the Mauricie and the Centre-du-Québec, 1990–2001**

| number of MRC  | Region and MRC          | Existing enterprises in 1990 | Enterprises created* from 1991 to 2001 | Creation rate | % high growth enterprises** from 1990 to 2001 |
|--|-------------------------|------------------------------|--|---------------|---|
|  | <u>Mauricie</u>         | <u>550</u>                   | <u>136</u>                             | <u>24.7%</u>  | <u>13%</u>                                    |
| 35   | Mékinac                 | 48                           | 6                                      | 12.5%         | 21%   |
| 36   | Centre-Mauricie         | 148                          | 31                                     | 20.9%         | 6%  |
| 37   | Francheville            | 234                          | 65                                     | 27.8%         | 10%   |
| 51   | Maskinongé              | 100                          | 29                                     | 29.0%         | 21%   |
| 90   | Haut Saint-Maurice      | 20                           | 5                                      | 25.0%         | 100%  |
|  | <u>Centre-du-Québec</u> | <u>895</u>                   | <u>181</u>                             | <u>20.2%</u>  | <u>21%</u>                                    |
| 32   | L'Érable                | 142                          | 34                                     | 23.9%         | 17%   |
| 38   | Bécancour               | 66                           | 14                                     | 21.2%         | 17%   |
| 39   | Arthabaska              | 238                          | 40                                     | 16.8%         | 16%   |
| 49   | Drummondville           | 346                          | 81                                     | 23.4%         | 27%   |
| 50   | Nicolet-Yamaska         | 103                          | 12                                     | 11.7%         | 25%   |
|  | All of Quebec           | 16 537                       | 3 750                                  | 22.7%         | 18%   |
| * more specifically: enterprises created from 1991 to 1996 and still in operation in 1996, and enterprises created from 1997 to 2001 and still in operation in 2001. |                         |                              |  |               |   |
| ** enterprises with growth in job creation equal to or greater than 100% from 1990 to 2001.  |                         |                              |  |               |   |

(Our own calculations based on the annual database of a financial evaluation firm)

**Table 2. Distribution by region of the enterprise sample according to the complexity of the strong and weak signal networks in percentage**

|                         |         | Centre-du-Québec |         |         | Mauricie   |         |         |
|-------------------------|---------|------------------|---------|---------|------------|---------|---------|
|                         |         | group 1          | group 2 | group 3 | group 1    | group 2 | group 3 |
|                         |         | % of firms       |         |         | % of firms |         |         |
|                         |         | 31               | 28      | 77      | 27         | 25      | 26      |
| Friends                 | A few   | 68               | 43      | 47      | 70         | 84      | 65      |
|                         | Several | 3                | 4       | 3       | 7          | 0       | 0       |
| Former Colleagues       | A few   | 16               | 32      | 12      | 30         | 24      | 12      |
|                         | Several | 3                | 0       | 0       | 7          | 4       | 0       |
| Customers               | A few   | 48               | 29      | 45      | 52         | 80      | 69      |
|                         | Several | 45               | 7       | 3       | 11         | 0       | 4       |
| Suppliers               | A few   | 45               | 39      | 45      | 67         | 80      | 50      |
|                         | Several | 52               | 4       | 8       | 0          | 4       | 8       |
| Other Entrepreneurs     | A few   | 65               | 39      | 51      | 70         | 88      | 19      |
|                         | Several | 19               | 18      | 3       | 19         | 12      | 0       |
| Competitors             | A few   | 23               | 21      | 5       | 37         | 8       | 23      |
|                         | Several | 3                | 0       | 0       | 0          | 0       | 0       |
| Consultants             | A few   | 77               | 71      | 40      | 78         | 44      | 62      |
|                         | Several | 6                | 4       | 0       | 15         | 0       | 0       |
| Industrial Associations | A few   | 68               | 32      | 3       | 48         | 12      | 12      |
|                         | Several | 6                | 4       | 0       | 7          | 0       | 0       |
| Financial institutions  | A few   | 71               | 71      | 26      | 89         | 48      | 27      |
|                         | Several | 6                | 4       | 0       | 4          | 0       | 0       |
| Public Agencies         | A few   | 55               | 79      | 3       | 85         | 4       | 12      |
|                         | Several | 0                | 4       | 0       | 7          | 0       | 0       |

(Julien, P.-A., Lachance, R., & Morin, M. "Signaux forts et signaux faibles : une enquête sur les liens réticulaires dans les PME dynamiques". *Géographie, économie et société*, n° 2, 2004, 179-201, for the data on the Mauricie. For those of the Centre-du-Québec, the results come from a survey in progress)

**Table 3. Some characteristics of manufacturing SMEs in percentage, according to the 3 groups in the 2 regions.**

|                       | Centre-du-Québec    |         |         | Mauricie |         |         |    |
|-----------------------|---------------------|---------|---------|----------|---------|---------|----|
|                       | group 1<br>31 firms | group 2 | group 3 | group 1  | group 2 | group 3 |    |
| % exporters           | 58                  | 43      | 44      | 63       | 40      | 23      |    |
| persons contacted (n) | less than 6         | 6       | 32      | 70       | 22      | 76      | 77 |
|                       | 6 and more          | 94      | 68      | 30       | 78      | 24      | 23 |
| advantage to firm     | little              | 6       | 29      | 30       | 4       | 12      | 22 |
|                       | sufficient          | 52      | 46      | 53       | 63      | 68      | 65 |
|                       | a lot               | 42      | 25      | 17       | 33      | 20      | 13 |

**Table 4. Crimes, gangsterism and entrepreneurship: three levels of explanation**

| <b>Level of explanation or approach</b>  | <b>Crimes in <i>The name of the rose</i></b>  | <b>Criminal network</b>                                    | <b>Entrepreneurship</b>   |
|--|---|--|---|
| <b>First level or positivist / behaviourist approach (Colombo)</b>                     | Personal conflicts, jealousy, hatred, by monks  | Criminal behaviours and gangsterism                        | Entrepreneurs and organizations (SMEs)  |
| <b>Second level or post-positivist/interpretationist approach (Holmes and Maigret)</b> | Conflict between the Pope and the Emperor and their supporters (Benedictines and Franciscans) | Poverty, exclusion, ostentatious wealth, corruptions, etc. | Networking, well or bad organized cooperation or complicities and innovation  |
| <b>Third level or constructivist approach (Baskerville)</b>                            | Importance of truth research by monks and people  | Permissiveness and social deliquescence                    | Rules, conventions, innovation spirit, finally conservative or dynamic entrepreneurial culture or industrial atmosphere |

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## ENDNOTES

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<sup>1</sup> To use as metaphor the most famous detective novels. We could, of course, have used other detectives like those of Agatha Christie with Hercule Poirot, who is somewhat like Sherlock Holmes, or Miss Marple, who is closer to Maigret, or again more contemporary detectives like the Italian Camilleri's Montalbano, the Swede Manke's Walander, or the American Connely's Bosh acting at times like one and at other times like the other.

<sup>2</sup> Except in the case of very small business or of the self-employed.

<sup>3</sup> In French, underworld is translated by the word "milieu", as in "Marseille's milieu", as explained by Maigret.

<sup>4</sup> In general, the Regional County Municipalities (MRC) consolidate all the villages and cities relatively close to one another in a small region with less than 100 000 inhabitants. They were created by the Quebec government to manage services in common and to plan the development of the territory. Their management comes under the authority of a council made up of the mayors and a few counselors in proportion to their population. There are 95 MRCs in Quebec not counting the groupings of the large agglomerations of Montréal, Québec, and Gatineau.

<sup>5</sup> For example, during an advanced formation meeting that our research institute ran, the entrepreneur tenants did few telephone calls to obtain some \$300 000 when they learned that all the elements of a project were in place, such as a product formerly imported by several firms in the region, new and used equipment, space, the presence of a mentor and a young entrepreneur full of promise.

<sup>6</sup> Evidently, according to "An ironic and affectionate confrontation between his *creator* and his character," these words were written by Simenon to explain "the mechanisms of his creation and to condemn the fictional character." In *Simenon. Romans*, vol. II, Paris, Bibliothèque de la Pléiade, 1419-20.

**Market size, market development and investments in human capital in the  
venture capital business: Theory and evidence**

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Keywords: Venture Capital, portfolio management, market size, market  
development, learning, regional differences

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## 1. Introduction

Recent studies have shed light on the fact that human capital is a key driver of the investment strategies of venture capital firms: The higher the education degrees of venture capitalists (Bottazzi et al. 2004), and the more industry specific knowledge they own (Jungwirth/Moog 2004, Dimov/Shepherd 2005) the more professional their investment activities seem to be. “Professional” here refers to an early stage/high tech orientation in portfolio management that is often accompanied by a considerable specialization in an industry and/or a financing stage of the venture capital firm. The US venture capital market represents the archetype of a professional approach in portfolio management: The greater part of venture capital managers is assumed to be well educated, to own relevant specific knowledge and to be specialized in one or a few high tech industries and early financing stages (Dotzler 2001, Amit et al. 1998, Norton/Tenenbaum 1993). Pushing the US economy’s high tech sector considerably, the US is the measure of all other venture capital markets. However, it is unique and – like the US market for higher education – hardly to top. The long experience with venture capital, the pension funds system, the well working capital market, the considerable pool of talent and many cultural reasons might cause this top position. Nevertheless, it is important to investigate other venture capital markets and to understand how they work and into which direction they will possibly develop. Results could give hints at how to foster the resource “technopreneurship” (Venkataraman 2004) within a national economy and how to provide it with capital.

A former study investigated venture capitalists’ strategies within the German-speaking region of Europe (Austria, Germany, and Switzerland) (Jungwirth 2004). Accidentally, it found similar differences in investment behavior between Austrian/Swiss and German venture capitalists that were stated between US and European venture capitalists (Bottazzi et al 2004). Austrian and Swiss venture capitalists focus on “later” stage / “lower” tech projects and own less specific knowledge. The result is interesting because Germany, Switzerland, and Austria are one cultural area<sup>1</sup> but differ in terms of geographical size and by the stage of development of the venture capital market. Germany is quite a bit larger than Austria and Switzerland and its venture capital market is rather well established (Becker/Hellmann 2002). Both, market size and market development, could cause these differences in investment behavior and thus

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<sup>1</sup> “Cultural” comprises here: same language, same university system, similar industry structure, same skill level, same risk propensity etc.

good rationales exist why both factors could have an effect: demand in small markets could be too small to amortize investments in specific knowledge; and a lack of specific knowledge increases the agency costs of high tech investments and with it the risk to fail in early stage / high tech projects. If venture capitalists do not own specific knowledge and do not attend to early stage/high tech projects, they do not have to focus on one or a few industries because no specific knowledge is needed (Jungwirth 2004). A delayed market development on the other side could be reflected in delayed learning and hinder appropriate investments in human capital.

This paper is organized as follows: the next section presents the related literature. Section three discusses the potential effects of market size and market development on the venture capitalists' willingness to thoroughly invest in human capital. Section four presents a unique and hand collected dataset. Venture Capitalists from Switzerland and Austria answered a standardized questionnaire referring to structure, strategic choices, and endowment with human capital, and subjective estimation of the market situation. The Swiss and Austrian markets are similar as to their geographical smallness and their relative late entrance into the venture capital business. Interestingly, they react quite differently to their market conditions. While Austrian venture capitalists seem to be sort of frustrated by the low opportunities of the small market Swiss venture capitalists act quite offensively: they invest much more in their human capital, try to specialize and go for internationalization. However, nationality seems not to be the deciding factor. The more a venture capitalist has invested in human capital the more similar are investment activities of Austrian and Swiss venture capitalists: They invest more in early stage/high tech projects, cooperate more intensively, and estimate the market situation as promising. That is the central result of this study.

## **2. Related literature**

The paper investigates national differences concerning the willingness of venture capitalists to invest in their human capital and focuses on market size and market development as possible influence factors. To my knowledge, this point has not been made in the literature yet. However, Bottazzi et al. (2004) and Jungwirth and Moog (2004) show evidence that investments in specific human capital are the key driver for investment behavior being prerequisite for early stage / high tech investments. While Bottazzi et al. (2004) use the

highest degree of venture capitalists' education (master, PhD) as measure for human capital Jungwirth and Moog (2004) categorize different types of knowledge, namely management knowledge and technical or scientific knowledge. Both studies were able to show that the propensity to do high tech investments correlates strongly with the amount of knowledge a venture capitalist owns.

Regional differences concerning the venture capitalists' predominant portfolio strategies are well known and well investigated within the literature: Bottazzi and Da Rin (2002) as well as Bottazzi et al. (2004) describe the peculiarities of the European venture capital market. They consider big differences between the European and the US venture capital markets concerning the early stage and high tech orientation even if the European venture capital market seems to grow fast. The reluctance of European investors to provide high risk money could be responsible for the fact that the sums invested are growing at a lower rate than in the US. Murray und Lott (1995), Murray und Marriott (1998), Lockett et al. (2002) analyze the bias of UK venture capitalists to invest in high tech portfolios. They also find an investors' reluctance to make risky investments. Additionally, they refer to government policies that evoke a more conservative investment strategy. Schertler (2004) concedes a strong influence of fund providing institutions on the investment strategies of venture capitalists. Banks seem to be much more risk averse than pension funds which are more willing to invest in early stage projects. These results could explain regional differences in investment strategies with differences in the predominance of certain fund providing institutions.<sup>2</sup> Studies investigating the Canadian venture capital industry with the peculiarity of labor sponsored venture capital funds (Cummings 2005) confirm the strong relationship between the fund providing institutions and certain investment strategies.

The peculiarities of certain national venture capital markets are investigated for example by De Clercq et al. (2001) (Finnish venture capital market), Dossani and Kenney (2001) (Indian venture capital market), Peneder and Wieser (2002) (Austrian venture capital market) and Gebhard and Schmidt (2002) (German venture capital market). All studies refer to a delay in realizing learning effects that hinders foreign venture capitalists to act as professionally as US venture capitalists. Results allow the conclusion that the stage of development of venture

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<sup>2</sup> In Austria for example banks provide 43% of the total amount of venture capital, pension funds provide 14% and private individuals 13%. In Switzerland banks, pension funds and funds of funds provide in each case 30% of the total amount of venture capital. In Germany banks provide 40%, government agencies 24%, and insurance companies 22% of the total amount of venture capital (EVCA 2004: 60-63).

capital markets has an important impact on venture capitalists' strategies. However, also market size should be important, even if I did not find a paper that refers to this influencing factor. The possible influence of both factors, markets size and market development, are explained within the following chapter.

### **3. The role of market size and market development for the willingness to invest in human capital**

#### **3.1 Market size**

Adam Smith (1776) states that "the division of labor is limited by the extent of the market." Small markets do not offer enough demand for specialization. That is also true for venture capital markets where specialization will only take place if the demand for e.g. biotech financing will be high enough. The reason is that the costs of specialization are independent of the amount of portfolio enterprises attended to by venture capitalists. Therefore, only a high demand allows amortizing the set-up costs of specialization (Besanko et al. 2000: 117-122). And a high demand is more probable in large markets. It then follows that market size should in fact influence the willingness of venture capitalists to invest in their human capital.

However, why should regional frontiers determine the size of venture capital markets? Capital can be invested elsewhere and regional frontiers should be meaningless. This is not true for venture capital (also called "smart" capital) where regional closeness foster a successful relationship between venture capitalists and portfolio enterprises. In quite an early paper Tyebjee and Bruno (1984: 1057) point out:

„When a venture capitalist invests in a company, he expects to meet regularly with the management of the new venture. To maintain travel time and expense at manageable levels, some venture capitalists limit their investment activity to major metropolitan areas with easy access. [...] Though most venture capital companies do not actively pursue a policy of restricting their investment activity to a specific geographic boundary, their portfolios often exhibit this specialization because of a tendency of entrepreneurs to search for capital close to their venture's home where their banking, legal and accountancy contacts are strongest.”

And in a recent paper Zook (2002: 151) is convinced that regions remain central to economic development of venture capital markets:<sup>3</sup>

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<sup>3</sup> See also Lerner (1995) and Sorenson/Stuart (2001).

„The ability to provide these types of value-added inputs in a timely manner is greatly assisted by geographic proximity. Rather than being an easily moved and fungible commodity, venture capital investing depends upon non-monetary inputs such as knowledge about possible investments and prefers to be close to companies in order to monitor and assist them. Thus, despite telecommunications technologies and global financial markets that have vastly expanded the geographic range of economic interaction.“

However, geographical small markets naturally have no problems with distances but they have another one: They do not own a big pool of potential start-ups that compete for venture capitalists' money and is prerequisite for successful investment activities, too. That pool allows venture capitalists to select the most promising projects as well as to match with the most appropriate projects. Nations like the US or Germany, Switzerland or Austria can be understood as pools that comprise potential start-ups, projects, and ideas and feed regional venture capital centers like the Boston region or the Silicon Valley in the US and the Munich or Frankfurt/M. region in Germany (Audretsch/Lehmann 2004: 21). While founders are limited to a certain extent to go where the money is, venture capitalists have to go where the founders are. This explains the development of regional venture capital centers that are often found close to big universities (Audretsch et al. 2004). However, even venture capitalists are not unlimited to follow their projects because leaving their region and/or country they lose a great deal of their (idiosyncratic) knowledge.<sup>4</sup> Therefore, the national market size determines the amount of potential projects to which venture capitalists have access to to a considerable extent. Or the other way around: the national market size determines the demand for venture capital to a considerable extent.

However, in order to estimate the relative market size of Austria and Switzerland some data are needed. The following table presents some statistical data that allow comparing the size of the nation, the size of the venture capital market and the size of the pool of potential projects of Austria and Switzerland. Besides our focused markets data were selected from Germany as reference point within the German-speaking region, from the UK as the most established venture capital market in Europe, from Europe at all and from the US as general reference point.

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<sup>4</sup> Venkataraman (2004) investigates local prerequisites fostering „technopreneurship“. He refers to factors like access to new ideas, role models, informal forums, region-specific opportunities, safety nets, access to large markets, and executive leadership. It is local knowledge that allows access to these resources. However, in case of cooperation (or syndication) these problems can be mitigated: a so-called lead investor monitors the start-up on location.

**Table 1: Relative market size of Austria and Switzerland compared to other markets**

|  | Austria | Switzerland       | Germany | UK   | Europe | USA   |
|--|---------|-------------------|---------|------|--------|-------|
| <b>Geographical size</b>   |         |                   |         |      |        |       |
| Area (1000 km <sup>2</sup> ) <sup>5</sup>                          | 84      | 41                | 357     | 244  | 4,113  | 9,631 |
| Inhabitants (in Mio) <sup>6</sup>                                  | 8.1     | 7.3               | 82.5    | 59.2 | 454    | 291   |
| GDP <sup>7</sup> (in € Billions) <sup>8</sup>                      | 221     | 287               | 2123    | 1624 | 10063  | 10369 |
| <b>Size of the venture capital market</b>                          |         |                   |         |      |        |       |
| VC invested without MBO (in € Mio) <sup>9</sup>                    | 114     | 212               | 1035    | 3464 | 10691  | 19432 |
| <b>Pool of potential start-up projects</b>                         |         |                   |         |      |        |       |
| Patent applications in 2002 (in 1000) <sup>10</sup>                | 1.4     | No data available | 24.8    | 7.7  | 60.5   | 45.6  |
| Citations SCI (in 1000) <sup>11</sup>                              | 9       | 17                | 80      | 93   | 447    | 424   |
| University degrees in S&E finished in 2000 (in 1000) <sup>12</sup> | 8       | No data available | 80      | 126  | 556    | 439   |

Source: Own composition but see footnotes.

The data show that national markets differ considerably concerning geographical and economical size, venture capital volume, and potential for start-up projects. I abstain from building relative data (e.g. GDP per capita) because the absolute size of a nation's pool of resources and capabilities is important. Estimating the relative market size of the Austrian and Swiss venture capital markets two points become evident: First, both markets in fact are small compared to Germany and UK. Second, a considerable difference between Austria and Switzerland exists: the Swiss venture capital volume is nearly twice as much as the Austrian one. Nevertheless, it is a small market compared to Germany, UK, and the US.

<sup>5</sup> Source: Federal Statistic Office Germany (2004: 24).

<sup>6</sup> Source: Federal Statistic Office Germany (2004: 24).

<sup>7</sup> GDP for Gross Domestic Product.

<sup>8</sup> Source: EVCA (2004).

<sup>9</sup> Source: EVCA (2004).

<sup>10</sup> Source: Federal Statistic Office Germany (2004: 122).

<sup>11</sup> Source: Own Research in the Web of Science ( <http://www.isinet.com/products/citation/wos/>).

<sup>12</sup> Source: European Commission (2003: 186).

### 3.2 Market development

Cohen und Levinthal (1990) refer to the need of experience and knowledge, called „absorptive capacity“, as a major factor in being able to learn. Therefore, existing knowledge cannot simply be used to improve a decider’s strategy elsewhere. If the buildup of absorptive capacity is lost in a certain period, the enterprise’s development is eventually prolonged for many periods: The environment’s information cannot be “absorbed” and no learning effects result from others’ experiences within the same enterprise. Therefore, a lack of absorptive capacity can lead to a false estimation of what the market calls for. If the market calls for specialization but venture capitalists do not realize it they will under invest in human capital.

De Clercq et al. (2001) investigated the emerging Finnish venture capital market for the period 1994 through 1997. They were able to show that, during that period, venture capitalists successively specialized the industry scope of their portfolio. They also found evidence that less experienced venture capitalists had a time lag in these investment patterns compared to more experienced ones. They explained these results with delayed learning effects in the young but emerging Finnish venture capital market.

A similar situation could affect the Austrian venture capital market that is well known to be “... still slightly behind when compared to other European countries.” (EVCA 2004: 81).

Peneder (1999) assumes that the traditional Austrian industry structure is responsible for that delay. Officials of the Austrian government and Austrian Private Equity and Venture Capital Association (AVCO) estimate that the Austrian venture capital market has made up and actually is nearly as developed as the neighbor venture capital markets (Peneder und Wieser 2002, Müller 2003) but we know from Cohen and Levinthal (1990) that a lack of experience in one period can affect strategic choices for the next periods. Therefore, path dependencies could be responsible for differences in investment behavior today.

Even Switzerland is described by EVCA (2004: 241) as “lagged behind other similar sized countries such as Finland and Israel”. EVCA (2004) suggests that a lack of entrepreneurial spirit could be responsible for the Swiss delay in building up its venture capital market. This is supported by studies focusing on a characteristic Swiss risk aversion (Hofstede 2001). However, things are more complex. Switzerland possesses capital far above international average but because of certain pension funds regulations (a yearly minimum rate of return of

actually 3.25%) it is quite limited to allocate pension funds money in the high tech sector. Therefore, venture capital has to be brought up by private persons, insurance companies, and banks, which runs it short artificially. Changes in legislation are considered but not realized by now (Volery et al. 2003).

### **3.3 Hypotheses**

If differences in portfolio strategies of less developed markets can be traced back to a lack of experience and knowledge, they should be mitigated in the long run. On the other hand, if market size does not lend itself to specialization, small markets will find its equilibrium on a low specialized level. High-tech investments will be rare because of a lack of knowledge. Both concepts could help to explain national and regional differences in market behavior and to forecast the venture capital market development of a specific country or region. However, it will be hard to separate both effects because the small markets are often the less developed ones. Therefore, the present paper tries to estimate in how far market development and in how far market size affects the portfolio strategies of venture capitalists within a certain market.

To some extent the question can be answered already. Data have shown that the Austrian and Swiss venture capital markets are considerably smaller and less developed than the German, UK, and US ones. And results of a former study affirm expectations that Austrian and Swiss venture capitalists invest relatively lowly in human capital. OLS-regressions show that an Austrian venture capitalist holds 26.5% less specific knowledge than her German colleague (significant on a 5%-level). A Swiss venture capitalist holds 8% less but the second result is not significant. Consequently both, Swiss and German venture capitalists, also show a lower high tech orientation than their German colleagues: An Austrian venture capitalist holds 14.5% less high tech projects in her portfolio (significant on a 10%-level) and a Swiss venture capitalist holds 16.0% less high tech projects in her portfolio (significant on a 5%-level). Additionally both, Austria and Swiss, attend to less specialized portfolios holding 3 (Austria) and accordingly 3.4 (Switzerland) more industries in their portfolio than their German colleagues (significant on a 5%-level) (Jungwirth 2004).

However, I have two problems with these results: First, as mentioned above it is hard to assess if market size or market development effects are responsible for that outcome. Second,

in spite of the same market conditions the portfolio strategies within the group of Austrian and Swiss venture capitalists vary considerably. The question is what method allows to differentiate between the two effects and to explain the variations between venture capitalists. Gabszewicz and Grilo (1992) formed the term of „heterogeneous beliefs“ explaining why equally informed individuals decide differently under the same market conditions. They assumed that beliefs about quality are heterogeneously distributed among individuals reacting rationally but differently. Assigned to our problem I assume heterogeneous beliefs as follows: Austrian and Swiss venture capitalists know that their markets are small regarding access to venture capital as well as access to promising projects. However, it is not clear how they estimate this fact: Does small mean “too small” or “rather small”. The same holds for their assessment of market development: Does a delayed development mean “too late” or “promising”? The market assessment of each venture capitalist allows analyzing how beliefs about market size and market development influence investment activities. This consideration leads to the following testable hypotheses:

1. *Venture capitalist believing the market to have a certain potential for development*
  - a. *show a considerably higher share of industry specific human capital,*
  - b. *specialize on a few industries,*
  - c. *attend to more high tech projects within their portfolio, and*
  - d. *invest in earlier stages.*
  
2. *Venture Capitalists believing the market to be too small*
  - a. *show a considerably lower share of industry specific human capital,*
  - b. *diversify over many industries,*
  - c. *attend rather to “medio” and low tech projects within their portfolio, and*
  - d. *invest in later stages.*

## **4. Database and methodology**

### **4.1 The data**

To test these hypotheses I generated a dataset based on addresses provided by the Austrian Private Equity and Venture Capital Organisation (AVCO), and the Swiss Private Equity and

Corporate Finance Association (SECA). Between November 2004 and January 2005 106 questionnaires were sent out via e-mail<sup>13</sup> and 58 well answered questionnaires were returned (return rate of 54.7%). Comparing the data with EVCA data (EVCA 2004) and AVCO data (<http://www.avco.at/>) and SECA data (<http://www.seca.ch/>) concerning the portfolio volume and the number of portfolio investments, the industry or investment stage orientation, and the geographical activities I assess returns as representative of the population of venture capitalists in Austria and Switzerland.

The standardized questionnaire collected extensive data on the venture capitalists' firm structure and investment focus as well as the type of enterprises they attend, their endowment with knowledge and experience, and their assessment of their home venture capital markets.

(1) **Firm structure and investment focus:** I asked for data that reflects the size of the company (measured in numbers of employees, number of portfolio companies, and the volume of the portfolio), company's development since foundation, the spatial focus of the company (regional, nationwide, or international), and the governance structure (being an independent business or not). Concerning the investment focus of the venture capitalist, I asked to what degree the venture capitalist was specialized in an industry (measured by the number of industries a venture capitalist is investing in, ranging from one industry - being more of a specialist - up to seven and more industries and thus being more a generalist or all-rounder, as the venture capitalists called themselves).<sup>14</sup> I need these data to control for differences across venture capitalists.

(2) **Knowledge and experience** to which the venture capital firm has access: the survey comprised information about education (the kinds of studies they had pursued and the kinds of university degrees they had obtained) and experiences of the employees and founders of the venture capital companies (industries in which they had obtained working experience).

(3) **Assessment of the venture capital market:** Questions referred directly to problems that deal with market size and market development. Mr. Thomas Jud, chairman of the AVCO, discussed all the statements with us and helped us to find items well known to all venture capitalists. Transferring the questionnaire to the Swiss venture capital markets I asked SECA

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<sup>13</sup> All companies did have email access. However, I offered them to send the questionnaire by email, by mail or by fax to increase the response rate. Only 10 percent of all responses did not return by email. Offering the other two possibilities to send back the questionnaire I could ensure that there was no response bias concerning the online survey technique (for more information on this kind of survey technique see Isfan and Moog 2003).

<sup>14</sup> I aggregated industries in seven fields, usually named by venture capitalist as typical investment fields, namely bio-technology, computer software, medicine, electrical engineering, computer hardware, communication technology, internet/e-commerce.

for support. They approved the importance of the items also for Switzerland. I will give an account of these items under “operationalization” because they are really important for the results of the analysis.

## 4.2 Methodology

Hypotheses claim a relationship between market assessment and investment behavior. Referring to Gabszewicz’s and Grilo’s (1992) heterogeneous beliefs – assessments of qualities, which are accidentally distributed among individuals within a certain population – I ask in how far the assessment of market size and market development influences investment behavior. A multivariate OLS regression seems appropriate to analyze this relationship in so far as a direct and linear relationship between market situation and investment behavior could be motivated within the theoretical part of the paper. Therefore, I test the influence of market assessment and some control variables at any one time on the dependent variables “investments in human capital” (HCSPEC), “investments in high tech projects” (HIGHTECH) and “in early stage projects” (FINSTAGE) as well as on “degree of specialization” (DEGRESPEC).

**Table 2: Estimated OLS Equations**

|           |   |  |
|-----------|---|--|
| HCSPEC    | = | $\alpha + \beta_1 \text{ EMERGINGMARKET} + \beta_2 \text{ GOODPOTENTIAL} + \beta_3 \text{ ENOUGH SUPPORT} + \beta_4 \text{ TOOSMALL} + \beta_5 \text{ WILLDEVELOP} + \beta_6 \text{ LITTLEPOTENTIAL} + \beta_7 \text{ VOLPERPU} + \beta_8 \text{ DUMMYCORP} + \beta_9 \text{ DUMMYDEPEND} + \beta_{10} \text{ AGEOFVCFIRM} + \beta_{11} \text{ EXPSPEC} + \varepsilon$ |
| HIGHTECH  | = | $\alpha + \beta_1 \text{ EMERGINGMARKET} + \beta_2 \text{ GOODPOTENTIAL} + \beta_3 \text{ ENOUGH SUPPORT} + \beta_4 \text{ TOOSMALL} + \beta_5 \text{ WILLDEVELOP} + \beta_6 \text{ LITTLEPOTENTIAL} + \beta_7 \text{ VOLPERPU} + \beta_8 \text{ DUMMYCORP} + \beta_9 \text{ DUMMYDEPEND} + \beta_{10} \text{ AGEOFVCFIRM} + \beta_{11} \text{ EXPSPEC} + \varepsilon$ |
| FINSTAGE  | = | $\alpha + \beta_1 \text{ EMERGINGMARKET} + \beta_2 \text{ GOODPOTENTIAL} + \beta_3 \text{ ENOUGH SUPPORT} + \beta_4 \text{ TOOSMALL} + \beta_5 \text{ WILLDEVELOP} + \beta_6 \text{ LITTLEPOTENTIAL} + \beta_7 \text{ VOLPERPU} + \beta_8 \text{ DUMMYCORP} + \beta_9 \text{ DUMMYDEPEND} + \beta_{10} \text{ AGEOFVCFIRM} + \beta_{11} \text{ EXPSPEC} + \varepsilon$ |
| DEGRESPEC | = | $\alpha + \beta_1 \text{ EMERGINGMARKET} + \beta_2 \text{ GOODPOTENTIAL} + \beta_3 \text{ ENOUGH SUPPORT} + \beta_4 \text{ TOOSMALL} + \beta_5 \text{ WILLDEVELOP} + \beta_6 \text{ LITTLEPOTENTIAL} + \beta_7 \text{ VOLPERPU} + \beta_8 \text{ DUMMYCORP} + \beta_9 \text{ DUMMYDEPEND} + \beta_{10} \text{ AGEOFVCFIRM} + \beta_{11} \text{ EXPSPEC} + \varepsilon$ |

Own Analysis 2005

I checked the model for linearity, multi-collinearity<sup>15</sup> and for heteroscedasticity (Wooldridge 2003) and found it valid leading to meaningful results.

<sup>15</sup> No correlation coefficient was higher than 0.502.

### 4.3 Operationalization

The next step is to operationalize our dependent, independent, and control variables.

#### *Dependent variables:*

First, I refer to the willingness of venture capitalists to invest in their human capital. The variable is called HCSPEC. Venture capitalists' knowledge is categorized on the basis of gathered information about the higher education of the firm's employees and founders. If they only have a degree and/or experience in business administration or law, they are categorized as having 'general knowledge'. If they have degrees or experience in science or technology, they have 'specific knowledge'. In fact, most of the companies have a knowledge mix that is specified by a percentage grading of specific knowledge. For instance: having two 'masters of business administration' and one lawyer and one technical scientist within the team yields a share of specific knowledge of 25% ((one specialist/venture capital managers at all) x 100). The second dependent variable within the multivariate regression model describes the share of high tech enterprises within the venture capitalists portfolio. I asked venture capitalists about their portfolio composition and gained the variable HIGHTECH directly. The degree of specialization (DEGRESPEC) is operationalized as amount of industries within the venture capitalist's portfolio. Venture capitalists selected industries according to a given sample and I counted their ticks. If they said they were an "allrounder" they got a ten. The lower the variable DEGRESPEC the higher is the degree of specialization of a venture capitalists because the variable reflects the number of industries within the venture capitalist's portfolio. The last dependent variable FINSTAGE differentiates early-stage investors and late-stage investors. I asked venture capitalists in which stages they invest. Early stage investments got a negative value and late(r) stage investments a positive value while "stage allrounders" got the value zero. Adding these values I built a scale from -1 (early stage investments) to +2 (late stage investments) that allows to categorize a venture capitalists as early or late stage investor.

#### *Independent variables*

The assessment of market size and market development is assumed to explain investment behavior of venture capitalists. The basis for this assessment is the following set of items that was part of the questionnaire. Two items were dropped because they did not reveal evidence to influence investment behavior of venture capitalists. The names of the other variables are put in the brackets behind the items.

1. With its risk-taking and committed founders, the Austrian/Swiss market gives rise to a quick establishment of the venture capital market. (EMERGINGMARKET)
2. The Austrian/Swiss market contains many innovative projects and, therefore, possesses a considerable potential for venture capital. (GOODPOTENTIAL)
3. With its tax and legal conditions, the Austrian/Swiss market supports the activities of venture capital companies. (ENOUGHSUPPORT)
4. The Austrian/Swiss market is too small to specialize in one or some branches. (TOOSMALL)
5. The Austrian/Swiss market is still in its infancy concerning venture capital. (WILLDEVELOP)
6. The Austrian/Swiss market has little potential for the high-tech projects, since the innovative activities take place within the existing industrial structures.” (LITTLEPOTENTIAL)

The items went into the regression analysis as the statement was made for the following reason: A factor analysis offered three clear distinguishable factors that comprised a very positive assessment of the market, a positive but reluctant assessment of the market, and a quite negative assessment of the market. However, using these factors as independent variables results showed clearly less evidence compared to the original items. The reason could be that every form of dimension reducing method loses information. In that case the factors mixed items concerning market size and market development but these factors revealed to be important in later analysis. Therefore, the original items are used. Being measured on a Likert scale, variables can be handled as metric variables because all of them showed a normal curve of distribution. Again, the independent variables are: EMERGINGMARKET, GOODPOTENTIAL, ENOUGHSUPPORT, TOOSMALL, WILLDEVELOP, AND LITTLEPOTENTIAL.

*Control variables:*

However, I know that apart from market assessment many other factors probably exist influencing the investment behavior of venture capitalists. A very important one is the amount of venture capital that is available to each venture capitalist. To differentiate between venture capitalists investing small amounts in many firms and venture capitalists putting “all eggs within one basket” I divided the invested volume of capital by the amount of portfolio enterprises attended. This variable is called VOLPERPU. We learned in section two that institutions matter. Therefore, I built two dummy variables stating if a venture capitalist is a corporate or another dependent venture capitalist. Reference category for both, corporate and other dependent (banks, governmental agencies) venture capitalist, is the class of independent venture capitalists. In the questionnaire I also asked if the venture capital firm depends on a mutual saving bank but no venture capitalist ticked this possibility. Therefore, I have only three institutional categories and the two I use are called DUMMYCORP and DUMMYDEPEND. I also know that the Swiss and the Austrian venture capital market differ regarding the amount

of venture capital available. That seems to be an important influencing factor so that controlling for country is worth while (DUMMYAUSTRIA). Another relevant factor independent from “market experience” should be the individual experience of a venture capitalist. The age of the venture capital firm can be used as proxy for experience (AGEOFVCFIRM). Venture capitalists indicated when they were founded (e.g. 1995). This year was subtracted from the actual year 2005 and delivered e.g. an age of 10 years. Another variable referring to specific experience (EXPSPEC) was build analogous to the share of specific human capital. A value of e.g. 75% means that  $\frac{3}{4}$  of venture capitalists collected their experience in a specific industry while  $\frac{1}{4}$  collected their experience in a bank, public administration or consulting firm.

The following table sums up all dependent, independent and control variables.

**Table 3: Definition of variables and descriptive statistics (n = 58)**

| Variables                    | Meaning   | Measure   | Medium | Standard deviation |
|------------------------------|---|---|--------|--------------------|
| <b>Dependent variables</b>   |   |   |        |                    |
| HCSPEC                       | Share of specific human capital within the VC firm        | Percent, metric   | 28,06  | 29,56              |
| HIGHTECH                     | Share of high tech projects within the VC's portfolio     | Percent, metric   | 52,38  | 36,90              |
| FINSTAGE                     | Predominant stage of financing of a VC firm               | Scale from -1 (early stage) to +2 (late stage), quasi metric                  | 0,63   | 1,00               |
| DEGRESPEC                    | Numbers if industries within VC's portfolio               | 1 to 10, Metric   | 5,91   | 3,55               |
| <b>Independent variables</b> |   |   |        |                    |
| EMERGINGMARKET               | Positive assessment of market development                 | Likert scale from 1 (I completely disagree) to 5 (I completely agree), metric | 2,32   | 0,81               |
| GOODPOTENTIAL                | Positive assessment of market development                 | Likert scale from 1 (I completely disagree) to 5 (I completely agree), metric | 3,32   | 0,96               |
| ENOUGHSUPPORT                | Positive assessment of governmental support               | Likert scale from 1 (I completely disagree) to 5 (I completely agree), metric | 2,89   | 1,21               |
| TOOSMALL                     | Negative assessment of market size                        | Likert scale from 1 (I completely disagree) to 5 (I completely agree), metric | 3,73   | 1,23               |
| WILLDEVELOP                  | Positive assessment of market development                 | Likert scale from 1 (I completely disagree) to 5 (I completely agree), metric | 3,61   | 1,00               |
| LITTLEPOTENTIAL              | Negative assessment of market size                        | Likert scale from 1 (I completely disagree) to 5 (I completely agree), metric | 2,40   | 0,83               |
| <b>Control variables</b>     |   |   |        |                    |
| VOLPERPU                     | Investment volume divided by portfolio enterprises        | Million Euro, metric  | 6,03   | 7,15               |
| DUMMYCORP                    | Corporate VC  | 1 = Corporate VC<br>0 = Independent VC  | 0,06   | 0,23               |
| DUMMYDEPEND                  | Other dependent VC  | 1 = Dependent VC<br>0 = Independent VC  | 0,15   | 0,36               |
| DUMMYAUSTRIA                 | Austrian VC   | 1 = Austria<br>2 = Switzerland  | 0,52   | 0,50               |
| AGEOFVCFIRM                  | Age of the VC Firm, (2005 – Founding year of the VC firm) | Years, metric   | 8,02   | 6,44               |
| EXPSPEC                      | Share of specific experience within the VC's firm.        | Percent, metric   | 27,18  | 30,89              |

Source: Own Data 2005

#### 4.4 Descriptive results

I deal with two different countries. Therefore, I want to know if significant differences exist in variable values between Austria and Switzerland. Results show considerable differences concerning investments in knowledge (HCSPEC) and portfolio management (HIGHTECH, DEGRESPEC). Swiss venture capitalists on average act more professionally owning more specific human capital, attending to more high tech projects and being more focused on a few industries. Interestingly, I could not find these differences in the 2003-study. I interpret this result as evidence for a different development of Austrian and Swiss venture capital markets since 2003. Comparing Austrian and Swiss venture capitalists' market assessment I also find significant differences concerning the items ENOUGH SUPPORT and TOO SMALL. Obviously, Austrian venture capitalists in average feel better supported by government. Swiss venture capitalists on the other hand assess market size as less problematic. These results seem to approve that venture capitalists indeed understood the meaning of the items. Austrian government actively fosters the venture capital market by supporting it with transaction cost reducing services while Swiss government acts quite reluctantly (Lüthy 2004). And the Austrian venture capital market is indeed smaller by size namely half in terms of venture capital available. Two other significant differences lie in the venture capitalists' status and in the experience they have gathered. While Austrian venture capitalists in many cases are dependent, Swiss venture capitalists are rather independent. Even this can be assumed to reflect the stronger participation of Austrian government in the venture capital market. The fact that Swiss venture capitalists own more managers with experience gathered in the industry also argues for a more professional approach in venture capital business.

**Table 4: T-statistics comparing Austrian and Swiss Data (n = 58)**

| Variables       | Country | N  | Medium   | Standard deviation | T-Value |
|-----------------|---------|----|----------|--------------------|---------|
| HCSPEC          | Austria | 29 | 16.59**  | 19.373             | -3.355  |
|                 | Swiss   | 25 | 41.36**  | 33.886             | -3.229  |
| HIGHTECH        | Austria | 28 | 42.46*   | 30.156             | -2.229  |
|                 | Swiss   | 22 | 65.00*   | 41.346             | -2.147  |
| FINSTAGE        | Austria | 29 | 0.7586   | 1.02313            | 1.025   |
|                 | Swiss   | 25 | 0.4800   | 0.96264            | 1.030   |
| DEGRESPEC       | Austria | 30 | 6.93*    | 3.423              | 2.450   |
|                 | Swiss   | 25 | 4.68*    | 3.363              | 2.454   |
| EMERGINGMARKET  | Austria | 29 | 2.28     | 0.649              | -0.432  |
|                 | Swiss   | 27 | 2.37     | 0.967              | -0.426  |
| GOODPOTENTIAL   | Austria | 29 | 3.41     | 0.867              | 0.747   |
|                 | Swiss   | 27 | 3.22     | 1.050              | 0.742   |
| ENOUGHSUPPORT   | Austria | 29 | 3.21*    | 1.048              | 2.106   |
|                 | Swiss   | 26 | 2.54*    | 1.303              | 2.081   |
| TOOSMALL        | Austria | 29 | 4.17**   | 0.889              | 2.971   |
|                 | Swiss   | 27 | 3.26**   | 1.375              | 2.927   |
| WILLDEVELOP     | Austria | 29 | 3.72     | 1.032              | 0.903   |
|                 | Swiss   | 27 | 3.48     | 0.975              | 0.905   |
| LITTLEPOTENTIAL | Austria | 25 | 2.44     | 0.870              | 0.336   |
|                 | Swiss   | 25 | 2.36     | 0.810              | 0.336   |
| VOLPERPU        | Austria | 26 | 5.0183   | 6.40479            | -1.054  |
|                 | Swiss   | 23 | 7.1735   | 7.89941            | -1.040  |
| DUMMYCORP       | Austria | 29 | 0.07     | 0.258              | 0.456   |
|                 | Swiss   | 25 | 0.04     | 0.200              | 0.464   |
| DUMMYDEPEND     | Austria | 29 | 0.24*    | 0.435              | 2.125   |
|                 | Swiss   | 25 | 0.04*    | 0.200              | 2.232   |
| AGEOFVCFIRM     | Austria | 30 | 7.77     | 6.548              | -0.328  |
|                 | Swiss   | 22 | 8.36     | 6.418              | -0.329  |
| EXPSPEC         | Austria | 29 | 17.5402* | 22.20296           | -2.635  |
|                 | Swiss   | 24 | 38.8194* | 36.03648           | -2.523  |

Own Analysis 2005. \*\*\* Significant on 0%-level; \*\* significant on a 1%level; \* significant on a 5%-level

However, our central question is not in how far Austria differs from Switzerland but in how far beliefs about market size and market development influence investments in human capital and portfolio management. I expected that venture capitalist believing the market to have a certain potential for development show a considerably higher share of industry specific human capital, specialize on a few industries, attend to more high tech projects within their portfolio, and invest in earlier stages. Venture Capitalists on the other side believing the market to be too small should show a considerable lower share of industry specific human capital, diversify over many industries, attend rather to “medio” and low tech projects within their portfolio, and invest in later stages. Correlation analysis revealed that venture capitalists

assessing the market as too small invest less in human capital, in later stages and hold more industries in their portfolio. Venture capitalists on the other side expecting the market as a developing one invest in earlier financing stages and hold fewer industries in their portfolio (all results significant on a 5%-level).

#### **4.5 Results from regression analysis**

Concerning investments in human capital (Table 5) I find that the assessment of the market as too small seemingly leads to lower investments in specific human capital. The size of the effect is quite considerable: one point on the Likert-scale leads to a change in investments of more than 7%. However, venture capitalists who do not believe that the markets have enough high tech potential invest considerably more in their specific human capital. That is a quite contradicting result that is hard to explain. Interestingly and unexpectedly, I find that dependent venture capitalists invest much more in specific human capital than independent venture capitalists. I know from T-statistics that dependent venture capitalists are rather found in Austrian than in Swiss firms. I interpret this result that in the case of Austria institutions own more absorptive capacity and other resources and, therefore, are able to learn faster than independent “lone fighters”. The Dummy Austria delivers the expected result that Austrian venture capitalists invest considerably less in specific human capital than Swiss ones. Regression results support the expectation that beliefs about market size influence the propensity to invest in specific human capital.

**Table 5: Regression 1 - Investments in Human Capital**

|                 | B   | Standard Default | T-Value |
|-----------------|---|------------------|---------|
| EMERGINGMARKET  | 1.576   | 5.392            | 0.292   |
| GOODPOTENTIAL   | 7.799   | 4.781            | 1.631   |
| ENOUGHSUPPORT   | -0.125  | 3.315            | -0.038  |
| TOOSMALL        | -7.364*   | 3.585            | -2.054  |
| WILLDEVELOP     | 4.870   | 4.185            | 1.164   |
| LITTLEPOTENTIAL | 12.628*   | 5.014            | 2.519   |
| VOLPERPU        | -0.847  | 0.575            | -1.472  |
| DUMMYCORP       | 23.775  | 15.880           | 1.497   |
| DUMMYDEPEND     | 35.602**  | 11.108           | 3.205   |
| DUMMYAUSTRIA    | -26.504**   | 9.097            | -2.913  |
| AGEOFVCFIRM     | -0.739  | 0.550            | -1.344  |
| EXPSPEC         | 0.294*  | 0.140            | 2.097   |
| MODELFIT        | <b>R<sup>2</sup> = 0,494 (corrected)</b><br><b>F = 3,933**</b><br><b>N = 36</b> |                  |         |

Own Analysis 2005. \*\*\* Significant on 0%-level; \*\* significant on a 1%level; \* significant on a 5%-level

Concerning investments in high tech projects assessment of the market does not show any influence. However, I find some unexpected results here: The higher the venture capitalist's investment volume per project, the lower is her share of high tech projects within her portfolio. And the older the venture capitalist is, the less she invests in high tech projects. Results reflect a considerable risk aversion and the opposite would make sense. Both, a higher investment per high tech project as well as more experience of the venture capitalist, would make the investment's success more probable. It is also contradictory to the finding of De Clercq et al. (2001) that the more experienced venture capitalists focus more on high tech projects. However, being an Austrian venture capitalist or a Swiss one makes the difference: Austrian venture capitalists can be expected to invest 41% less in high tech projects than their Swiss colleagues. That is a huge difference and reflects a different state of the market.

**Table 6: Regression 2 - Investments in High Tech Projects**

|                 | B   | Standard Default | T-Value |
|-----------------|---|------------------|---------|
| EMERGINGMARKET  | -3.554  | 8.106            | -0.438  |
| GOODPOTENTIAL   | -6.430  | 7.333            | -0.877  |
| ENOUGHSUPPORT   | 8.120   | 5.014            | 1.619   |
| TOOSMALL        | -0.468  | 5.472            | -0.086  |
| WILLDEVELOP     | -4.245  | 6.377            | -0.666  |
| LITTLEPOTENTIAL | -10.857   | 7.750            | -1.401  |
| VOLPERPU        | -2.290*   | 0.865            | -2.647  |
| DUMMYCORP       | 4.190   | 23.884           | 0.175   |
| DUMMYDEPEND     | -25.377   | 16.905           | -1.501  |
| DUMMYAUSTRIA    | -40.960**   | 13.913           | -2.944  |
| AGEOFVCFIRM     | -2.014*   | 0.829            | -2.429  |
| EXPSPEC         | -0.240  | 0.211            | -1.137  |
| MODELFIT        | <b>R<sup>2</sup> = 0,351 (corrected)</b><br><b>F = 2.578**</b><br><b>N = 35</b> |                  |         |

Own Analysis 2005. \*\*\* Significant on 0%-level; \*\* significant on a 1%level; \* significant on a 5%-level

Regression 3 analyzes the relationship between the beliefs about the market and the financing stage a venture capitalist chooses. The later she places her investment, the less risky the investment is. First, regression 3 reveals why factors from the factor analysis did not sharpen up results from the regression analysis. While venture capitalists assessing the market as developable (GOODPOTENTIAL and WILLDEVELOP) invest in earlier stages – as expected – venture capitalists assessing the market as too small (TOOSMALL) invest in later stages – also as expected. However, venture capitalists assessing the market as emerging in general (EMERGINGMARKET) invest in later stages. The “emerging market” item is more general and, therefore, it could reflect a quite unspecific belief about the market situation. That could explain that this belief is not linked to the expected reaction. Another result is that corporate venture capitalists invest considerably later than independent venture capitalists. That reflects the business model of corporate venture capitalists supporting companies that often have been started in-house and are hived off later (Maula et al. 2005). At last I find a flimsy hint that more experienced venture capitalists invest earlier. All in all this regression supports the expectation that beliefs about market size and market development influence investment behavior.

**Table 7: Regression 3 - Investments in an Early or Late Financing Stage**

|                 | B   | Standard Default | T-Value |
|-----------------|---|------------------|---------|
| EMERGINGMARKET  | 0.561*  | 0.205            | 2.742   |
| GOODPOTENTIAL   | -0.434*   | 0.191            | -2.277  |
| ENOUGHSUPPORT   | 0.119   | 0.126            | 0.946   |
| TOOSMALL        | 0.374*  | 0.136            | 2.753   |
| WILLDEVELOP     | -0.314 <sup>†</sup>   | 0.166            | -1.888  |
| LITTLEPOTENTIAL | 0.186   | 0.193            | 0.967   |
| VOLPERPU        | 0.034   | 0.022            | 1.523   |
| DUMMYCORP       | 1.481*  | 0.602            | 2.462   |
| DUMMYDEPEND     | 0.712   | 0.427            | 1.670   |
| DUMMYAUSTRIA    | -0.082  | 0.347            | -0.237  |
| AGEOFVCFIRM     | 0.000   | 0.022            | -0.019  |
| EXPSPEC         | -0.009 <sup>†</sup>   | 0.005            | -1.761  |
| MODELFIT        | <b>R<sup>2</sup> = 0,429 (corrected)</b><br><b>F = 3.188**</b><br><b>N = 35</b> |                  |         |

Own Analysis 2005. \*\*\* Significant on 0%-level; \*\* significant on a 1%level; \* significant on a 5%-level

The last regression analyzes the influence of beliefs on the degree of specialization. In the theoretical part of the paper I argued that a small market will not amortize investments that are necessary for specialization and, therefore, specialization will stay on a low level. If individuals on the other hand expect a developing market, specialization should be superior because specialization now prepares competitive (first mover) advantages in a later period. Results show that the assessment of the market as a developing one leads to a significantly higher degree of specialization. Venture capitalists who believe that the venture capital market is promising and will develop, hold fewer industries in their portfolio than others. However, the assessment of market size does not show a significant reaction even if result shows into the right direction. And venture capitalists who believe that their venture capital markets have little potential for high tech projects, also hold fewer industries in their portfolios. That fits the result of the first regression where the belief “little potential” led to higher investments in human capital. Austrian venture capitalists – as expected – hold nearly three more industries in their portfolio than Swiss venture capitalists. All in all expectation can be supported that beliefs about market size and market development influence the propensity to specialize.

**Table 8: Regression 4 - Degree of Specialization**

|                 | B  | Standard Default | T-Value |
|-----------------|--|------------------|---------|
| EMERGINGMARKET  | 0.527  | 0.729            | 0.723   |
| GOODPOTENTIAL   | -1.119 <sup>†</sup>  | 0.647            | -1.730  |
| ENOUGHSUPPORT   | -1.130*  | 0.448            | -2.520  |
| TOOSMALL        | 0.392  | 0.485            | 0.808   |
| WILLDEVELOP     | -1.269*  | 0.566            | -2.241  |
| LITTLEPOTENTIAL | -1.251 <sup>†</sup>  | 0.678            | -1.844  |
| VOLPERPU        | -0.057   | 0.078            | -0.735  |
| DUMMYCORP       | -1.956   | 2.148            | -0.911  |
| DUMMYDEPEND     | 0.074  | 1.502            | 0.049   |
| DUMMYAUSTRIA    | 2.279 <sup>†</sup>   | 1.230            | 1.853   |
| AGEOFVCFIRM     | 0.072  | 0.074            | 0.971   |
| EXPSPEC         | -0.016   | 0.019            | -0.852  |
| MODELFIT        | <b>R<sup>2</sup> = 0,352 (corrected)</b><br><b>F = 2.632*</b><br><b>N = 36</b> |                  |         |

Own Analysis 2005. \*\*\* Significant on 0%-level; \*\* significant on a 1%level; \* significant on a 5%-level

## 5. Discussion and Conclusion

The question of this paper has been in how far beliefs about market size and market development influence the investment behavior of venture capitalists. Investment behavior refers to investments in specific human capital, investments in high tech projects, investments in early stage projects, and it also refers to a focus strategy limiting the portfolio to one or a few industries. All parts of this investment behavior are closely linked to each other: Venture capitalists need specific human capital to be able to deal with the principal agent problems of early stage/high tech projects (Jungwirth/Moog 2004, Dimov/Shepherd 2005). However, because they cannot build up more than a few stocks of specific human capital they have to focus on a few industries. The paper analyzed if and in how far a small market size and a delayed market development would bar venture capitalists from specialization. The rationale was that the demand in small markets is too small to amortize the investments in the specific stock of human capital. In delayed developed markets on the other hand, a lack of absorptive capacity deters venture capitalists from understanding adequately what the market calls for. From a former study I knew that the Austrian and Swiss venture capital markets are small and lately developed. I also knew that the Austrian and Swiss venture capitalists invested less in human capital, in early stage/high tech projects and are broader diversified. However, I did

not know how much of this investment behavior refers to market size and how much refers to the delayed market development. Another point was that variations between venture capitalists in the control sample were considerable. Therefore, it could be assumed that not the objective market situation should be relevant for investment behavior but the subjective assessment of the market situation should be the crucial factor. The questionnaire asked some important items concerning market assessment of the Austrian and Swiss venture capital market that were taken as explanatory variables.

Results are illuminating but ambivalent for two reasons:

First, beliefs about the market show a considerable and significant influence on investment behavior. Mostly they support expectations but sometimes they seem to be contradictory. E.g. the two items “the Austrian/Swiss market is too small to specialize in one or more industries” and “the Austrian/Swiss market has little potential for high-tech projects, since the innovative activities take place within the existing industrial structures” consistently lead to different reactions in investment behavior: While the “market is too small” belief leads to less investment in human capital and to a broader diversification the “little potential for high-tech projects” belief leads to the opposite. Obviously, a relationship that is quite logic and clear for me is not as matter of course for venture capitalists.

Second, the strongest influence on investment behavior is being an Austrian venture capitalists or a Swiss one. That is – in a sense – a strong support for our hypotheses: Starting from nearly the same investment behavior in the beginning of 2003 differences in market size (measured as venture capital available) led to considerable differences in investment behavior in the beginning of 2005. To assure that national effects are not caused by certain non-discussed influence factors (e.g. tax regulation that punish high tech investments) I compared venture capitalists with more general knowledge and venture capitalists with more specific knowledge and found that national differences become less important: An Austrian venture capitalist owning a high share of specific human capital behaves similar as her Swiss colleague owning a high share of specific human capital.

However, what can I say about the influence of market development and market size? At first glance it seems that market size accelerates market development. However, another factor could distort evidence. Switzerland is a financial center and financial knowledge is deep-

seated as a national resource. Therefore, it is not clear if venture capital is provided because of the knowledge or if the venture capital provided fostered the building up of knowledge. Nevertheless, I could show that market size and market development are crucial for investment behavior of venture capitalists. And that is what I wanted to show.

The limits of the study are obvious: Dealing with 58 cases is a good number relative to the Swiss and Austrian venture capitalists available but quite a small number for meaningful regression analysis. Nevertheless, results are quite robust as the specifications of different models show. The next step lies in a refinement of the regression analysis trying to find some more elaborated results using a linear probability model.

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# **SPIRITUALITY AND THE ENTREPRENEUR**

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## **ABSTRACT**

This qualitative exploratory study is based on interviews with 29 entrepreneurs on spirituality and work. Information from the interviews was organized using *Atlas.ti* software, resulting in an interesting conceptual framework. The findings are organized around four research questions: (1) What motivated the entrepreneur to get into business? (2) How do entrepreneurs find meaning and purpose in their lives? Did the choice to start their own business influence perceived meaning and purpose? (3) How do entrepreneurs view spirituality? (4) How do entrepreneurs view success? Key purposes of the study were to add the entrepreneurial perspective to current literature in the field of spirituality in the workplace; and to explore entrepreneurs' motivations with regard to how their businesses may bring meaning and purpose to their lives. Respondent entrepreneurs were frequently influenced by family role models. Difficulties with previous careers were also instrumental in the decision to start a business. Most entrepreneurs expressed some dissatisfaction with previous positions or bosses. They felt the job they left could be performed equally well or better on their own. The interviewed entrepreneurs realized meaning and purpose through accomplishment, filling a need, as well as through the aspects of love, appreciation, and respect. The entrepreneurs were proud of their accomplishments. Money is a large factor, but is not the only factor in this group's definition of success. Success was better realized by serving people, enjoying repeat customers, building relationships, helping staff grow, and 'loving what you do.'

## **INTRODUCTION**

In conventional thinking, work and spirituality do not seem to go together. Work is about making money and creating value for oneself and the organization. Spirituality is about transcendence and understanding *Self*. The two concepts seem to be at opposite ends of a spectrum. However, interest in spirituality in the workplace is growing. Spirituality at work has become a subject of popular articles in periodicals, books, and scholarly research journals, mostly in the context of larger organizations. The examination of spirituality in the workplace is wide-ranging, both in attempts to define this construct (Khanna and Srinivas, 2000; Levine, 1994, Boozer, 1998; Sperry, 1997, Ashmos and Duchon, 2000; Mitroff and Denton, 1999) and in comparisons with spirituality in the context of religion (McKee, 2003; Mitroff and Denton, 1999; Gibbons, 2000.)

Entrepreneurial research has studied entrepreneurs in the context of various psychological attributes of the entrepreneur (Stewart, 1996; McClelland, 1961; Drucker, 1985.) It has also examined social and cultural factors that promote entrepreneurship (Dollinger, 2003.)

Entrepreneurs are an important group of business professionals to examine in pursuit of the relationship between work and spirituality. In examining the relationship between entrepreneurship and spirituality, it would seem that if the entrepreneur views business as a

vocation or calling she may find more satisfaction, meaning, and fulfillment from it (Leider, 1997.) Exploring these different perspectives can provide insight as to different motivational factors that drive individuals to start businesses. This information will be useful for both educators and students in learning the various reasons why someone would become an entrepreneur. Starting one's own business may be less about making money, security, or flexibility and more about finding meaning and purpose in life.

To better understand what drives entrepreneurs, the researchers interviewed 29 entrepreneurs to seek personal opinions as to: motivations for starting the business, enjoyment of work, definition of success and whether being an entrepreneur provides a greater opportunity to achieve a sense of meaning and purpose. This research explores whether and how the entrepreneurial experience of enterprise creation moves people toward more satisfaction and purpose to achieving a calling in life. Through in-depth conversations with these entrepreneurs, the researchers have explored their motivations for starting a business, as well as how they perceive spirituality, meaning, and purpose.

## **LITERATURE REVIEW**

### **The Modern Workplace**

Accelerating change in the workplace, whether derived from technology, or downsizing/rightsizing tends to create a sense of chaos and instability, blocking the individual quest for meaning. In order to compensate for the sense of deprivation as well as absence of perceived individual meaning and worth within the large organizational setting, many are embracing a spiritual (not necessarily religious) focus. Often, religion assumes a sectarian orientation, one that is more doctrinaire; it can create division rather than unity. The individual focus on spirituality tends to be more tolerant of heterogeneity.

The need to develop connection and a sense of community has become increasingly important, yet the traditional sources such as family and religion are often found lacking in this regard (Conger, 1994; Jung, 1933; Spencer, 1996.) As the workplace has become an increasingly dominant element of life, individuals are seeking some sense of spirituality within it. The experience of dislocation in the workplace and the loss of spirit experienced by many in larger organizations have been the impetus to force individuals out of their comfort zone – to consider what is truly meaningful. The heightened sense of insecurity, loss of connection to the *Self* and personal values, have prompted individuals to reconsider how to pursue their careers. It is likely that this is at least one impetus for the increase in entrepreneurship education evident in universities during the past decade (Solomon, 1998) as well as the increase in small business start-ups (Pulley, 1997.)

Work must provide people with something more than conventional rewards if they are to fully employ personal capabilities (Auger & Arenberg, 1992; Secretan, 1997.) Individuals who experience work as a calling are able to pursue work as an opportunity to enhance their sense of wholeness, energized by spiritual connection with others (Depree, 1989; Marcic, 1997; Morris, 1997; Stein & Hollowitz, 1992.)

There clearly seems to be a drive to find work that is more meaningful and purposeful. Many individuals are feeling a loss of job security and disconnect from their values. As such, there is a continued growth in entrepreneurial businesses. Nevertheless, do entrepreneurs really have a different experience of work than individuals that are employed by others? What are the

measures that entrepreneurs use when defining their success? These questions are the bases for the present study.

### **Entrepreneurs: What is important to them?**

The number of entrepreneurs has continued to rise over the years. The main reason given for the attraction to self-employment are freedom from rules and regulations normally associated with a more formal organization (Chay 1993; Ketz de Vries 1980,) freedom to make decisions, accountability to oneself, potential for higher rewards, opportunity to do challenging work, and a feeling of achievement and pride (Akande 1994; Begley and Boyd 1987; Rodgers and Rodgers 1989; Timmons 1978.)

The above research suggests that entrepreneurs are more creative, happier with their jobs and enjoy opportunity to find alignment with personal values. All of these criteria are in line with human intrinsic motivation to fully experience spirituality in work. (King-Kauanui, 2002.)

### **Defining Spirituality in Organizations**

Researchers are trying to define spirituality in the workplace. This has proven quite the challenge, as the concept does not lend itself to a single idea. Mitroff talks about the definition 'obsession' of researchers in the field of spirituality at work in a recent interview with Kathy Lund Dean (Dean, 2004.) He says, ". . . the fact that there is no single definition to spirituality should not deter us from study of the field." It is reasonable to research the concept without an exact definition of 'spirituality at work.' Allowing entrepreneurs to give their own perceptions, feelings, and responses to spirituality allows for a personal and unaltered perspective. It therefore, seems reasonable to conduct this research by directly seeking this information from respondents.

### **Entrepreneurship**

Entrepreneurship has been analyzed from numerous perspectives such as the entrepreneurs' psychological characteristics, sociological influences, personal motivation, and even definition of success. Some aspects of entrepreneurship depend less on the psychological makeup of the individual than on the situational forces, familial influences, role model, and cultural forces that the entrepreneur faces. These factors are then activated or moderated by the desirability and feasibility of going into business (Dollinger, 2003.)

Researchers have suggested that the reasons people start their own businesses include not only innovation, independence, and vision (Amit, et. al., 2000,) but also self-fulfillment, achievement, and a desire to help others (Pokela, 1989.) Several studies of entrepreneurs that examined motivating factors have found that money was not the most important factor (Amit et al., 2000; Alstete, 2002; King-Kauanui, 2003; Katz, 1992; Kolvereid, 1996; Brenner, Pringle and Greenhaus 1991.)

If the motivation for an entrepreneur is something other than financial, looking at the personal definition of success in business may provide a glimpse into what the entrepreneur finds most meaningful. King-Kauanui, (2003) conducted a study over a 3 year period in which university students surveyed 152 entrepreneurs. The entrepreneurs were asked many open-ended questions from a structured survey, but with emphasis on one question, "how do you define success?" (King-Kauanui, 2003.) The factors most often indicated are: being happy, achieving a dream, making money, helping others, and personal freedom. These results show that entrepreneurs are predominantly interested in personal satisfaction, freedom, and enjoying what they do.

Therefore, it is logical to frame this research on spirituality at work in terms of motivation to start a business, definition of meaning and purpose, and perceptions of the meaning of success.

## **METHODOLOGY**

### **Research Design**

It is consistently clear that the subject matter of spirituality does not lend itself to short answers or neat Likert scale type questions (Fornaciari & Dean, 2001.) No simple prescriptive answer is available to encompass all aspects of an entrepreneur's behavior or view of spirituality.

Therefore, an exploratory qualitative research design was chosen. A semi structured interview process, based on a broad set of questions, was used to gain a better understanding of the entrepreneurs' real experiences, as well as to gather pertinent demographic information. Specifically, the interviews were designed to explore the following research questions to understand how entrepreneurs might be better able to integrate the search for spirituality into their work:

- (1) What motivated the entrepreneur to get into business?
- (2) How do entrepreneurs find meaning and purpose in their lives? Did the choice to start their own business influence perceived meaning and purpose?
- (3) How do entrepreneurs view spirituality?
- (4) How do entrepreneurs view success?

### **Sample Selection**

The sample consisted of 29 practicing entrepreneurs from California and neighboring states. This convenience sample was drawn from lists obtained through alumni groups of Cal Poly Pomona and Cal State Fullerton, as well as entrepreneurship networking circles and professional contacts. Although most were based in California, some respondents conducted business in neighboring states. Therefore, no defined location was placed on the study. Respondents differed by gender, ethnicity, nationality, age, and years in business and came from a variety of professional and educational backgrounds.

### **Data Collection**

The researchers used established, ethical practices for interviewing all subjects. This included disclosing the purpose of the study along with the promise of confidentiality. A confidentiality agreement was proposed, however, most participants were comfortable with a verbal explanation of the process. The interviews were conducted either in person or over the telephone. They were taped, with the entrepreneur's permission and later transcribed. The definition of spirituality at work was not presented to the potential respondents. This way they were not limited to agreeing or disagreeing with the definition. Rather, an open-ended question similar to the one used by Mitroff and Denton (1999) was asked to ascertain the respondent's views on spirituality and then followed up with questions about meaning and purpose of business life.

### **Data Analysis**

The resulting manuscript files were saved in rich text format. A software product called *Atlas.ti* was utilized as the repository and data analysis tool for the project. This software aided in the analysis and interpretation process by creating an environment for organizing, coding, clustering and annotating the large volumes of collected text. This software enabled researchers to extract pertinent quotes and phrases through the use of coding and keyword searches.

## RESULTS

### Demographics

Demographic information about participating entrepreneurs was gathered. This section provides a description of the demographics of the sample. Twenty-nine individuals were interviewed for the study, 16 of the respondents (55 %) were male and 13 or 44 % were female.

### Age

The average age of the respondents was 51 years. Table 1 illustrates the different age categories of the participating entrepreneurs.

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Table 1 about here

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### Question 1: What motivated each entrepreneur to get into business?

The preliminary ideas drawn from the literature review were that there are certain influencers or motivators that push entrepreneurs toward getting into business. The aspects of family, previous careers, and socioeconomic factors were known influencers in starting a business and are discussed below. The last section explores the other motivators given as reasons to start a business.

**Role of family:** Entrepreneurs were asked about the role of family in their business. 25% mentioned specifically that their mother or father had been in business for themselves. Some respondents discussed family events that led to starting the business. Several were driven to start their own business so they could do something different. Family events played a role in influencing some entrepreneurs. In some instances, tragedies in the family triggered a need to depend upon themselves. For example, one entrepreneur came from a poor family and as a young man began selling flowers for extra money. Another entrepreneur's spouse had cancer and the reality of her impending death gave him courage to start the business. Another entrepreneur's marriage and family fell apart and the entrepreneur chose to focus on the business rather than dwelling on the devastation of his personal life.

**Role of entrepreneurs' previous career:** The entrepreneurs interviewed rarely started in a completely unknown business. Many had worked in businesses that were similar to the ones they currently owned. Disagreement with management, control of their own destiny, and using the new company to give back to the community were some of the reasons for some entrepreneurs to start their own business. As employees, many entrepreneurs expressed that their good ideas were not being heard. They felt that they could manage processes better than their company or they did not get along personally with the old boss. Navigating the many layers of bureaucracy took too much time and energy. Several felt they had hit the ceiling of opportunity in the company. Some spoke of waking up one day to the realization that they would be doing the same job in twenty years if they did not make a change. Therefore, they went out on their own seeking independence and control of their destiny. Most had at least one or more clients that would remain loyal when they started their business. They felt that the risk was manageable because of experience in the field and a potential client base.

**Role of entrepreneurs' socioeconomic factors:** The role of socioeconomic factors in this study related to the entrepreneurs' history. Some entrepreneurs stated they were selling things at a young age or had experiences in their youth that formed desires to be successful later in life. Others felt that the economic rewards of their previous positions were not in line with the effort

they expended. They wanted more control over the rewards they received from their efforts. Some entrepreneurs were motivated by the prospect of success after an upbringing in poverty. For them, the success of their company had a direct connection to personal feelings of self-worth. They described the feeling that there was no option but success. One entrepreneur said he had to succeed in order not to disappoint because he had put himself “out there for family and friends to see.” Other entrepreneurs recounted the experience of working very hard for a previous employer without fair reward. One entrepreneur said, “. . . if I had stellar performance and accomplished things, the benefit to me was so infinitesimally incremental that it was personally insulting.” The desire to create and obtain equitable rewards for hard work was very strong.

**Other factors:** The rank order of themes from responses about motivation to start a business is illustrated in Table 2. The most often cited themes were: ‘to serve people, better work environment, and money.’ The themes of ‘passion, challenge, creativity, independence, autonomy, necessity, and fear’ were mentioned less often. These responses were part of a discussion in response to the question, “. . . what motivated you to start your business?” The entrepreneurs chose topics and areas that were important to them in the framework of motivation to start the business.

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Table 2 about here

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These entrepreneurs favored creating more economic opportunity, a better working environment including the ability to choose staff and clients, and the flexibility to meet the demands of work and family. The flexibility to set schedules, to meet family obligations and special events and the flexibility to decide how to schedule their work were all important.

In Table 3, these ten major themes with number of responses are listed and positioned from ‘more altruistic’ to ‘less altruistic.’ Several of the entrepreneurs mentioned more than one theme, for example, one entrepreneur who indicated ‘service to other people’ as a factor to start a business also mentioned ‘money.’ Approximately 40% of the responses are toward the ‘more altruistic’ end of the scale with 60% at the ‘less altruistic.’

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Table 3 about here

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**Question 2: How do entrepreneurs find meaning and purpose for their life? Did the choice to start their own business influence their perceived meaning and purpose?**

Table 4 illustrates the themes or ways respondent entrepreneurs indicated that they found meaning and purpose. The most often cited theme was ‘accomplishment’ was expressed by such comments as, “. . . building something that had not previously been built,” “. . . getting pleasure from a job well done,” “. . . sense of accomplishment from doing the job well.” The second most often cited theme was the ability to ‘fill a client’s need.’ A great sense of pride comes when customers are well served, happy, and return for another transaction. Entrepreneurs generally had a clear sense of how customers should be treated. Perhaps the other themes can be summed

up in the frequent comment by respondents “do unto others as you would have them do unto you” as a principle guide for all business dealings.

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Table 4 about here

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### **Question 3: How do entrepreneurs view spirituality?**

In order to get a better understanding of how entrepreneurs viewed spirituality, questions were structured to create discussion about the importance and relevance of spirituality in their business. Some of the entrepreneurs felt that spirituality did not belong in business. Table 5 illustrates responses.

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Table 5 about here

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Approximately 28% of the entrepreneurs felt spirituality was not valid in the workplace. However, it is interesting to note, the majority of the entrepreneurs said that spirituality is valid in the workplace if religion is removed. Many of the entrepreneurs were concerned about promoting religion in the workplace. Those who did think of spirituality as equating to religious beliefs were strident in their opposition to any sort of promotion of religion in the workplace. They felt that certain values, integrity, and character were important, but that each person should be allowed their own religious views. When spirituality was separated from religion and discussed as values or as ‘having a higher purpose in life,’ then most of the entrepreneurs saw a definite connection. Several said that something more than the quest for money was needed to drive the business or it became drudgery.

Definitions of spirituality by the entrepreneurs interviewed were wide-ranging. Samples of respondent comments included: “A higher purpose in life,” “. . . be true to yourself and lead by example,” “. . . discern your path, develop it, and enjoy it,” “. . . find our essence in love and the choices we make,” “. . . we are not alone,” “. . . give back to your community,” “. . . let go of the outcome and live in intention and love,” “. . . natural beauty of trees, light, and mountains,” “. . . integrity and character.”

These comments collectively form the definition of spirituality reflected by these entrepreneurs. Some were reluctant to connect spirituality to their work because to them, spirituality implied religion. They felt that a separation of business and religion is needed for fear of making employees uncomfortable. When religion was factored out of the discussion of spirituality many of the entrepreneurs felt that spirituality does have a place in business, but they may not actually call it spirituality.

### **Question 4: How do entrepreneurs view success?**

This question seeks entrepreneurs’ motivations by looking at how they perceive success. Is money the main motivator? Table 6 illustrates responses.

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Table 6 about here

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As popularly expressed in the literature, money alone was not the determining factor of the entrepreneurs' view of success. Only about 17% of the respondents thought that either 'money' or for that matter 'other factors' alone defined their success; whereas over half felt that the combination of these two themes came close to expressing their view of success. A variety of answers were provided to define 'other factors,' including, ". . . doing good work and keeping employees employed," ". . . doing good work or having a good reputation," and ". . . serving customers and employees well." Other expressions of success included, ". . . serving a need that had not been met before," ". . . helping people," and ". . . putting money back into the community." The entrepreneurs also took very seriously the fact that employees were relying on the business for personal income. One entrepreneur spoke of ". . . happiness in sharing the profits in good years. . . how several employees had amassed substantial sums in their profit-sharing accounts."

Therefore, money is important, but it is not the only indicator of success; other aspects such as meeting a need in a way that had not yet been done, creating a reputation, serving others, having clients return, being able to work with persons of choice, developing employees, and forging new relationships were also important. The entrepreneurs in this study have found a sense of self-control and self-determination that is fulfilling. They have made a personal connection with their staff, their clients, as well as the community. This connection, along with the financial rewards, translates to success.

### **Summary and Conclusions**

The study of entrepreneurs has been undertaken from numerous perspectives, but not in the context of spirituality. This qualitative study of entrepreneurs consisted of personal interviews with 29 entrepreneurs discussing their: motivation to start the business, definition of success, definition of spirituality, and perception of meaning and purpose in life. One purpose of this study was to add the entrepreneurial perspective to the current literature in the field of spirituality in the workplace and to explore entrepreneurs' motivations with regard to how their businesses may bring meaning and purpose to their lives. The respondent group of entrepreneurs were frequently influenced by family role models. Some aspects of previous careers were instrumental in the decision to start a business. Most entrepreneurs expressed some dissatisfaction with previous positions or bosses. They felt the job could be equally well performed, or even better on their own. The role of socioeconomic factors did not seem to be as strong as previous careers or family factors. Usually, entrepreneurs saw an opportunity and took the risk, figuring out how to solve problems along the way. Money was popular as a motivator, but was by no means a singular force. Other reasons included service to people, better working environment, and flexibility. The aspects of creativity, passion, and challenge were not expressed as main reasons. However, the motivation to start a business includes significantly more than just the expectation of monetary reward.

Personal values were expressed in terms of desiring better working environment or realizing the need for more control and independence. The entrepreneurs felt strongly about creating an environment where the reward was equivalent to effort, where fairness was maintained in dealing with employees and customers, and where one could choose with whom to do business. The freedom to control these factors improved personal relationships with clients and staff and allowed the entrepreneurs to live and work more closely in tune with the principles and values they thought were important.

Meaning and purpose for the interviewed entrepreneurs were realized through accomplishment, filling a need, and through the aspects of love, appreciation, and respect. The entrepreneurs were proud of their accomplishments. They believed that clients should be well served. Being in business is more than just about the money, it is about forming relationships. The belief that constituents should be treated well may come from previous careers lacking in human caring and fairness. Divergent beliefs with previous employers frequently influenced how these entrepreneurs run their own companies. The aspects of love, appreciation, and respect are important for employees, customers and other stakeholders. It is integrating these aspects of work that provides the basis for entrepreneurs to bring their whole *Self* into their work.

Spirituality in business is a personal concept for this group of entrepreneurs. Spirituality is a connection to something larger than themselves or their communities. It is about integrity and character and a sense of possibility. It was not about religion, although some entrepreneurs mentioned examples from the Bible as providing guidance in dealing with clients and staff. There was a concerted effort to keep religion out of the workplace. When spirituality was separated from religious beliefs and put in the context of values or higher purpose, most of the entrepreneurs felt that there was a connection between spirituality and business.

### **Recommendations for Future Research**

This groundbreaking research provides the researchers with at least two areas to explore in the future: targeting the intangible motivating factors for starting a business; and focusing on the spiritual aspects of individual growth and development of entrepreneurs. In addition, a larger group of entrepreneurs could be used in the next project. The sample of this study is one of convenience and may be self-selecting. It is possible that these entrepreneurs were interested in this subject and agreed to be interviewed. It would be interesting to find a group of entrepreneurs, such as in an organization, and use statistical sampling methods in the methodology. Research targeting the intangible motivators of starting a business has not been undertaken as much as research targeting the effects of family, previous careers, and socioeconomic factors. An in-depth study targeting the themes of service to people, passion, challenge, creativity, independence, and autonomy as motivation for starting a business would broaden understanding of motivation. Research on this topic would be of value to educators who seek to understand why entrepreneurs start businesses and how to train the next generation of entrepreneurs.

The spiritual aspects of individual growth and development of entrepreneurs in the process of starting and growing a business is an interesting idea. A research study could look at entrepreneurs from the standpoint of personal growth. Personal growth could include growth in the areas of emotional intelligence, individuation, or spiritual growth. This work would again further the study of entrepreneurs as well as the literature on spirituality in business and leadership in business.

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**Table 1: Age of Entrepreneurs**

| Age          | Frequency | Percent       |
|--------------|-----------|---------------|
| 25-34        | 1         | 3.4%          |
| 35-44        | 4         | 13.8%         |
| 45-54        | 13        | 44.8%         |
| Over 55      | 6         | 20.7%         |
| No Age Given | 5         | 17.3%         |
| <b>Total</b> | <b>29</b> | <b>100.0%</b> |

**Table 2: Motivational Themes**

| Theme                   | Number of Entrepreneurs Citing Theme in their Responses | Percentage of Total Responses |
|-------------------------|---|-------------------------------|
| Serve People            | 6   | 18.20%                        |
| Better Work Environment | 6   | 18.20%                        |
| Money                   | 6   | 18.20%                        |
| Flexibility             | 5   | 15.20%                        |
| Challenge               | 2   | 6%                            |
| Creativity              | 2   | 6%                            |
| Independence & Autonomy | 2   | 6%                            |
| Fear                    | 2   | 6%                            |
| Passion                 | 1   | 3%                            |
| Necessity               | 1   | 3%                            |
| Totals                  | 33  | 99.8%*                        |

**Source: Interview data** \*Total percentage does not total 100 due to rounding.

**Table 3: Thematic View of Motivational Factors**

|                 |              |         |           |            |                         |                         |             |           |       |      |                 |
|-----------------|--------------|---------|-----------|------------|-------------------------|-------------------------|-------------|-----------|-------|------|-----------------|
| More Altruistic | Serve People | Passion | Challenge | Creativity | Independence & Autonomy | Better Work Environment | Flexibility | Necessity | Money | Fear | Less Altruistic |
|                 | 6            | 1       | 2         | 2          | 2                       | 6                       | 5           | 1         | 6     | 2    |                 |

**Source: Interview data**

**Table 4: Thematic View of Meaning and Purpose in Business**

| Theme          | Number of Responses | Percentage |
|----------------|---------------------|------------|
| Accomplishment | 4                   | 23.5%      |

|              |    |       |
|--------------|----|-------|
| Fill a Need  | 3  | 17.6% |
| Love         | 3  | 17.6% |
| Appreciation | 2  | 11.8% |
| Respect      | 2  | 11.8% |
| Generosity   | 1  | 5.9%  |
| Authenticity | 1  | 5.9%  |
| Spirituality | 1  | 5.9%  |
| Totals       | 17 | 100%  |

**Source: Interview data**

**Table 5: Spirituality in the Work Place**

|                  | <b>Frequency</b> | <b>Percent</b> |
|------------------|------------------|----------------|
| <b>No</b>        | 8                | 27.6%          |
| <b>Yes</b>       | 18               | 62.1%          |
| <b>No Answer</b> | 3                | 10.3%          |
| <b>Total</b>     | 29               | 100%           |

**Source: Interview data**

**Table 6: Entrepreneurs' View of Success**

|                                  | <b>Frequency</b> | <b>Percent</b> |
|----------------------------------|------------------|----------------|
| <b>Money Alone</b>               | 5                | 17.2%          |
| <b>Money &amp; Other Factors</b> | 15               | 51.8%          |
| <b>Other Factors Alone</b>       | 5                | 17.2%          |
| <b>No answer</b>                 | 4                | 13.8%          |
| <b>Total</b>                     | 29               | 100%           |

**Source: Interview data**

## CONTINUOUS IMPROVEMENT IN SMALL BEER DISTRIBUTION BUSINESSES.

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### **EXTENDED ABSTRACT**

Convulsive change in the beer industry over the past two decades has created an increasingly complex operating environment for its distributors. From a supply chain perspective, the three tier distribution system in the beer industry (Brewer → Distributor → Retailer) is structured to focus the distribution link on marketing and delivering beer to licensed retailers for sale to consumers. As the major brewers have expanded their product offerings in an effort to increase sales, they have also been consolidating their operations and distribution network with the goal of improved productivity. Consolidation initiated by the brewers has reduced the number of beer distributors by nearly fifty percent in the past twenty years. While the number of beer distributors has decreased, their retail customer base has expanded dramatically in both total number of outlets as well as type, with the introduction of new store formats such as convenience stores, mass merchandisers and gas/oil retailers.

This research examined the multitude of issues facing small beer distributors operating as the critical link between two powerful supply chain partners, each with demands and expectations that often conflict with the beer distributor's own goals. Beginning with an electronic survey to validate the highest priority issues, the research drilled down into a key operational concern that appeared to be widespread. With the expanded product offerings from the brewers, today's beer distributor is challenged to effectively sell a product portfolio nearly ten times greater than twenty years ago to a larger and more powerful retail customer base. Most beer distributors attempt to employ some comprehensive retail sales and marketing process designed to increase the sales and profitability of their product portfolio. The process generally includes a pay for performance program for the sales force that targets retail account objectives, such as new product placements or selling the retailer on a sales promotion program. Considering that each sales rep calls on an average of ten retailers each day, it is not inconceivable that the rep may have dozens of pay for performance objectives to achieve every single day.

Research results from beer distributors across the country indicated that the logistics of managing their pay for performance program can be overwhelming. Additionally, in many beer distributors there does not appear to be any evaluation and control process for measuring the effectiveness of their program. For example, when distributors focus pay for performance objectives on new product distribution and volume increases, they rarely evaluate the profitability impact of accomplishing those objectives. If the distributor does not establish and reward complementary objectives focused on product rationalization and profitability, the result often translates to higher costs in the form of finished product loss and missed sales due to out of stocks. This research revealed examples of finished product losses costing distributors up to \$700,000 a year, depending on size and type of program implemented.

# Perceived barriers to entry: Is there any difference between Small, Medium-Sized and Large companies?

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## Abstract

The objective of this paper is to provide some empirical evidence about the importance of barriers to entry. In particular, the perceptions of firms are considered. Three questions are raised: Which entry-barriers are important in the perception of firms in the Dutch economy? Do these perceptions differ between sectors? Do these perceptions differ between small and large firms? It is shown that the procurement of a viable sales volume, access to capital and financial risk, are considered to be the major barriers. The ranking of the importance of specific barriers to entry coheres among the sectors under study. The most remarkable result is that the figures indicate that micro firms perceive lower barriers to entry than medium-sized and large firms.

## 1. Introduction<sup>i</sup>

Entry of new competitors into the market is generally approved from an economic point of view. It is expected to create employment and to foster the dynamics in an industry. New competitors play an equilibrating function, as firms will enter the market if profits are above the long-run competitive level. As a result of entry, profits would decrease to the long-run equilibrium level. Entrants are also considered as important agents of change, as new firms may introduce new products or production processes. The upshot is that entry contributes to allocative as well as dynamic efficiency in the market (Audretsch and Thurik, 2001). However, several mechanisms can prevent firms from entering the market and, consequently, hamper the process of allocative and dynamic efficiency. In line with this perspective it is easily understood that barriers to entry constitute an important issue in competition policy.

In a previous EIM report the results of a comprehensive literature study on entry-barriers have been published (Blees *et al.*, 2003): the theoretical background and the operating mechanisms are discussed. The report describes in total 37 structural and strategic barriers to entry and discusses the expected specific effects on small businesses. The literature study concludes that SMEs suffer more from barriers to entry than large companies (often existing companies active in another product or geographical market). For example, it is argued that barriers related to advertising, brand name, capital requirements, cost of operating abroad, high wages, R&D and selling expenses are less relevant for large firms. Large companies are expected to be able to solve these problems more easily as they have better access to distribution channels, financial capital, and they have more organizational and technological experience (see also Golodner, 2001; Fotopoulos and Spence, 1998; Acs and Audretsch, 1989). Remarkably, most literature addresses the consequences of barriers to entry for large firms while most entrants are SMEs.

The present paper is the result of a follow-up study and aims at addressing empirically the question whether small firms in the Dutch economy face more and different barriers to entry than large companies? Several authors stress the need for empirical evidence on extant barriers to entry (Scherer, 1989; Geroski *et al.*, 1990; Bunch and Smiley, 1992; Karakaya, 2002). The literature study (Blees *et al.*, 2003) interprets the mechanisms of each barrier and discusses whether the barrier constitutes a specific hurdle for SMEs. From a theoretical perspective it is concluded that several barriers affect the smaller firms differently. However, this does not necessarily mean that the problem is widespread, nor does it measure to what extent the problem is perceived by small firms. The present study wants to shed some light on the latter issue and, in particular, verify whether the perceptions differ between small and large businesses. It is expected that small companies will emphasise the importance of barriers to entry that constitute a problem especially for SMEs. The relevance of this approach is discussed by Singh *et al.* (1998: 230). They observe that many theoretical models exist but that empirical evidence in support of these models is rather weak. Subsequently, they raise the question: 'how important empirically are the types of strategic behaviour, which have been modelled [theoretically] so copiously?'.

From a policy perspective this is a relevant issue as entrepreneurship and new ventures are encouraged to reduce unemployment and to increase the dynamics in the economy. The existence of entry-barriers is a potential threat for the effectiveness of these policies. In the Netherlands several policy changes are debated and some have been implemented to reduce the barriers to entry start-ups were facing as a result of existing rules and regulations (licences, diploma's).

This leads to the following research questions:

1. Which entry-barriers are important in the perception of firms in the Dutch economy?
2. Do these perceptions differ between sectors?
3. Do these perceptions differ between small and large firms?

The next Section starts with a concise overview of the literature on entry-barriers. The concept is defined and the method to measure the importance of entry-barriers is discussed. Subsequently the sample and the questionnaire are presented. In total 1170

Dutch firms have been interviewed. Section 4 discusses the empirical findings. Finally conclusions and recommendations for further research are made.

## 2. Literature review

A large body of literature discusses the importance of entry-barriers. Two different traditions can be distinguished: industrial organization (e.g. Bain, 1956; Stigler, 1968; Von Weizsacker, 1980) and strategic management (e.g. Porter 1980, 1985; Singh *et al.*, 1998, Robinson *et al.*, 2001). The first tradition focuses on the industry as the unit of analysis, strives for efficiency and identifies harmful barriers for economic development. Various models are developed to show how entry-barriers affect the behaviour of firms and the performance of the industry. One of the main issues concerns the question whether government policy is needed to neutralise the effects of the barriers. The second tradition takes the firm as the unit of analysis and assesses entry-barriers as a resource to create competitive advantage for individual firms. In line with this approach superior strategies should create sustainable competitive advantage. In other words, a firm should make use of entry-barriers that deter new competitors in the firm's market.

The contradictory assessment of the value of barriers to entry is related to the unit of analysis and the role competition is expected to play in the two traditions. At the firm level it is indeed important to develop resources that are difficult to copy by competitors (Rangone, 1999; Barney, 1991). A reduction of competitive forces is generally in the interest of incumbent firms. However, from a welfare economic point of view, this should not lead to social costs, as a reduction of competitive forces may hamper the allocative and dynamic efficiency of the industry. The latter argument is put forward by Von Weizsacker (1980) to justify public policies. This study does not focus on the role of competition and the assessment of social costs. The objective of this research is to identify important entry-barriers perceived by firms (Yip, 1982; Karakaya and Stahl, 1989; Singh *et al.*, 1998; Smiley, 1988). It aims at recognising the major constraints that hamper firms in making their entry decision. The unit of analysis is the firm.

In line with the two traditions, two types of barriers can be distinguished: structural and strategic barriers to entry. The structural barriers stem from market structure characteristics and are widely discussed in the tradition of industrial organisation. Bain (1956) introduced the concept of 'barriers to new competition'. The concept is based on the assumption that competition is key in the operation of industries and that any artificial barrier to competition may reduce the efficient allocation of resources in the industry. Bain stressed the importance of structural characteristics that hamper market entry of potential competitors: economies of scale, technological advantages, absolute cost advantages, etc<sup>ii</sup>. The conclusion of this research is that entry-deterrent mechanisms limit the intensity of competition and may enable incumbent firms to raise prices and to realise supernormal profits. The Chicago School (Stigler, 1968) contributed to the debate on barriers to entry by stressing the importance of costs asymmetry between incumbents and potential entrants: The research should not focus on supernormal profits but on the question whether the conditions of entry for the incumbents were less difficult than for the new entrants. The importance of this argument becomes clear when the advantages of economies of scale are interpreted.

According to the Chicago School, scale economies do not represent a barrier to entry if they imply penalties for companies operating at sub-optimal levels of production. A third approach that stems from this tradition focuses on the welfare effects and defines barriers to entry as a difference in cost structures which provokes a distortion in the use of economic resources from a social point of view (Von Weiszacker, cited in Geroski *et al.*, 1990: 10). Each approach has its specific difficulties. These are beyond the scope of this paper and will not be discussed. However, what is important is to understand that the different approaches lead to different definitions of entry-barriers. We conclude that Bain's perspective provides the broadest scope, while the other two approaches consider additional requirements in order to identify the 'real' barriers that hamper the efficient allocation of resources in the economy.

The strategic management tradition stresses the importance of strategic barriers. Barriers to entry do not only result from structural characteristics of the market but they are created as a result of strategies of individual firms that reduce the threat of new entrants. Following Barney (1991), firms are advised to 'obtain sustained competitive advantages by implementing strategies that exploit their internal strengths, through responding to environmental opportunities, while neutralizing external threats and avoiding internal weaknesses'. Porter (1980: 9-13) does not define the concept but specifies seven major sources of barriers to entry: Economies of Scale, Product Differentiation, Capital Requirements, Switching Costs, Access to Distribution Channels, Cost Disadvantages Independent of Scale and Government Policy. Implicitly he uses a broad definition for barriers to entry in order to encompass the barriers that result from strategic behaviour. He provides a kind of typology of barriers to entry that firms should take into account when their competitive strategy is developed. Porter's specification also shows that structural and strategic barriers are related. The barrier may be rooted in the market structure, but this will not discourage firms to react to this characteristic strategically. The upshot is that most structural barriers have a strategic component too. For example, advertising can be considered as a structural phenomenon in the automobile industry, however, each actor develops its own advertising strategy (brand) that may affect new competitors.

Fotopoulos and Spence (1998) have shown that barriers to entry are not independent from size: 'Some limited evidence is offered that small firms are different in that they manage to overcome entry barriers, perhaps adopting different survival strategies, and that large firms are well aware of market conditions and are in an advantageous position to overcome many of the problems. Size classes in the middle of the distribution offer rather mixed results due to size-related advantages and disadvantages' (*ibid.*, p. 141-142). Consequently, some barriers to entry pose a higher obstacle for SMEs entering a new market than they do for larger firms. In their literature study on barriers to entry, Blees *et al.* (2003) concluded that small firms are more vulnerable than large firms: about half of the barriers constitute a specific hurdle for SMEs. Large entrants are expected to take advantage of business activities in other industries and their large experience with organisational and technological issues; their well-established relationships with suppliers, customers, and distribution networks; and their easier access to financial capital or cash flow. Moreover, it is usually easier for larger companies to profit from *economies of scale and scope* and to counter the incumbents' *advertising and selling expenses*.

The report also observes that some barriers to entry may apply specifically to large firms. *(Dynamic) Limit-pricing, excess capacity* and *(anticipated) retaliation by incumbents* are expected to pose a relatively high barrier to larger entrants. Small entrants are usually unable to influence total supply and to induce a serious market price reduction. Incumbents will not react to such entrants and may even not observe them. Large entrants do influence total supply and will expect reactions of incumbents. Thus, large firms can anticipate a higher barrier in this respect than smaller entrants.

### **3. Definition of concepts and data collection**

In line with the broad perspective of this research we used the following definition of barriers to entry: “*all advantages of established sellers in an industry over potential entrant sellers, as perceived by firms which seek to enter a new market*”. The focus is on the perception of firms and on entry to a new market. We prefer the concept ‘market’ to ‘industry’. According to Ferguson (1992: 32) markets group together firms producing close substitutes from the buyers point of view, while an industry groups together close substitutes from the suppliers point of view. These are usually broader groupings than markets. The advantage of the market concept is that it has a clearer meaning for the interviewed firm. Small firms operating in a specific niche do not always have an idea about the potential new competitors for the industry but they have a good overview of potential new competitors in the market in which they are active.

The distinction between small and large is of special interest for this study. Defining the size of the firm is not straightforward. Several criteria may serve as a yardstick. Most authors conclude that a mix of criteria would result in the best classification, e.g. employment, type of ownership, invested capital (Storey, 1994). The problem is that a sophisticated classification is difficult to apply in practice as proper information about the used criteria is not easily available. Therefore, most authors use one simple criterion: the number of full-time employees. In the report we applied the following classification: micro enterprises < 10 employees (MI), small enterprises 10-<50 (SM), medium and large enterprises 50+ employees (ME).

A large number of structural and strategic barriers to entry were presented in the questionnaire (see annex 1). However, not all the barriers identified in the literature study (Blees, *et al.*, 2003) were addressed. Most important were time limitations. On the basis of previous experiences we decided that the total interview by telephone should not take more than 15 minutes. Some issues were difficult to describe in an unambiguous question (e.g. causal ambiguity). Other barriers to entry were covered by the answers on similar barriers (brand name and customer loyalty are part of advertising, experience advantages are related to cost advantages, government policies are related to government licences, know how is related to level of technology and patents).

Some aspects were covered by two separate questions in order to be able to make a distinction between the importance of structural characteristics and behavioural characteristics. For example, with regard to advertising we presented two statements:

1. Firms in the market have high expenditures for advertising and promotion

(structural), 2. The products are heavily supported by advertisement and promotion in order to make entry to the market less attractive for new competitors (strategic). We claim that the listed barriers to entry in Annex 1 give an overview of the most important barriers discussed in the extant literature. Some of these barriers are branded as they are expected to raise a specific hurdle for SMEs.

Incumbent companies were asked to indicate on a five point Likert scale to what extent new competitors would encounter the barrier in question<sup>iii</sup>. Ideally the survey should have addressed new and potential competitors<sup>iv</sup>. However, potential newcomers are difficult to identify and, therefore, we decided to interview incumbents. As we are interested in barriers (potential) entrants may face and not the behaviour of the specific incumbents per se, the questions were directed at practices in the industry rather than the firm's specific behaviour. In general, the incumbents were asked to indicate how important a specific barrier is if a comparable company (same size) wants to enter the major product market in which the incumbent is operational. As barriers to entry are related to product markets and most firms manage multi-product operations, we explicitly referred to the most important product market. The advantage of this format for the question is that all companies have experience with the market and, therefore, are able to value the importance of the specific barrier.

As the concepts involved are sometimes difficult to circumscribe in unambiguous questions a pilot study has been carried out in November 2004, in which 40 students participated. The students tested the survey and were asked to write about 100 case studies of the companies they interviewed. The case studies have allowed us to grasp the functioning of the perceived barriers to entry in the different industries under study and, therefore, have facilitated the interpretation of the results of the questionnaire. Moreover, some questions were refined to avoid ambiguous interpretations. The final questionnaire was pre-tested by telephone with potential respondents.

The sample consists of 1,170 Dutch firms in six industries, i.e. furniture, employment agencies, chemical industry, ICT, food (production of bread) and retail (clothing and shoes). The aim was to collect data for approximately 175-200 firms per sector divided over three size categories (< 10 employees, 10 to < 50 employees, and 50+ employees). Per size category, the firms were selected at random from the Direct Marketing CD-database of MarketSelect<sup>v</sup>. Especially in the size category of 50+ employees, in some sectors, all existing firms were contacted because of the limited number of firms with over 50 employees.

In total 3,562 firms were contacted for the telephone survey. This resulted in 1,074 completed responses: a response rate of 30%. Of the contacted firms, 33% refused to cooperate. Another 24% of the contacted firms could not be reached because of an answering machine, get no answer, number engaged or more than 6 attempts with no response. Finally, with 13% of the contacted firms an appointment was made but it did not result in a completed questionnaire because the targeted sample was reached. The other 96 respondents were interviewed by our students in the pilot phase<sup>vi</sup>.

The MarketSelect database was used to test for non-response bias. Smaller firms were more willing to participate in the research than large firms. This holds for the total sample as well as for the sectors furniture, employment agencies, chemical industry

and ICT. No significant differences related to size were found for the food industry and retail. In the food industry, firms were less willing to participate in the research compared to the other sectors, probably because of the Christmas rush.

#### 4. Results

In Table 1 the number of observations per industry and per size class are presented. Most observations are in the class of < 10 employees, or micro firms. In retail, we only have five observations of firms with 50 employees or more. As the sample was drawn from a database including subsidiaries and branches of larger firms, and responses were provided by local managers, the questions concern employment figures of the selected subsidiary. About 40% of the interviewed establishments are related to a larger company.

Table 1 about here

In Table 2 the perceived barriers are presented. Overall, securing input, collusion, knowledge, retaliation and strategic knowledge protection are the least important barriers. According to the interviewed firms most barriers concern unimportant constraints (value lower than 3)<sup>vii</sup>. This can be interpreted as a good sign for the Dutch economy as competitive forces seem to be operational. Remarkably, some of the interviewed managers/owners raised the question why we were bothering about these issues, as solving these problems was considered to be their key competency. However, it is noted that only incumbents were interviewed, which may lead to a certain bias as these firms have surmounted existing barriers. Knowing how to solve a problem makes the problem trivial. To counter this argument it may be stated that only incumbents should be interviewed, as only the opinion of viable firms has to be taken into account.

In general the ranking of the importance of specific barriers to entry coheres between the sectors: securing input and collusion are of minor importance for all but two sectors (respectively retail and employment agencies), while sales volume and capital are most important for all sectors. However, for all barriers some significant sectoral differences are observed at the 5% level, except for sales volume, which is significant at the 10% level. For instance, securing input is relatively important in retail and knowledge is relatively important in the chemical industry. In the last column of table 2 the significant differences are presented.

The most important barrier is the procurement of a viable sales volume. The average value attached to this barrier is significantly higher than the average value for other barriers. It may be argued that this high value results from the cumulative effect of all kinds of other (strategic) barriers (collusion, retaliation, limit pricing, switching costs). However, the values given to these specific entry barriers were significantly lower than the importance given to sales volume. This indicates that the problem is more related to the operation of normal competitive processes and, subsequently, that the requirements for successful entry (and survival) are not easy to meet. Moreover, the procurement of a viable sales volume is also related to survival once entered, which is strongly influenced by the unknown reaction of incumbents.

Other important barriers are cost disadvantages, strategic behaviour related to differentiation and financial risk. Two sectors, employment agencies and ICT, have relatively low scores, whereas the food industry shows the highest scores on these barriers. Overall, the firms value only a few barriers as important constraints. Finance and sales volume are key issues in all sectors. The ICT and furniture industry are sectors with relatively low barriers, the chemical, retail and food industry show relatively high values for the barriers under consideration.

Table 2 about here

The importance of the majority of barriers does not differ significantly between firms of different size. However, for collusion, knowledge, retaliation, switching costs, strategic behaviour related to R&D, government policy, excess capacity, economies of scale, and strategic behaviour related to differentiation, some significant differences are observed between firms of different size (5% level).

The excess capacity barrier is more important in the perception of medium-sized firms than for micro and small firms. In a market with excess capacity, it will be more difficult for a relatively large firm to enter because it brings considerable extra capacity to the market. This finding confirms the difference that is made in theory between small-scale and large-scale entry. The barrier related to collusion is somewhat higher for micro firms. However, we note that even the average value of micro firms for the importance of this barrier is low. All other barriers, with significant differences between firm size classes, indicate that micro firms give lower values than medium and large firms. Also the value given to the most important barrier (sales volume) is lower than the value given by medium and large firms. The upshot is that, on average, micro firms perceive lower barriers to entry than medium-sized and large firms.

Table 3 about here

## 5. Conclusions

The question raised by Singh *et al.* (1998) regarding the need for empirical evidence about the importance of entry barriers is highly relevant. Some issues seem to be purely based on theory, however, other barriers play a role in the real business world and need proper attention of policy makers.

The most important barriers are rooted in characteristics of the market structure: sales volume, capital, financial risks, cost disadvantages, costs of capital, economies of scale. Only one of the major barriers stems from strategic behaviour: behaviour with regard to differentiation.

Some differences between sectors are observed. However, in general, the ranking of the importance of specific barriers to entry coheres. This indicates that the differences between firms are not primarily explained by differences between sectors.

Interestingly, our results reject most expectations formulated in the literature study (Blees *et al.*, 2003). The results of the survey show that the importance of barriers to entry like access to distribution channels, advertising, capital requirements and R&D is not significantly higher valued by smaller companies. Two barriers (economies of scale and product differentiation) were expected to be a specific hurdle for small firms but our results indicate that in particular larger firms perceive these problems. A possible explanation for this result is that small firms are 'less punished' if they produce on a small scale, or specialize at specific market niches. Larger entrants may have to produce the whole range of products/services to serve the market properly.

What does this mean for policy? Financial issues seem to be key and, therefore, policy should address in particular the functioning of the financial market. No indication is found that specific policies are needed for SMEs. On the contrary, more attention should be given to larger entrants as they will have a more dramatic impact on the competitive processes in the market.

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Annex 1: Barriers to entry derived from the literature survey

| <i>Barrier to entry</i>                                     | <i>Source</i>   | <i>Constitutes a barrier mainly for SMEs</i> | <i>Constitutes a barrier mainly for LEs</i> | <i>Constitutes a barrier mainly for both</i> |
|---|---|--|---|--|
| Cost disadvantages (absolute cost advantages of incumbents) | Bain 1956; Scherer 1970; Yip 1982; Karakaya & Stahl 1989; Geroski et al. 1990; Han et al. 2001                    |  |   | *  |
| Access to distribution channels (distribution)              | Porter 1980; Karakaya & Stahl 1989; Yip 1982; Han et al. 2001   | *  |   |  |
| Strategic behaviour distribution channels                   | Singh et al. 1998   | *  | *?  |  |
| Advertising   | Karakaya & Stahl 1989; Yip 1982; Netter 1983; Harrigan 1981; Schmalensee 1983; Spence 1980                        | *  |   |  |
| Strategic behaviour advertising                             | Bunch & Smiley 1992; Singh et al. 1998  |  | *?  |  |
| Capital requirement   | Bain 1956; Karakaya & Stahl 1989; Yip 1982 Porter 1980; Harrigan 1981, 1983; Shepherd 1997                        | *  |   |  |
| Cost of capital / special risks and uncertainties           | Shepherd 1997; Demsetz 1982   | *?   |   |  |
| Securing input / control over strategic resources           | Karakaya & Stahl 1989; Singh et al. 1998; Yip 1982; Scherer 1970; Shepherd 1997; Cabral 2000                      |  |   | *  |
| Customer switching costs                                    | Karakaya & Stahl 1989; Porter 1980; Klemperer 1987, 1992; Shepherd 1997; Shy 2002                                 |  |   |  |
| Collusion   | Singh et al. 1998   |  |   | *  |
| Sales volume  | Yip 1982  |  |   | *?   |
| Economies of scale  | Bain 1956; Dixit, 1980; Geroski et al. 1990; Yip 1982; Harrigan 1981; Scherer 1980; Spence 1980; Schmalensee 1981 | *  |   |  |
| Government policy   | Karakaya & Stahl 1989; Porter 1980; Dixit & Kyle 1985; Shepherd 1997  |  |   | *  |
| Access to knowledge / patents                               | Karakaya & Stahl 1989; Yip 1982; Harrigan 1983; Shepherd 1997   |  |   | *  |
| Differentiation   | Bain 1956; Karakaya & Stahl 1989; Porter 1980; Schmalensee 1982; Shepherd 1997; Martin 2002                       | *  |   |  |
| Financial risk / sunk costs                                 | Baumol et al. 1982; Shepherd 1997; Bain 1956; Porter 1980; Geroski et al. 1990; Sutton 1991                       |  |   | *  |
| Excess capacity   | Bunch & Smiley 1992; Singh et al. 1998; Spence 1977; Harrigan 1983; Shepherd 1997; Dixit 1980; Lieberman 1987     |  | *   |  |
| Strategic behaviour   | Bunch & Smiley 1992; Cabral   | *  |   |  |

|  |  |    |   |   |
|--|--|----|---|---|
| differentiation / packing the product space        | 2000; Schmalensee 1978; Shepherd 1997  |    |   |   |
| Strategic behaviour R&D                            | Bunch & Smiley 1992; Singh et al. 1998; Yip 1982; Deams & Douma 1985; Harrigan 1981                                  | *? |   |   |
| Retaliation  | Karakaya & Stahl 1989; Bunch & Smiley 1992; Yip 1982; Shepherd 1997; Gatignon et al. 1997; Thomas 1999; Scherer 1980 |    | * |   |
| Limit pricing                                      | Bain 1951, 1956; Milgrom & Roberts 1982; Geroski et al, 1990; Bunch & Smiley 1992; Singh et al. 1998                 |    | * |   |
| Masking profit / gaps and asymmetric information   | Bunch & Smiley 1992; Milgrom & Roberts 1982; Geroski et al. 1990   |    |   | * |
| Strategic behaviour knowledge / preemptive patents | Bunch & Smiley 1992; Singh et al. 1998   | *? |   |   |

Table 1 Industry and size (full-time employees)

|                     | <i>Furniture</i> | <i>employment agencies</i> | <i>chemical industry</i> | <i>ICT</i> | <i>food</i> | <i>retail</i> | <i>total</i> |
|---------------------|------------------|----------------------------|--------------------------|------------|-------------|---------------|--------------|
| < 10 employees      | 109              | 128                        | 79                       | 95         | 82          | 170           | 663          |
| 10 - < 50 employees | 73               | 41                         | 57                       | 77         | 37          | 18            | 303          |
| 50+ employees       | 27               | 35                         | 38                       | 43         | 38          | 5             | 186          |
| unknown             | 3                | 1                          | 6                        | 1          | 3           | 4             | 18           |
| Total               | 209              | 204                        | 174                      | 215        | 157         | 193           | 1152         |

Source: EIM

Table 2 Perceived barriers to entry (differences per sector)<sup>a</sup>

| <i>barrier</i>                 | <i>furniture (f)</i> | <i>employment agency (e)</i> | <i>chemicals (c)</i> | <i>ict (i)</i> | <i>food (b)</i> | <i>retail (r)</i> | <i>total</i> | <i>Sign. differences</i>        |
|--------------------------------|----------------------|------------------------------|----------------------|----------------|-----------------|-------------------|--------------|---------------------------------|
| Securing input                 | 1.54                 | 1.13                         | 1.92                 | 1.36           | 1.77            | 2.81              | 1.74         | f,b>e; f,e,i<c,r;<br>c,b<r; i<b |
| Collusion                      | 1.45                 | 2.37                         | 1.50                 | 1.62           | 1.82            | 1.89              | 1.78         | f<e,b,r;<br>e>f,c,i,b,r; c<r    |
| Knowledge                      | 1.75                 | 1.46                         | 2.70                 | 2.03           | 1.94            | 1.71              | 1.92         | f,e,I,b,r<c; e<i,b              |
| Retaliation                    | 1.71                 | 2.17                         | 2.24                 | 1.84           | 2.35            | 2.07              | 2.04         | f<e,c,b; c,b>i                  |
| Behaviour knowledge            | 2.03                 | 1.94                         | 2.70                 | 1.99           | 2.16            | 2.06              | 2.13         | f,e,I,b,r < c                   |
| Limit pricing                  | 2.15                 | 2.53                         | 2.27                 | 2.05           | 2.51            | 2.02              | 2.25         | e,b>i,r                         |
| Switching costs                | 2.00                 | 2.04                         | 2.57                 | 2.93           | 2.13            | 1.91              | 2.27         | f,e,b,r<c,i;                    |
| Masking profit                 | 1.97                 | 2.44                         | 2.28                 | 2.21           | 2.47            | 2.37              | 2.28         | f<e,b,r                         |
| Behaviour R&D                  | 2.05                 | 1.90                         | 3.06                 | 2.65           | 2.31            | 2.01              | 2.32         | f,e,r<c,i; e<b;<br>c>I,b        |
| Behaviour advertising          | 2.21                 | 2.52                         | 2.27                 | 2.17           | 2.46            | 2.77              | 2.39         | f,c,I<r;<br>e>I                 |
| Behaviour distribution channel | 1.88                 | 3.00                         | 2.58                 | 2.34           | 2.52            | 2.25              | 2.42         | f<e,c,i,b;<br>e>f,c,i,b,r       |
| Government policy              | 2.42                 | 2.47                         | 3.35                 | 1.69           | 3.53            | 2.06              | 2.53         | f,e<c,b; f,e,c,b>i;<br>e,c,b>r; |
| Distribution                   | 2.60                 | 2.89                         | 2.99                 | 2.60           | 3.06            | 2.55              | 2.76         | f,i,r<b; c>r                    |
| Advertising                    | 2.72                 | 2.90                         | 2.68                 | 2.53           | 2.77            | 3.24              | 2.80         | f,c,I,b<r; e>I                  |
| Excess capacity                | 2.79                 | 2.95                         | 2.84                 | 2.71           | 3.25            | 2.75              | 2.87         | f,i,r<b                         |
| Differentiation                | 2.76                 | 2.65                         | 3.17                 | 3.22           | 3.21            | 3.25              | 3.03         | f,e<c,I,b,r                     |
| Economies of scale             | 3.35                 | 2.96                         | 3.27                 | 2.89           | 3.58            | 2.93              | 3.15         | f>e,i,r; e,i,r<b;<br>c>I        |
| Costs of capital               | 3.18                 | 3.21                         | 3.04                 | 2.83           | 3.66            | 3.56              | 3.23         | f,c,I<b,r; e<b                  |
| Cost disadvantage              | 3.23                 | 2.93                         | 3.31                 | 2.96           | 3.74            | 3.44              | 3.24         | f,e,c,i<b;<br>e<c,r; i<r        |
| Behaviour differentiation      | 3.24                 | 3.11                         | 3.40                 | 3.22           | 3.63            | 3.44              | 3.32         | e,i<b                           |
| Financial risk                 | 3.40                 | 3.38                         | 3.53                 | 3.10           | 3.84            | 3.88              | 3.50         | f,e,I<b,r; c<r; c>I             |
| Capital                        | 3.55                 | 3.29                         | 3.59                 | 3.03           | 3.99            | 3.89              | 3.53         | f,c,b,r>I;<br>f,e,c,<b; e<r     |
| Sales volume                   | 3.80                 | 3.72                         | 3.90                 | 3.79           | 4.03            | 3.83              | 3.84         | e<b (p<.10)                     |
| Mean score all barriers        | 2.31                 | 2.52                         | 2.64                 | 2.43           | 2.68            | 2.64              | 2.52         | f<e,c,b,r<br>I<c,b,r            |

<sup>a</sup> significant at  $p<.05$  unless otherwise indicated. The reply options were: 1 = not at all, 2 = nearly not, 3 = somewhat, 4 = to a large extent, 5 = to a very large extent

Source: EIM

Table 3 Perceived barriers to entry, (differences per size class)<sup>a</sup>

| Barrier to entry                    | 10 - < 50              |                   |                        | total | sign differences    |
|-------------------------------------|------------------------|-------------------|------------------------|-------|---------------------|
|                                     | < 10 employees<br>(MI) | employees<br>(SM) | 50 + employees<br>(ME) |       |                     |
| Securing input                      | 1.79                   | 1.66              | 1.65                   | 1.73  | NS                  |
| Collusion                           | 1.91                   | 1.66              | 1.53                   | 1.78  | MI>SM, ME           |
| Knowledge                           | 1.80                   | 2.03              | 2.14                   | 1.92  | MI<SM, ME           |
| Retaliation                         | 1.97                   | 2.07              | 2.28                   | 2.04  | MI<ME               |
| Behaviour<br>knowledge              | 2.12                   | 2.17              | 2.10                   | 2.13  | NS                  |
| Limit pricing                       | 2.22                   | 2.24              | 2.39                   | 2.25  | NS                  |
| Switching costs                     | 2.07                   | 2.60              | 2.47                   | 2.27  | MI<SM, ME           |
| Masking profit                      | 2.29                   | 2.29              | 2.26                   | 2.28  | NS                  |
| Behaviour R&D                       | 2.08                   | 2.65              | 2.62                   | 2.32  | MI<SM, ME           |
| Behaviour<br>advertising            | 2.45                   | 2.35              | 2.25                   | 2.39  | NS                  |
| Behaviour distri-<br>bution channel | 2.34                   | 2.54              | 2.53                   | 2.42  | P<.10               |
| Government<br>policy                | 2.39                   | 2.63              | 2.80                   | 2.52  | MI<SM, ME           |
| Distribution                        | 2.75                   | 2.78              | 2.82                   | 2.77  | NS                  |
| Advertising                         | 2.85                   | 2.69              | 2.75                   | 2.80  | NS                  |
| Excess capacity                     | 2.74                   | 2.86              | 3.33                   | 2.87  | MI, SM< ME          |
| Differentiation                     | 2.99                   | 3.03              | 3.19                   | 3.03  | NS                  |
| Economies of<br>scale               | 3.04                   | 3.23              | 3.41                   | 3.15  | MI<SM, ME           |
| Costs of capital                    | 3.30                   | 3.17              | 3.12                   | 3.24  | NS                  |
| Cost<br>disadvantage                | 3.24                   | 3.24              | 3.28                   | 3.25  | NS                  |
| Behaviour<br>differentiation        | 3.25                   | 3.32              | 3.60                   | 3.33  | MI<ME               |
| Financial risk                      | 3.45                   | 3.50              | 3.66                   | 3.50  | NS                  |
| Capital                             | 3.52                   | 3.50              | 3.59                   | 3.53  | NS                  |
| Sales volume                        | 3.81                   | 3.83              | 3.99                   | 3.84  | MI < ME<br>(P< .10) |
| Mean score all<br>barriers          | 2.49                   | 2.55              | 2.61                   | 2.52  | MI < ME             |

<sup>a</sup> significant at  $p < .05$  unless otherwise indicated. The reply options were: 1 = not at all, 2 = nearly not, 3 = somewhat, 4 = to a large extent, 5 = to a very large extent

Source: EIM

## Endnotes

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- <sup>i</sup> These are the views of the authors and need not reflect those of EIM. We would like to thank all students who participated in the fieldwork and the course 'Small Business Economics'. Their reports, enthusiasm and critical comments were highly appreciated.
- <sup>ii</sup> The emphasis of Bain on market structure has been criticized within the discipline of Industrial Organisation. By the late 1970s these views became known as the 'The New Industrial Organisation' (Geroski *et al.*, 1990). They stressed the importance of behavior as a determinant for market performance and market structure (in the long run). The approach comes close to the tradition of strategic management as behavioral aspects are considered to be key. However, in line with the tradition of Industrial Organisation, the unit of analysis is the industry.
- <sup>iii</sup> The reply options were: not at all, nearly not, somewhat, to a large extent, to a very large extent (or alternatively: strongly disagree, disagree, not agree/disagree, agree, strongly agree).
- <sup>iv</sup> Even the group of new and potential competitors can be considered as too broad. For the research information from the 'marginal entrant' is needed. This marginal firm is indeed difficult to identify.
- <sup>v</sup> The database is based on information on business registrations by the Chambers of commerce, address information by TPG Post and checks by MarketSelect.
- <sup>vi</sup> For most barriers, no significant differences were found between the data from the telephonic interview and the students' interviews. Therefore, pooling the data is admissible.
- <sup>vii</sup> The scores have the same range as previous research, see e.g. Smiley (1988) and Karakaya (2002).

## **ETHICAL ENTREPRENEURS: AN OXYMORON?**

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### **ABSTRACT**

This paper presents the results of a survey of early-stage incubator sited entrepreneurial firms. Firms were asked about their views on ethics and the ethical climate of their organizations. Results indicated that respondents tend to think of themselves as ethical and do not feel they must sacrifice their ethics to succeed in their ventures. The results also show that most early-stage entrepreneurs have a code of ethics that is communicated to employees. Contrary to anecdotal and theoretical suggestions that entrepreneurs are by nature more likely to “bend rules” and act unethically, these results lend support to studies that have found that entrepreneurs are more ethical.

### **INTRODUCTION**

Are entrepreneurs ethically different from others to the extent that one can consider the phrase "ethical entrepreneur" an oxymoron? Do the demands of the entrepreneurial business, with its risk and profit expectations, create circumstances where conducting oneself in an ethical manner

is difficult? Anecdotal evidence abounds about the unethical nature of entrepreneurs. Very recently a telecommunications entrepreneur was arrested and charged with the largest criminal case of tax evasion ever brought; he allegedly hid over \$450 million in income (Johnston, 2005).

Since entrepreneurs first began generating new ideas and attempting to take them to market, these innovators have been praised for their contributions and criticized for acting unethically (Hannafey, 2003). Because entrepreneurs are thought to think “outside the normal box” in creating the innovations that make them entrepreneurs, it is thought that they also act outside the normal box as well. Terry (1993), for example, said that entrepreneurship implies a mindless disrespect for tradition. Much earlier Fisher (1983) argued that entrepreneurs work at the edges of society, not the mainstream.

The research literature in entrepreneurship and ethics presents the same contradictory picture. Reasons are suggested as to why entrepreneurs are unethical, but empirical work suggests that entrepreneurs think of themselves as highly ethical. Discussing the moral reasoning skills of entrepreneurs, Teal & Carroll (1999) expressed a view that entrepreneurs may be seen as rejecting the norms of society, but the results of their study suggest "that entrepreneurs as a group may exhibit higher levels of moral reasoning skill" (p. 238). Taking an historical perspective, Timmons & Spinelli (2004), stated, "A touch of suspicion still tinges entrepreneurial activity, and the word entrepreneur may still connote to some a person who belongs to a ruthless, scheming group located a good deal lower than the angels" (p. 334). They also state, however, that "successful entrepreneurs believe that high ethical standards and integrity are exceptionally important to long term success" (p. 332).

## **BACKGROUND**

As noted above, entrepreneurs may not always be viewed in a positive light. While that perception may result from stereotypes of the past, entrepreneurs--regardless of actions--have a tough road ahead of them given the stereotypes. High ethical standards have been identified as essential to long term success (Timmons & Spinelli, 2004), so the entrepreneur must and should demonstrate ethical behavior. The first need, then, for this discussion is to determine why these negative perceptions about entrepreneurial behavior have developed in the broad public.

Some researchers have identified cognitive sources for unethical activity on the part of entrepreneurs. Specifically, the demands of time and money under conditions of severe uncertainty as to outcome are thought to create cognitive pressures that lead entrepreneurs to take shortcuts (Baron, 2000; Timmons & Spinelli, 2004), especially in the early stages of the entrepreneurial activity (Fassin, 2000; Morris et al., 2002). Others are noted below.

### **Age and Firm Size**

In his review of the ethics and entrepreneurship literature, Hannafey (2003) noted that because of the need to work long hours, often in isolation from others, there is little time for entrepreneurs to reflect upon the decision they are making, a situational factor that can lead to less ethical behavior. Other researchers have looked at the characteristics of the new venture creation process and found certain characteristics of that process (external time pressures, scarce resources, competition) as situational sources of the pressures that act upon the entrepreneurs' cognitive ethical abilities (Chau & Siu, 2000). These situational factors that lead to cognitive

ethical failures should be more severe in the early stages of the life of the entrepreneurial venture. Further, the larger the company, the less isolated the entrepreneur would be and the more able to share workloads, thus the cognitive ethical failures likely should be more severe the smaller the firm size.

From this literature evolve the first two null hypotheses for this study:

*Hypothesis 1:* There is no difference in the ethical behavior of entrepreneurs related to the age of the enterprise.

*Hypothesis 2:* There is no difference in the ethical behavior of entrepreneurs related to the size of the firm.

### **Entrepreneurial Characteristics**

In addition to situational factors such as age and size of the enterprise, researchers have studied personal characteristics of the entrepreneur used to explain perceived differences in ethical behavior of entrepreneurs and managers. DeLeon (1996) discusses some of the virtues and vices of entrepreneurs. Virtues are defined as innovation, go-after-it attitude and risk taking. DeLeon defines the following characteristics for the entrepreneur: egotism, selfishness, waywardness, domination and opportunism. Each of these characteristics is seen as necessary and not necessarily negative. Longenecker et al. (1988) located entrepreneurial ethics in the individualism that characterizes entrepreneurs (as does deLeon [1996]). Others pointed to the bias for action that they believe characterizes entrepreneurs as sources of unethical behaviors

(Bhide, 1996). Bucar & Hisrich (2001) discussed the independent, self-centered focus that entrepreneurs bring to business as a characteristic that differentiates entrepreneurial ethics from managerial ethics. They suggested, however, that this focus leads to more ethical behavior on the part of entrepreneurs because entrepreneurs identify with their firm to a greater extent than managers do. Bucar & Hisrich (2001) drew this conclusion: "Entrepreneurs consistently demonstrated higher ethical attitudes in the internal dealings of the company" (p. 78).

These individual characteristics show no consistent affect on entrepreneurial ethics in the studies that have been performed. However, when combined with entrepreneurs' perceptions about the impacts of their activities on society, an explanation for the inconsistencies in the literature might be forthcoming. As stated earlier, entrepreneurs may not be perceived in a positive light because of the history of entrepreneurs in the United States. Newbert (2003), however, discusses today's entrepreneur in a very positive way. Newbert states that "for the majority of today's entrepreneurs, the pursuit of material wealth is generally not the dominant motivational force behind the decision to start a new business" (p. 255). The entrepreneur can not be solely invested in economic self-interest. For success, the entrepreneur must look beyond self-interest. Miles et al. (2004) stated that in free societies, entrepreneurial activities result in enhanced social welfare due to the innovations entrepreneurship brings to society. This is echoed in other studies that note the positive economic effects of entrepreneurship (Hannafey, 2003).

Given the historical stereotypes and Newbert's statements regarding today's entrepreneurs, it appears that interesting ethical challenges face an entrepreneur. Morris et al. (2002) goes on to say "entrepreneurial behavior is a set of actions fraught with ethical dilemmas. Entrepreneurs are

often admired for the creative ways in which they overcome significant limitations, obstacles and sources of resistance to their new venture ideas" (p. 334).

It may be that the entrepreneur, when viewed from the outside, appears to be acting selfishly, without regard to societal rules, and in other ways behaving in a manner that society might deem to be unethical. However, the entrepreneur's personal perspective may be that the actions that are being taken are in service to the betterment of society and are ethical just for that reason. This would suggest that entrepreneurs reason differently about ethics than managers or other individuals.

Thus our null hypothesis with respect to the personal characteristics of entrepreneurs is:

*Hypothesis 3: Entrepreneurs do not view themselves as ethical.*

### **Organization Issues**

A related factor is often discussed in the entrepreneurial ethics literature and concerns the types of organizations that entrepreneurs develop (Hannafey, 2003). An organization may be characterized according to its ethical climate. The ethical climate of an organization is developed over time and consists of a set of shared values about the nature of the organization and its goals. Recall that many researchers theorize that entrepreneurial ventures are unique in their level of stress and the volatility of their business environments (Hannafey, 2003). In the early stages of venture creation, the ethical climate is likely to depend solely on the ethical behavior of the entrepreneur. As the organizations grow in size and age, the ethical climate may change (Morris et al., 2002). Morris et al. (2002) found that while firm size and age were not associated with

whether firms were exemplary or deficient in their ethical behaviors, one factor, the extent to which formal management systems were in place, was a good predictor of ethical behavior. It can be argued, however, that these formal management systems are more likely to be in place in older firms, unless the founding entrepreneur explicitly set a solid moral tone in the firm from the beginning as the result of personal vision (deLeon, 1996). In that case, it would be expected that the entrepreneur's personal ethics would be the same as those of the firm and further, that those ethical values would be formalized in the firm, in the form of ethical codes.

This leads to the fourth null hypothesis:

*Hypothesis 4:* There is no relationship between entrepreneurial firms with positive ethical climates and their established codes of ethics.

### **THIS PAPER**

Given this contradiction in perception and research findings, the present study seeks to add to the ethics and entrepreneurship bodies of knowledge by conducting a survey of technology-based firms housed in business incubators to determine their views on ethics. This research differs from earlier research in using a narrower definition of entrepreneur that captures the distinctions between true entrepreneurial work and small business management that drive the conceptual but not the empirical literature. Longenecker et al.(1988), for example, included all self-employed individuals and small business owners in their study of entrepreneurial ethics. Teal & Carroll (1999) define the entrepreneur as someone who establishes and manages a business for profit and growth. But more recent research utilizes Drucker's definition of the entrepreneur as someone who "searches for change, responds to it, and exploits it as an opportunity" (1985, p. 28; see also

Brenkert, 2002). The true entrepreneur takes the old and changes it, or creates the new, paralleling Schumpeter's (1950) original "creativity" definition. Entrepreneurs take greater risks than managers and small business owners. These risks bring the potential for a larger range of unethical actions in pursuit of the opportunity. It is necessary, therefore, to distinguish the entrepreneur from both the manager and the small business owner to understand and distinguish the ethical behavior of all of these groups.

## **METHODOLOGY**

### **Sample**

A random telephone survey of 79 technology-based firms was conducted. All firms were US-based and housed in US technology-based incubators. By definition, then, these firms were entrepreneurial.

### **Instrument**

The survey was written and conducted in three parts: general firm information, an ethics survey, and a Sarbanes-Oxley survey. All respondents were asked to complete all sections during the telephone interview. Survey questions included demographic information; a series of yes/no questions; and a series of Likert scale questions. Survey questions were drawn from the literature on entrepreneurial ethics. Specifically, several survey questions were taken from Bucar & Hisrich's (2001) study comparing entrepreneurs and managers.

Some of the questions used were designed to establish the personal attitude of the entrepreneur about ethical behavior. For example: “People are basically good;” “People act honestly;” and “Illegal acts are ethically wrong” are questions that establish ethical expectations about people and can be interpreted to be self-characterizations. These questions served as proxies for the ethics of the entrepreneur.

To distinguish these personal attitudes about ethical behavior from expectations of business behavior, questions such as “When working with other firms we have been dealt with fairly;” “Our personal ethics are sacrificed to the goals of the business;” and “I have conflicts when it comes to personal versus business decisions” were included. These distinguishing questions were also used as proxies for ethical behavior in business. Entrepreneurs who agreed with the last two questions would be thought to act less ethically than would those who disagreed.

The survey also included a series of questions concerning the firm’s ethical climate. Yes/no questions included “Have you ever taken a course/seminar in ethics?”; “Does your firm have a written code of ethics?”; “If no, does it have an unwritten code?”; and “How is your firm’s code of ethics communicated to employees?” (answer choices were “verbal”, “written”, or “by example”). Finally, the survey asked for disagreement/agreement with the statement on a six-point Likert scale, “Our code of ethics is used in decision-making.” See Table 1.

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Insert Table 1 About Here

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## Hypotheses

*Hypothesis 1:* There is no difference in the ethical behavior of entrepreneurs due to the age of the enterprise.

*Hypothesis 2:* There is no difference in the ethical behavior of entrepreneurs due to the size of the firm.

To test these hypotheses regarding firm, age and size the following questions were means tested across the two groups:

- My personal ethics are sacrificed to the goals of the business.
- When working with other firms we have been dealt with fairly.
- Trying to respond to a variety of stakeholders produces conflicts.
- I have conflicts when it comes to personal versus business decisions

*Hypothesis 3:* Entrepreneurs do not view themselves as ethical.

To test this hypothesis, that relates to the individual entrepreneur, and his view of others, the following questions were means tested across the sets of groups, i.e., by age and size.

- People are basically good.
- People act honestly.
- Some people are hard to work with because of ethics
- Illegal acts are ethically wrong.

*Hypothesis 4:* There is no relationship between entrepreneurial firms with positive ethical climates and their established codes of ethics.

To test this hypothesis, the following variables were means tested across both groups, i.e., by firm age and size and whether a written or unwritten code existed. Further, if a firm had no written code of ethics, the variables were again run by age and size against how the firms' code of ethics was communicated.

- Does your firm have a written code of ethics?
- How is your firm's code of

ethics communicated to  
employees?

- Our code of ethics is used  
in decision making.
- Trying to respond to a  
variety of stakeholders  
produces conflicts.
- I have conflicts when it  
comes to personal versus  
business decisions

### **Comments on Methodology**

The original data set had seventy-nine firms, with the size of respondent firms as measured by employee numbers ranging from one to 285 employees. The average firm size was 8.99 employees (sd 9.22) and the outlier with 285 employees was removed from the data set. The total number of firms remaining was seventy-four. The firms were then split for analysis using the mean, with 68% of the firms smaller than 8.99 employees. While one could argue that the firms should have been split so both groups were equal, the frequencies of firm sizes did not allow for that.

The original data set then had firms ranging in age from one to thirty-eight years old, with an outlier of thirty-eight years. With the outlier removed, the firms' average age was 4.76 (sd 3.44).

The

firms were split for analyses at an age of five and 72.4% of the firms were five years or less in age. Again, one could argue that the firms should have been split so both groups were equal. The frequencies of the firm ages did not allow for that.

Graduate research assistants performed the surveys. One of them commented that he doubted that respondents would tell him they were not ethical. Perhaps one reason for a disparity in the literature about the lack of ethics among entrepreneurs and survey results, anonymous or not, may be the social desirability bias. Fernandes & Randall (1992) found that some form of social desirability bias was detected in over half of the ethics relationships they studied. They also noted that the bias is more prevalent when attitudes rather than behavior are being surveyed. Even so, researchers in ethics have little choice in relying on self-reported attitudes and behaviors (Fernandes & Randall, 1992).

Finally, the data set is not overly large, which leads to the inability to generalize results for technology-based entrepreneurs and their firms.

## **RESULTS**

The average education of the respondents included some graduate school; a result that is similar to that of other researchers in technology based firms (Teach et al., 1985). The entrepreneurs were predominately male (69 males and 10 females). The respondents were CEO's, VP/COOs or others ranging from senior managers and engineers.

Three questions were answered differently by gender with differences that were significant at <.100 level. The firm position of the female respondents was not at the same level as the males;

more males than females were CEOs or VPs/COOs. More males than females had advanced education. All other responses were not significantly different, but because there were differences all female responses were left out of the ensuing analyses, resulting in sixty-seven firms with the two outliers noted earlier removed. Four firms that were either retail or distribution were all also removed resulting in sixty-three total firms.

Not all respondents answered all questions, making multivariate analyses such as clustering, factoring or discriminant analyses impossible. Thus only means testing was used. While strategies are multivariate in nature, the results nevertheless provided some insight into how these firms perform ethically. As firms covaried in size and age, no analyses were performed across the groupings, only within the groups.

*Hypothesis 1:* There is no difference in the ethical behavior of entrepreneurs due to the age of the enterprise.

Table 2 displays the results for this hypothesis. Responses were analyzed across the two age groups, firms five years of age or less or greater. On the question “my personal ethics are sacrificed to the goals of the business,” respondents in both younger and older firm strongly disagreed with this statement. It is interesting to note that in the Bucar and Hisrich (2001) study 52 percent of the entrepreneur respondents felt that personal ethics were sacrificed to goals of business. On the questions “when working with other firms we have been dealt with fairly” and “trying to respond to a variety of stakeholders produces conflict;” both respondents in both younger and older firms had very similar responses, agreeing to the truth of these statements. On

the last question posed, “I have conflicts when it comes to personal versus business decisions;” again respondents in both young and more established firms were similar in their disagreement.

The null hypothesis is thus supported by the results of the means testing. No significant differences at less than the 0.100 level between younger and older firms were observed.

---

Insert Table 2 here

---

*Hypothesis 2:* There is no difference in the ethical behavior of entrepreneurs due to the size of the firm.

Table 2 displays the results for this hypothesis. On the questions asked regarding business attitudes about ethical behavior, the responses for small and large firms did not significantly differ. Respondents in both small and large firms showed disagreement on the questions “my personal ethics are sacrificed to the goals of the business;” and “I have conflicts when it comes to personal versus business decisions.” On the questions “when working with other firms we have been dealt with fairly” and “trying to respond to a variety of stakeholders produces conflicts;” respondents in both small and large firms agreed.

The null hypothesis is supported by the results of the means testing. No significant differences at less than the 0.100 level between smaller and larger firms were observed.

*Hypothesis 3:* Entrepreneurs do not view themselves as ethical.

Table 3 displays the results for this hypothesis. Respondents in both younger and older firms agreed that “people are basically good” and “act honestly” but the smaller versus larger firms differences were significant and respondents in the older firms thought that people were “more” basically good. Perhaps this is due to younger firms finding it slightly more difficult to deal with others due to their lesser experience or perhaps they were more cynical due to their age. The younger, smaller and larger firms slightly agreed that "some people are hard to work with because of ethics." The older firms slightly disagreed with the statement. It may be that due to more experience these firms felt they were better able to work with ethical issues. All agreed that “illegal acts are unethical.”

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Insert Table 3 here

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*Hypothesis 4:* There is no relationship between entrepreneurial firms with positive ethical climates and established codes of ethics.

The results for hypothesis 4 are displayed in Table 4. For younger and older firms and small and large firms, whether the code of ethics is written or unwritten all respondents strongly agreed that the code of ethics is used in decision-making. The majority of firms have an unwritten code of ethics. The majority of smaller firms do not have a written code of ethics. Larger firms are fairly evenly divided between written and unwritten codes of ethics. Whether the code is written or unwritten, it is communicated to employees in a variety of ways. The means of communication written or unwritten include verbal and by example and combinations of both. The majority of smaller firms identified the primary means of communication of the code of ethics “by example.”

For the question “trying to respond to a variety of stakeholders produces conflicts” young and old firms, small and large, with written and unwritten codes agreed. Significantly different, but both agreeing, younger firms responded more positively. Large and small firms with an unwritten code of ethics also agreed that “trying to respond to a variety of stakeholders produces conflicts.” On the question “I have conflicts when it comes to personal versus business decisions,” younger and older firms, smaller and larger, with unwritten and written ethics codes relatively strongly disagreed with the statement.

The hypothesis is not supported.

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Insert Table 4 here

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## **Other Research**

In Table 5 the results of the Bucar & Hisrich (2001) study were compared with the present study. On the question of “code of ethics used in decision-making” 73.5 percent of the Bucar & Hisrich entrepreneurs responded yes when asked if a code of ethics was being used. In the present study entrepreneurs also very highly agreed that a code was used in decision-making. On the question of personal ethics sacrificed to goals of business 52.5 percent in the Bucar & Hisrich study agreed with the statement. In the present study entrepreneurs very strongly disagreed. This difference may be due to the types of firms used in both studies and perhaps because of changes in the ethical environment brought on by the Enrons of the world. On the question “personally dealt with fairly by business” Bucar & Hisrich entrepreneurs agreed by 93.3 percent. In the present study entrepreneurs agreed but not as strongly.

On the question of “man is basically good” Bucar & Hisrich’s study had a strong positive response of 88.8 percent. The present study responses were in agreement, but again not as strongly as the Bucar and Hisrich response. “Others reciprocate honestly” was a question with which Bucar and Hisrich had a 67.7 percent positive response. The present study responses were also in agreement with the statement. In both studies entrepreneurs agreed with the statement “Things illegal are ethically wrong”. In both studies, there was strong agreement that a code of ethics was used in decision-making.

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Insert Table 5 here

## SUMMARY/CONCLUSIONS

The findings provide support for the use of a code of ethics in decision making by entrepreneurs in incubator technology firms, whether a code of ethics is unwritten or written, irrespective of the age or size of the firm. The findings also support that in these firms there is agreement that illegal acts are ethically wrong. This study found that entrepreneurs did not find that their personal ethics were sacrificed to the goals of the business. Entrepreneurs in technology incubator firms defined people as basically good and honest. These results support Newbert's (2003) positive view of today's entrepreneur, i.e., not solely interested in material wealth. There was no difference in ethical behavior due to the age or size of the firms. Respondents do view themselves as being ethical. These responses indicate that entrepreneurs see themselves as ethical and believe that their firms are being operated ethically.

A comparison of this study with a prior one (Bucar & Hisrich, 2001), utilizing similar questions, indicated some differences in responses. These differences likely were due to both differences in sample sets as well as the time frame of the study, with the examples of Enron and other unethical firms likely impacting the more current responses. As always, generalized results do not allow for specificity by firm types, but the current study does provide empirical data for incubating technology based firms, although male only responses.

Additional research is needed to identify the factors that influence ethical decision-making in entrepreneurs, both male and female, and their firms.

The findings with regard to the ethical climate and codes of ethics in entrepreneurial firms provide significant and interesting implications for both practice and research. The majority of

entrepreneurial firms do not have codes of ethics that are written. Many entrepreneurs responded that their ethics code was “unwritten” and communicated either verbally or by example. Due to the scrutiny that external stakeholders are applying to firms of all sizes, and especially due to the negative anecdotal and theoretical perspectives on entrepreneurs, the one recommendation that could be made as a result of this research is that entrepreneurs need written ethics codes. While generalizing, the results support much of the research in the field that shows entrepreneurs think of themselves as ethical and their firms as acting ethically. The difficulty is in ensuring that the reality fits the image and the image fits reality.

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**Table 1 Questionnaire**

|   |
|---|
| Age   |
| Employee Numbers  |
| Gender  |
| Firm type   |
|   |
| A <b>yes</b> answer is coded 1.<br>A <b>no</b> answer is coded 2.                             |
|   |
| Have you ever taken a course/seminar in ethics?   |
| Does your firm have a written code of ethics?   |
| If no, does it have an unwritten code?  |
|   |
| How is your firm's code of ethics communicated to employees?<br>(Verbal, written, by example) |
|   |
| <b>Likert like 1-6 (highly agree)</b>   |
|   |
| Our code of ethics is used in decision making.  |
| My personal ethics are sacrificed to the goals of the business.                               |
| When working with other firms we have been dealt with fairly.                                 |
| People are basically good.  |
| People act honestly.  |
| Illegal acts are ethically wrong.   |
| Trying to respond to a variety of stakeholders produces conflicts.                            |
| Some people are hard to work with because of ethics   |
| I have conflicts when it comes to personal versus business decisions                          |

**Table 2 Results of Hypotheses Testing H1 and H2**

|  | Hypothesis 1<br>Younger /<br>Older<br>(n=65/67)<br>(n=48/17) | Hypothesis 2<br>Smaller /<br>Larger<br>(n=67)<br>(n=34/33) |
|--|--|--|
| <b>Likert like 1-6 (highly agree)</b>                                |  |  |
| My personal ethics are sacrificed to the goals of the business.      | 1.43 (44)<br>1.47 (15)                                       | 1.30 (30)<br>1.60 (30)                                     |
| When working with other firms we have been dealt with fairly.        | 4.42 (42)<br>4.44 (15)                                       | 4.43 (30)<br>4.50 (28)                                     |
| Trying to respond to a variety of stakeholders produces conflicts.   | 4.70 (44)<br>4.06 (16)                                       | 4.55 (31)<br>4.60 (30)                                     |
| I have conflicts when it comes to personal versus business decisions | 1.84 (44)<br>1.75 (16)                                       | 1.84 (31)<br>1.80 (30)                                     |

**sign. <.100**

**Table 3 Results of Hypotheses Testing H3**

|   | Hypothesis 3<br>Younger /<br>Older   | Hypothesis 3<br>Smaller /<br>Larger  |
|---|--------------------------------------|--------------------------------------|
| <b>Likert like 1-6<br/>(highly agree)</b>                 |                                      |                                      |
| People are basically<br>good.                             | 4.36 (44)<br>4.31 (16)               | <b>4.14 (31)</b><br><b>4.63 (30)</b> |
| People act honestly.                                      | 4.12 (43)<br>4.12 (16)               | 4.03 (31)<br>4.28 (29)               |
| Some people are<br>hard to work with<br>because of ethics | <b>4.31 (43)</b><br><b>3.56 (16)</b> | 4.03 (31)<br>4.10 (29)               |
| Illegal acts are<br>ethically wrong                       | 4.78 (47)<br>4.29 (17)               | 4.72 (33)<br>4.54 (32)               |

**sign. <.100**

**Table 4 Results of Hypotheses Testing H4**

|   | Hypothesis 4<br>Younger /<br>Older<br>Written | Hypothesis 4<br>Smaller /<br>Larger<br>Written | Hypothesis 4<br>Younger /<br>Older<br>Unwritten | Hypothesis 4<br>Smaller /<br>Larger<br>Unwritten |
|---|---|--|---|--|
| Does your firm have a written code of ethics?   | Yes (26)<br>19/48<br>7/17                     | Yes (28)<br>12/34<br>16/33                     |   |  |
| If no, does it have an unwritten code?  |   |  | Yes (37)<br>27/48<br>10/17                      | Yes (37)<br>20/34<br>17/33                       |
| How is your firm's code of ethics communicated to employees?<br>(Verbal, written, by example) |   |  |   |  |
| <b>Likert like 1-6 (highly agree)</b>   |   |  |   |  |
|   |   |  |   |  |
| Our code of ethics is used in decision making.  | 5.47 (19)<br>5.14 (7)                         | 5.36 (11)<br>5.43 (16)                         | 5.59 (27)<br>5.33 (9)                           | 5.60 (20)<br>5.54 (16)                           |
| Trying to respond to a variety of stakeholders produces conflicts.                            | 4.47 (19)<br>4.28 (7)                         | 4.50 (12)<br>4.50 (16)                         | <b>4.86 (29)</b><br><b>4.00 (10)</b>            | 4.59 (22)<br>4.70 (17)                           |
| I have conflicts when it comes to personal versus business decisions                          | 1.52 (19)<br>1.57 (7)                         | 1.75 (12)<br>1.43 (16)                         | 2.17 (29)<br>1.90 (10)                          | 2.13 (22)<br>2.05 (17)                           |

sign. <.100

**Table 4-A Results of Hypotheses Testing H4**

|   | Hypothesis 4<br>Younger /<br>Older         | Hypothesis 4<br>Smaller /<br>Larger |
|---|--|-------------------------------------|
| How is your firm's code of ethics communicated to | Written 10/6<br>Verbal 4/2<br>Example 11/4 | 6/9<br>5/3<br>12/3                  |

|  |           |            |
|--|-----------|------------|
| employees?<br>(Verbal, written, by<br>example) | Mixed 9/1 | <i>3/7</i> |
|--|-----------|------------|

**Table 5: Comparative Results**

|   | <u>Bucar/Hisrich</u> | Entrepreneurs | <u>Present Study</u>                                       |
|---|----------------------|---------------|--|
|   | <u>Yes</u>           | <u>No</u>     | <u>Likert Scale</u><br>1 highly disagree<br>6 highly agree |
| "Code of ethics" in decision making             | 119 (73.5)           | 43 (26.5%)    | 5.48   |
| Personal ethics sacrificed to goals of business | 85 (52.5%)           | 78 (47.9%)    | 1.52   |
| Personally dealt with fairly by business        | 152 (93.3%)          | 11 (6.7%)     | 4.44   |
| Man basically good                              | 143 (88.8%)          | 18 (11.2%)    | 4.39   |
| Others reciprocate honestly                     | 107 (67.7%)          | 51 (32.3%)    | 4.14   |
| Things illegal are ethically wrong              | 85 (52.5%)           | 77 (47.5%)    | 4.68   |

Adapted from Bucar and Hisrich, Table 4: Ethical Perceptions Regarding Others (2001, p. 76).

## **WOMEN ENTREPRENEURSHIP IN OMAN**

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### **ABSTRACT**

In the Middle East countries and specially the AGCC countries (Arab Gulf Cooperation Council consisting of Oman, Saudi Arabia, UAE, Qatar, Bahrain and Kuwait), the process of participation of the women in enterprise and businesses has been given due attention in the recent past. The long term development strategy, "Vision 2020" adopted by Oman has provided an encouraging environment for women entrepreneurs to participate and contribute towards this effect. Availability of education, training and awareness has helped Omani women to emancipate in recent past and resultantly, Oman has a significant number of women entrepreneurs in the male dominated Arab society.

In Oman, two main programs namely "**Fund for Development of Youth Projects**" and the "**SANAD**" Program have been launched in recent years to promote entrepreneurship for both men and women. The Youth Fund was established in 1999 and it encourages young Omani men and women to start small and medium enterprises. This program has been successful to some extent in attracting young entrepreneurs. The SANAD program was started in the year 2001, its main objective is to speed up the process of Omanization by creating self employment

opportunity. This program has attracted a significant number of women who are interested in establishing their micro-enterprise.

Training and development plays important role in making women entrepreneurs successful. “**Intilaaqah**” program was established in 1995 by Shell Oil Co. in Oman to provide training, counseling and consultancy and its role in supporting women entrepreneurs has been very encouraging with its limited resource.

Key Words: Women Entrepreneurship, Oman.

## **INTRODUCTION**

Since 1980s, policy makers worldwide have been considering the role of women entrepreneurs in the process of economic development. The participation of women in the global economy has been tremendous in the recent past. Worldwide, it is estimated that approximately one third of all businesses are owned by women (Lerner and Almor, 2002; OECD, 2000). The number of women of women-owned businesses and enterprises are also on the increase in Asia, Africa, Eastern Europe and Latin America. This strong presence of women entrepreneurs is noticeable since many studies have shown that business creation and development is an even greater challenge for women than men. Access to credit, reconciliation of work and family, cultural barriers, among others, have been pointed out as obstacles that women business owners have to overcome in order to succeed in their venture (OECD, 2000). The other problems faced by the women entrepreneurs are marketing/sales skills, management skills, access to markets, awareness of business support, discrimination by finance providers, discrimination by support providers, and overall discrimination in the economy and society which are visible or invisible at times.

## **WOMEN ENTREPRENEURS: EMERGING CHALLENGES**

The lack of role models in entrepreneurship is one of the many obstacles for women entrepreneurs. There exists a strong connection between the presence of role models and the emergence of entrepreneurs (Shapero and Sokol, 1982). Women historically have not been present as entrepreneurs in general and consequently have lacked close role models. The influence of role models is gender related. That is, an individual will be more influenced by another individual of the same sex, as one’s aspirations and choices tend to be more influenced by persons of the same sex (Deaux and Lafrance, 1998). This is a result that has been replicated in different countries and employing different methods. The presence of role model helps women to develop attributes making them a keen follower and achiever.

Lack of awareness and experience among women is another obstacle. All stages in entrepreneurship development are dependent on relevant experience, from the identification of opportunities to the execution of running a business. The access to information is vital in this

information age and only those people will survive in this highly competitive world who are informed and groomed to handle information to make appropriate decisions. This truly applies uniformly to the big MNCs (Multi-National Corporations) or the small and medium size business. The women entrepreneurs lack the proper awareness and relevant skills and experience to handle the business environment that is uncertain and guides entrepreneurs to thrive on chaos.

Recent research on developed economies has identified a potential problem when it comes to women's entrepreneurship: highly educated women seem to choose other career options than self-employment and entrepreneurship (OECD, 2004). Entrepreneurship is therefore relatively more dominated by unskilled women or very skilled and already wealthy women. Skilled women must therefore become more attracted to entrepreneurship. If women are relatively less skilled than their male counterparts, *ceteris paribus*, then the firms they will create will have a lower probability of survival and growth than the firms created by men.

Lack of relevant networks and of societal position for women is another impediment. Women have in general a lower social position than men, which affects the kind of networks they can access or participate. There is evidence to prove that women are less involved in networks than men are, and their type of network is different. For business, it is as important to have weak-tie networks as strong ties (Aldrich and Zimmer, 1986; Burt, 2000; Granovetter, 1985; Granovetter, 1973). The strong and personal networks that women traditionally engage in are well suited to purposes linked to the family related tasks that may prove to be a hindrance in the marketplace (Lin, 1999). Thus, women differ from men in the kind of networks they use and in the social capital available to them through the network. Women have therefore less access to critical resources, support and information needed to successfully start and manage a new firm compared to men.

Lack of wealth among women is a hindrance. A prerequisite for starting a firm is to have capital in terms of financial assets and in terms of relevant knowledge assets. Women's positions in society have led to a lack of assets in both these aspects. The constraints of family obligations make it harder for women to take on work on a full time basis and to engage in a career. This in turn decreases the range of possible work opportunities for women, leading to jobs in lower paid sectors. Being a part-time worker with low pay will not permit creating personal wealth.

Some major areas have been identified as potential or real problems for women when it comes to financing: a) women may be disadvantaged in raising the initial capital to start a new firm; b) collateral needed for external financing may be above the wealth level of most women; c) financing for an existing firm may be less available, because women are less likely than men to penetrate informal financial networks; and d) women entrepreneurs' relationship with different financial institutions might suffer because of gender stereotyping and discrimination (Carter *et al.*, 2001; Storey, 1994).

Another recurring obstacle for women to engage in entrepreneurship is the perceived lack of time or competing demands on time. Because women are responsible for so many different domestic chores and the raising of children, they do not have enough free time to develop either their entrepreneurial skills to become entrepreneurs or to develop an existing business. The lack of free time does not allow them time to travel to institutions, banks and other finance houses for advice and information on credit, to attend training programs to acquire skills, or to seek out

better customers or suppliers. This lack of free time has been observed in a number of studies across different countries: for example Bangladesh (Karim, 2000), Côte d'Ivoire, Ethiopia, Mali, Morocco, Senegal and Zimbabwe (De Groot, 2001), or Sweden (Holmquist *et al.*, 2002). The results suggest that lack of time is a barrier for most women, in most economies, independent of the level of development.

Low female participation has also been blamed on social norms. For example, this is seen in the drop in female labor force participation that occurs with marriage. In Egypt, female market work drops sharply with marriage rather than with childbearing (Assaad and El-Hamidi, 2002). In Iran, married women have the lowest participation rates, followed by single and widowed women. Divorced women participate at a rate three times that of married women with similar characteristics (Salehi-Isfahani, 2000). In Kuwait, labor force participation of single women aged 25-39 is more than twice that of married women at 60 percent compared to 30 percent (Shah and Al-Qudsi, 1990). Gender norms have proven resistant to economic change and costly for growth.

In the Middle East countries and specially the AGCC countries (Arab Gulf Cooperation Council consisting of Oman, Saudi Arabia, UAE, Qatar, Bahrain and Kuwait), the process of participation of the women in enterprise and businesses has been a concern. With this literature review, this paper evaluates and analyzes the existing entrepreneurship policies of the Sultanate of Oman for promoting women entrepreneurship and identifies the problems and bottlenecks associated with its implementation.

## **EMANCIPATION OF WOMEN IN OMAN**

Participation of women in the economy is the real barometer of women empowerment in any society. Education and training of women play a key role for women development and empowerment. In a country like, Oman, until 1970, the women education was non-existent. The country had only 3 primary schools with 900 boys and there was no provision for education of girls. Following the accession of His Majesty Sultan Qaboos in 1970, education was made available to all Omani nationals alike irrespective of sex. The opening of the co-educational Sultan Qaboos University in 1986 and making the primary to tertiary education available to women played a key role towards the efforts of emancipation of women in Oman (Al-Lamki, 1999; Oman Daily Observer, April 1996). Since 1970, Oman has achieved a lot in making education available to boys and girls alike. From 3 schools and 900 students in 1970, it has reached 1,020 government schools and 134 private schools with 601,461 students studying in schools of which girls constitute nearly half (Ministry of Information, 2002: 119).

The girls have been at the top of the students merit lists in the secondary schools for more than a decade and this domination is spreading to the degree courses of the Sultan Qaboos University as well. The girls are performing very well. The declared government policy guarantees women equal rights in both education and employment as enshrined in the Personal Status Law (PSL). His Majesty has repeatedly called upon female citizens to lend their full support to the development of the country. He has frequently described them as representing "half of Oman's potential". Oman is rightly proud to be first Arab country to appoint a woman as its overseas ambassador and currently, three women hold positions of council of ministers with a fourth having an equivalent role. Today, women are playing important role in the Consultation Council (Majlis A'Shura) and the State Council (Majlis A' Dawla) and recently, five women were

appointed as attorney generals to the legislature. In October 2004, a woman was appointed as the minister of social development. Though there is no official data available, it is likely that Oman employs the largest number of women in AGCC countries. (Ministry of Information, 2003, see also [www.omanet.om](http://www.omanet.om)).

The General Directorate for Women and Children Affairs was established in 1985. The directorate under the auspices of the Ministry of Social Affairs and Labour has set up a network of women development centres throughout the country. The general aims and mission of the Directorate is to setup special programs to deal with mother and childcare, eradication of illiteracy, education, the development of traditional and modern handicraft and many other programs related with developing the women minds and strengthening their role as responsible citizens. This was a significant move by the government to enhance the status and role of the women in Omani society (AlLamki, 1999).

The Omani Women's Association (OWA) was established in 1970 as a voluntary organization and has played a significant role in the development of women in the Sultanate. It is envisaged that the OWA could be instrumental in providing a network for Omani women who are employed (AlLamki, 1999) or running their own businesses. It is the first women's organization in Oman that was formed with the main aim of providing quality education and training to women in increasing their knowledge so as to facilitate them to secure good jobs. OWA also promotes the traditional Omani custom and values so that the tradition culture continues to remain in the country. It encourages its members to actively contribute to the economy by whatever ways possible. At the end of the year 2003, there were 39 local OWA groups established all over Oman that had 2,738 members (Ministry of Information, 2003). A Women's Voluntary Work Co-ordination Committee has been created to regulate the activities of the OWAs and help Omani women to play active role in the economic and social development programmes. There are four government centres as well as six non-government training centres for women being run which help raise women's general awareness about cultural, health and social issues, develop their productive skills and enable them to make profitable use of their leisure time (Ministry of Information, 2003). The role of OWA has been very encouraging in helping women to learn skills and education and make them self-reliant. It has been helpful in harnessing the traditional craftsmanship of women and building confidence and competency to deal with the hardships of life and occupation.

Thus Oman women have come a long way in the last 10-15 years. In 1993, Women constituted 9 percent of the total Omani labor force and three-fourth of them were employed in government sector (AlLamki, 1999). Today, women participation in private and public sectors has increased significantly. In the last ten or more years there have been tremendous increases in women participation in employment. Women comprise 36 percent of employees in the Omani public sector as of now and most importantly, they are participating actively in decision-making and occupy leading posts in government sector (Oman Daily Observer, January 9, 2005). Thus, the participation of women in education, employment and decision-making has grown considerably and it has resulted into the emancipation of Omani women in the twenty first century presenting an example for other Arab countries to follow.

## **OMAN ECONOMY AND THE ENTREPRENEURSHIP ENVIRONMENT FOR SMALL BUSINESSES**

Oman is the third largest country of the AGCC countries bordering Yemen, Saudi Arabia and the United Arab Emirates lying on the southeast corner of the Arabian Peninsula. The commercial export of oil began in 1967 in Oman. Since then, oil has been the major contributor to the GDP. The fourth five-year plan (1991-1995) for the first time emphasized the need to diversify the production base other than oil and the Government paid special attention to the sectoral and regional development process.

The Government of Oman identified the role of privatization and liberalization of its policies to accelerate the rate of economic growth. Government encouraged men and women equally to participate in the process of economic development of the Sultanate. The fifth five year plan (1996-2000) considered as did the first plan within the framework of the long term development strategy (1996-2020) also emphasized on the diversification of the national income resources encouraging the domestic and foreign private investments and increasing the share of the private sector in the total investments. It also emphasized the role of human resources and participation of Omani men and women in the private sector development and diversification process (Ministry of National Economy, 2002)

By 1995, Oman had completed four five-year plans. Taking advantage of its earlier planning and visualizing the changes in the global economy, a new vision of Oman's economic future evolved. "Vision Oman 2020" proposed a policy for the Sultanate's development over twenty-five years (1996 to 2020). It took into account the far-reaching changes in the world economy and the revolution in telecommunications and information technology that has transformed the global system of production and exchange. In fact, "Vision Oman 2020" represents a dividing line between two stages of the Sultanate's economic and social development, marking both the end of initial development up to the country's Silver Jubilee celebrations in 1995 of the accession of His Majesty Sultan Qaboos, and a new journey into the third millennium. The vision stipulated that the contribution of crude oil to GDP is expected to drop to around 9 percent in 2020, compared to 41 percent in 1996. Gas is expected to generate 10 percent of GDP in 2020, compared to less than 1 percent in 1996. The industrial sector is expected to increase its contribution from 7.5 percent in 1996 to 29 percent in 2020 (Ministry of Information, 2003).

Subsequently, the sixth five year plan (2001-2005) emphasized three core goals for this period: a) the development of human resources and basic structures, b) economic diversification, and c) encouraging growth of the private sector.

The key aims of the Sixth Five-year Plan were to:

- guarantee stable personal incomes;
- increase the number of secondary school students enrolling in higher education and technical colleges;
- create more jobs for Omanis;
- adopt sustainable financial policies;
- promote economic diversification ; and

- develop the private sector.

The sixth five-year plan envisioned growing the national economy by an annual average rate of 4 percent and increasing the per capita GDP share at constant prices at average annual rate of about 1.9 percent (Ministry of National Economy, 2002: 67). In fact, the result has been encouraging and the Omani economy grew to a higher level than what was envisioned in the Plan for the year 2001 due to the increased value of the non-oil sectors and higher than the predicted oil prices (Ministry of Information, 2003).

Oman joined the WTO in November 2000 which has provided significant challenge for the country to liberalize its policy without compromising its objective of Omanisation in ownership and employment. It is expected that with joining WTO, the efficiency of certain sectors, especially finance and telecommunication and also the tourism and manufacturing sector, will increase and Oman manufactured products will penetrate into the markets of both developed and developing countries, especially, the exports of petrochemical (Kamoonpuri, 2004:13).

### **Development of Small and Medium Enterprises**

The sixth five-year plan place emphasis on the industrial development of small and medium enterprises (SMEs). The plan also puts emphasis on creating employment opportunities through economically feasible labor intensive production facilities. Though there is no separate policy framework drawn up for the SMEs, the government has adopted certain steps in this regard like the availability of Oman Development Bank loans, incubator facilities, equity funding by the Youth Fund, and micro-business development facilities offered through the SANAD program. The small entrepreneur development facilities offered by Intilaaqah represent contributions by the private sector. These programs aim at promoting the small and medium enterprises in Oman (Kamoonpuri, 2004:13). Michael Porter who has written extensively on competitive advantage is of the view that “Oman could become a role model for the region if the country focuses on certain priorities”. He identifies five important priorities in this direction and is of the view that launching a comprehensive program for entrepreneurship and developing strategy to attract investment and developing a cluster strategy is very important (Times of Oman, Dec. 2, 2004).

### **Creation of Oman Development Bank (ODB)**

The ODB has encouraged young entrepreneurs in establishing their small businesses in the recent past. In fact, ODB plays pivotal role by promoting entrepreneurship among the youth by providing them soft loans (a loan with generous repayment terms) and curtailing bureaucracy. ODB was established as a public joint-stock company in April 1997 by a royal decree with a capital of RO 20 million after a merger took place between the Oman Development Bank and the Oman Agriculture and Fisheries Bank. The main functions of ODB are: to support small and limited cost projects; to encourage would-be and upcoming entrepreneurs; and to finance private sector projects in several fields, including industry, agriculture, fisheries, animal resources, exports, tourism and self-employed and workshop projects, through the making of medium- and long-term loans and capital participation. It also offers technical assistance and consultancy services. ODB is also responsible for the making and recovery of government-backed soft loans, export credit guarantees and distribution of proceeds from the Fisheries Research Fund. By the

end of 2002, the ODB had advanced loans totaling Rial Omani (RO) 45.1 (around USD 115) million with government subsidized annual interest rates of between 2 percent and 6 percent. The ODB's assets stood at RO 64.1 (around USD 166) million at the end of 2002 and its paid-up capital totaled RO 20 (around USD 51) million. ODB enjoys exemption from all taxes, and the government subsidizes the interest rate on the soft loans. (Ministry of Information, 2003)

## **WOMEN ENTREPRENEURSHIP IN OMAN**

There is no separate program or policy to develop women entrepreneurship that exists in Oman but women participation in the small businesses has been encouraging lately. More and more women have come out and ventured into business in the recent past. In Oman, two main programs namely **“Fund for Development of Youth Projects”** and the **“SANAD”** Program have been launched to promote entrepreneurship for both men and women.

### **Fund for Development of Youth Projects**

The Fund for Development of Youth was established in 1999 and it encourages young Omani men and women to start small and medium enterprises. The fund provides financial and management assistance to young people wishing to embark on business in the private sector. In its first year of operation, 15 projects were financed. The fund was established with a grant of RO (Rial Omani) 1 million granted by His Majesty and the fund has accumulated RO 5.36 million as equity from the private companies. The fund's financial involvement is limited to half the capital of each project and the maximum available is RO 50,000 (1 RO= 2.6 US \$). The fund ascertains the economic viability of the project and provides consultants from banks and corporations who give technical and administrative advice voluntarily to get the project started. The beneficiaries are exempted from the company income tax for a period of 10 years that may be extended for a similar period. It also provides exemption from the corporate tax and tax on profits for five years to the fund's industrial and commercial projects. The main emphasis in this project is the viability of the project and the promoter must be an Omani. Since its inception in 1999, 20 projects had been funded by September 2003. The youth fund concentrates more on quality rather than quantity (OER, 2003:26).

The policy by this fund is to invest in the equity of the small and medium sized projects and to render administrative, financial and technical support. The entrepreneur has the flexibility to buy back the equity in his or her enterprise by paying back to the fund after an exit period of 5 years. The idea of the fund was very innovative but it has not been so successful in attracting young entrepreneurs. The entrepreneur feels that their freedom of decision-making and enterprise is limited by the involvement of the fund in the administration of the business.

As far as, the women participation in this fund is considered, it has not been able to attract the numbers of women entrepreneurs as large as the SANAD program. The objective of this fund is also different as it focuses more on a bigger enterprise in comparison to the SANAD program. There is likelihood that the provisions of this program will be revised to attract more entrepreneurs in time. It should also attract women entrepreneurs as a category making special provisions to cut down the bureaucracy. Even the equity idea can be intertwined with the normal funding proposition as adopted by other financial agencies.

## **SANAD Program and Women Entrepreneurship**

SANAD is targeted for the unemployed youths. “SANAD” means support in Arabic that succinctly describes the primary objective of the SANAD as Self-employment And National Autonomous Development (OER, 2003: 23). This program helps in creating business opportunities for Omani men and women. The SANAD program was started in October 2001 under the Ministry of Manpower with an objective to help promote and foster the development of small-scale enterprises in Oman. It encourages and sponsors the individual initiatives and the self-employment projects. The program provides opportunity for men and women job seekers, craftsmen/craftswomen and vocational aspirants to start and run their own business. The age group chosen for this program is 18-40 years and under this program a loan of 5,000 Rial Omani (around \$13,000) is provided as a loan. The period of loan settlement is seven years including one year as a grace period. The Government has created SANAD offices in each governorates and regions that provide technical and administrative support to the beneficiaries.

### **General Objectives of the SANAD Program**

- Supporting the work-seekers (vocational and craftsmen) by establishing individual and family self employment projects and by sharing in finding job opportunities for workers of different educational and vocational levels with those who are interested in investment as business owners.
- Participating in spreading the individual initiatives and enhancing the efforts of self-independence as a condition to achieve the everlasting development.
- Supporting the developmental efforts by establishing productive and serviceable small projects as a main source of the national income.
- Enlarging the base of private sector and businessmen.
- Developing the small projects sector and suggesting the policies and mechanisms for realizing them.
- Participating effectively in the Omanisation plan in the private sector.
- Mobilizing the efforts for deepening the idea of free business and enhancing the initiatives for work and production in the minds of youth and Omani society.

For this program, the targeted categories chosen were the jobseekers (male and female) including the new graduates who were interested in starting small projects managed by them and, craftsmen who were interested in starting new productive or serviceable work for themselves or interested in expanding their existing business. Twenty two sectors were selected as focus areas namely: grocery shops (sale of food stuffs); vegetables and fruit shops; sale and supply of electrical items; sale of watches; masterpieces and gifts; sale of ready-made garments; sale of natural flowers; delivery vehicles; carwash; Internet café; photography shops; sale of fish; butchery shops; poultry shops; home appliances maintenance; sale and repair of tires; electrical

installation; sale and supply of electrical items; repair and maintenance of home cooling appliances; painting of buildings; house furniture upholstery; carpentry shops; iron smithery shop (metal doors and windows); and goldsmithery shops.

In addition to these occupations and businesses, the applicant is free to choose any business of his or her choice. Some of the basic conditions that are stipulated for the approval of the projects are as follows:

- The project should provide a new job opportunity.
- The project should have suitable technical and economical benefits.
- Local raw materials to be used in the project.
- Products of the project should be of good quality and easy to market.
- Modern technology to be used in the project.
- The ability to continue and expand in the future.
- The project should comply with the conditions and requirements of the environment preservation.
- The project should satisfy the need for quality products at competitive prices.
- It should employ 100 percent Omani workforce.

Some other conditions of this project are that the applicant should be able to read and write well, not employed at present, and be fully free for the project. For the loans for sewing and designing clothes, which are the women's domain, a training certificate has to be enclosed. The applicant must have a personal guarantor (father, brother, sister etc.) and have a place for establishing the project (owned or rented). One is also required to present a feasibility study of the project showing the cash flow during the period of the loan and an acknowledgement to employ Omani manpower only (Ministry of Manpower, 2004).

The Oman Development Bank disburses the loan amount after approval and recovers it as per the Fund regulations. The period of the loan settlement is seven years including one year as a grace period starting from the date of granting the loan. The fund charges an interest rate of 2 percent per annum to cover the administrative cost of the loan. The SANAD offices in the governorates and regions provide the technical and administrative support to the beneficiaries by providing advice and consultancy services to the owners of the small projects regarding the activities to be practiced, organizing short courses for training the owners regarding management, accounts, cost and marketing with the cooperation of the concerned parties in the public and private sectors, and follow-up of the projects in order to be assured of quality whether they are goods or services. It also solves the problems and difficulties that may be faced by these projects. It also helps in marketing the products and suggesting the possibilities available inside or outside the Sultanate. More importantly, it also conducts periodical evaluation of the small projects and their effects on the targeted categories of businesses (Ministry of Manpower, 2004).

### **SANAD and Women Entrepreneurs**

The SANAD program has been successful in helping young entrepreneurs and so far it has benefited 8581 entrepreneurs (during 2002-2004). Out of which 37 percent<sup>1</sup> funds have been provided to women. In total, it has created job opportunities for 10,000 Omanis in different

activities like foodstuff outlets, SANAD committee projects, vegetables and fruit outlets, management of school canteens and others (See Table 1). The program has trained 1,921 people who started their own businesses. At present, it is running four incubators, out of which three are targeted for women entrepreneurs for whom training is being imparted in tailoring and fashion designing. There have been 1,117 people trained and almost all of them are women<sup>1</sup> (See Table 2).

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Table 1 here

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Table 2 here

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As of the end of 2004, the success rate of this program is 76 percent. The beneficiaries are repaying their loans and running their enterprises successfully. Though there is no separate data available on women entrepreneurs' success rate, it is thought that the success rate is higher in case of women entrepreneurs. This trend is not specific to any particular district rather in all wilayas (districts). Women have emerged as more responsible and serious entrepreneurs. They are diligent and hardworking and they do what is required to make a business successful<sup>2</sup>.

The Omanisation process has been intensified through the SANAD initiative in certain activities and establishment and the foodstuff outlets has been Omanized in 45 wilayas out of a total 59 wilayas of Sultanate. It is planned to achieve 100 percent Omanization in foodstuff outlets by May 2006. The participation of women in this drive is quite encouraging and the total participation of 37 percent of women with high success rate is reflective of the bright future of women micro-entrepreneurs. The recent impetus to the training of women through the SANAD program will surely increase their participation tremendously in coming years.

### **Intilaaqah Program and Women Entrepreneurs**

**“Intilaaqah”** program was started by the Shell Oil Company in Oman in the year 1995. It is part of the Shell group worldwide initiative, LiveWIRE. The Intilaaqah in Arabic means “rapid take-off”. This program helps the young entrepreneurs by providing them the right kind of training, counseling and consultancy services which enables them to start their own businesses. The objective of the training program imparted by the Intilaaqah is to develop the candidate's ability to conceptualize the business environment by enabling him or her to acquire necessary skills to run small businesses professionally. This program targets young men and women who are 18-35 years of age and are unemployed or self-employed. They should have a viable business idea and have approval from a funding institute or have the financial ability to start their businesses ([www.intilaaqah.org](http://www.intilaaqah.org)).

A number of companies sponsor (See the Table 3) the trainees who get a National Vocational Qualification (NVQ) level 2-3 in Business Planning and Ownership to start a micro project or a

small and medium enterprise (SME). The training program duration is three months and the training is imparted in Arabic and covers all aspects of setting up and running a business. It covers issues like market research, preparing cash flow, and financial forecasts, importance of the right location, use of computer and proper filing system. This program also provides counseling support and advice to the beneficiaries. It has a network of voluntary advisers besides after care support to its graduates who have started their enterprises. The program conducts workshop for the young entrepreneurs and it also give awards to the best businesses every year to boost the motivation of the entrepreneurs (OER, 2003: 25).

The initiative taken by Intilaaqah is helping the diversification strategy adopted by the government to move from oil sector to non-oil sector by creating gainful employment and contributing to the GDP. The program which was initiated in Muscat area has been expanded to 18 centers across the Sultanate (OER, 2003: 25). It has trained 680 people so far (upto the end of 2004, since its inception in 1997) out of which 49.2 percent are females. The women participation in training has been more accentuated in last four years. In fact, the women constitute more than men i.e., 53.25 percent in the training imparted to the young entrepreneurs by Intilaaqah in last four years during the period 2001-2004 (See Table 4). The kinds of business which women have started after the Intilaaqah training are: tailoring of ladies dresses; photo and video shooting in wedding parties; sale of readymade garments; beauty saloons; and health clubs.

The success rate of Intilaaqah program is high and only 32.05 percent of trainees who have gone through the three-month training program are unemployed. The percentage of trainees who have joined organizations for gainful employment is 34.26 percent. This shows that the participants get attracted towards good jobs rather than running their own businesses. However, 26.76 percent of trainees are able to start their business and they have created job opportunities for 383 people (See Table 5). Though, the gender-specific data was not available; it was suggested that was an equal percentage of the success rate<sup>3</sup>. As women participation has already been more than half of the total participation in the last 4 years, the role of young Omani women is going to be more important in the near future.

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Table 3 here

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Table 4 here

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Table 5 here

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Intilaaqah also gives award to young entrepreneurs for successful running of their businesses. It gives awards in five different categories: the best entrepreneur, the best business in terms of Omanization, the best business idea, best display and best Intilaaqah progressed startup for the

Intilaaqah trainees. In 2004, 13 entries were short-listed for the award and out of which four were women. The 2004 award for the best entrepreneur and the best display award were won by women. The best entrepreneur award was also won by females in the year 2000 and 2002<sup>4</sup>.

### **Role of other Agencies in Promoting Women Entrepreneurship in Oman**

The role of voluntary private organizations is very important in establishing the network of the entrepreneurship programs. The sensitization of the society to the concern of Omanization in terms of employment and ownership is important in this regard and all stakeholders have to play their active role in encouraging and promoting small and medium enterprises to move its reliance from oil sector to non-oil sector. The role of the Omani Women's Association (OWA) has been important in this regard. OWA is attracting more and more women to become its members so that it can help and support women by making them more self reliant and productive. Awareness is the first and foremost affair for women entrepreneurs and it can play a more important role in this regard. OWA organizes seminars and other activities concerning women. It also participates in various seminars and workshops organized by many international women's forums and organizations. The members can participate in such seminars and take an active part in them. They can also take part in the local seminars organized by other organizations concerned for their interests. OWA has plans to expand its activities by inducting more experts who would provide training in the fields like IT and administration. OWA is also helping the young women realize their dreams and it offers courses free of cost to its members in areas like computing, tailoring, and interior designing. Members can project their skills and also sell their products at exhibitions held by OWA or by participating in exhibitions and trade fairs organized by other organizations (Aman Daily News, 2002). These efforts will surely help women in becoming more empowered and visible in the Omani society. The local community development centres (LCDCs) funded by the Ministry of Social Development also help women to improve the quality of life for their families and improve their contributions to the community. The role of both OWA chapters and LCDCs becomes very important in promoting entrepreneurship in women.

In 2004, a new voluntary organization of businesswomen, "Women in Focus" was launched in Oman. The primary goal of this forum is to establish a platform for the Omani women through which they can contribute vigorously to the community. This forum will underline the role of women as partners and leaders in the business and professional sectors. The four areas of concern identified by the forum are: networking; mentoring; training; and research. This forum will encourage networking among women that will help in sharing their learning and experiences. Women who are relatively new to the workplace and who manages the enterprises will have an opportunity to learn from each and other. The role of women as role model and mentor is also important and helps any society in encouraging the women participation in vocations and enterprise (Khaleej Times, 2004).

### **Women Entrepreneurs as Role Model in Oman**

Oman has been known for its trade and businesses for ages. The great Sindbad story and the role of Oman as a prosperous seafaring nation is well known. There have always been a great number of role models in the Omani society. As of today there are also entrepreneurs who are role models for others. One such example is the founder of the Bahwan group, Sheikh Saud who

started his small non-descript shop in Muttrah souq selling Toshiba TVs and Seiko watches and went on to establish one of the most successful business houses in the Gulf region touching an annual turnover of US \$ 1 billion (Kamoonpuri, 2004: 10, 18). There are plenty of such male examples available for the young entrepreneurs in Oman. But women need role models who are women which they can imitate and relate to them. The tradition and cultural background of the society makes it more important to find out the role model who can play important role in encouraging young entrepreneurs.

Recently, the participation of women in all spheres has made such role models available in Oman. Women are visible everywhere. In a documentation of successful entrepreneurs in Oman undertaken by the government-sponsored press (a national daily, Oman Daily Observer), 23 such entrepreneurs were identified with 5 being women. This indicates the achievement of women entrepreneurs in recent time. One such figure in recent time in Oman is Lujaina Mohsin Haider Darwish. She is a woman of multi-faceted personality. She is an academician, entrepreneur, and politician all embedded in one. She was chosen as “Young Entrepreneur of the Year 2001”, an award given by ‘Oman Awards for Excellence’ instituted by the private sector to celebrate the accomplishment of individuals. Lujaina is member of Majlis A’Shura for the second term. She is also an active member of the board of Oman Chamber of Commerce & Industry (OCCI). She is trying to form a committee that will provide women entrepreneurs a platform to create business contacts and additional leadership skills. She feels that the proposed committee will help in building partnership between local communities, society and government to provide access to finance, business mentoring and other kind of support to young women entrepreneurs. She is of the view that the government of Oman is determined to promote policies and programs which remove barriers to growth and ensure the long term viability of women in business (Kamoonpuri, 2004: 95-100).

Sabrah Al-Riyami is another role model. She represents the new breed of entrepreneurs of Oman. She began her career by joining Oman TV as one of the first GCC national woman television journalists. Later, she co-founded a company that provides services for event management, tourism, and filming. She was chosen as the “Young Entrepreneur of the Year 2002”. Her company Darran LLC was the first company in the Middle East to receive the Gold Star Award in 2002 and Diamond Star Award by the Business Initiative Direction, Spain. She feels that the Sultanate recognizes the contribution of women entrepreneurs in the national economy. She is of the view that women are more likely to be interpersonally aware than men. She suggest business women are often more people oriented and less authoritarian and use a participative or interactive management style in running their businesses resulting in forging a lasting relationship with employees and clients (Kamoonpuri, 2004: 143-148).

## **CONCLUSION**

The efforts undertaken by the Government has been fruitful in Oman and women have equipped themselves with appropriate education and motivation in recent times. Oman has a significant number of women entrepreneurs in the male dominated Arab society. The participation of women in SANAD program is 37 percent and this is likely to increase seeing the fresh impetus being given to women training and development. The women participation in public sector employment has also increased significantly from a mere 9 percent in 1993 to 36 percent in

2004. The participation of women in education and employment has been tremendous in recent past. Women constituted 54 percent of students entering the universities in Oman in 2002.

Diversification of the economy of Oman from dependence on oil and gas, non-renewable sources have led to a drive to encourage the employment of Omani nationals instead of relying on a high percentage of expatriates in the labor force. Women who form about half of the population have an important role to play in this regard (Khoury and Moghaadam, 1995: 35)

The most common problem related with the women businesses in Oman are that most of these are concentrated in service sector and run on small size. There is lack of network and forum in Oman where women can share their learning and exchange information, it makes them a disadvantageous group. (McElwee and AlRiyami, 2003: 345). Establishing network, and encouraging women to participate and share their learning and experience is also important. Though, the role of OWA and LCDCs has been important in handling more of the social issues in Oman, it is required that these efforts can be integrated with the economic empowerment of women. There is a need to create and organize more networking agencies which can provide a platform to women entrepreneurs and its approach should be pervasive involving all regions and all size of enterprise in Oman.

The existing programs like SANAD, Youth Fund and Intilaaqah needs to be reevaluated. The SANAD program that is being run under the Ministry of Manpower should be equipped with more resources and infrastructure to deal with the Herculean task given to it. It needs to provide more training by establishing incubators and training centres. The Youth Fund also needs appraisal to involve more and more women entrepreneurs and to widen its coverage. It can broaden its base by providing support and fund without holding equity and involving smaller enterprises. The size of the Intilaaqah program is also small seeing the number of job seekers in Oman and those interested in establishing their businesses. It needs to train more and more women entrepreneurs to widen its coverage. In fact, such training should be available to all those who wish to start their businesses. Sensitization of youth by media and providing awareness to them is a must for encouraging entrepreneurship for men and women. Including a chapter on the SANAD program in high school textbook and showing concern by the government is a welcome step in this regard. These steps will surely help women entrepreneurs to equip themselves with proper skill, competency, support and motivation to contribute to the process of diversification of the national economy and their social and economic empowerment.

## ENDNOTES

1. No segregated data is available for men and women. This data was provided by Mr. Salem AlNabhani, Executive Director, SANAD program in an interview conducted by one of the authors on March 6, 2005.
2. This view was expressed by the Executive Director, SANAD Program.
3. This information was provided by Mr. Al-Mutassim, Intilaaqah program.
4. Information provided by the Intilaaqah office, Muscat.

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**Table 1: Total Number of People Benefited and the Activities Targeted by the SANAD Program (Year 2002-2004).**

| <b>Activities Targeted</b> | <b>No. of Beneficiaries</b> | <b>% of Women Beneficiaries</b> |
|----------------------------|-----------------------------|---------------------------------|
| Foodstuff Outlets          | 5401                        | NA                              |
| Sanad Committee Projects   | 1709                        | NA                              |
| Vegetables & Fruit Outlets | 893                         | NA                              |
| Managing School Canteens   | 56                          | NA                              |
| Financing Projects         | 522                         | NA                              |
| <b>Total</b>               | <b>8581</b>                 | <b>37 %</b>                     |

Source: Sanad Directorate, Muscat, Oman, 2005.

**Table 2: Total Number of People Benefited by the Training Support Extended by the SANAD Program (Year 2002-2004).**

| <b>Activities</b>        | <b>No. of Beneficiaries</b> | <b>% of Women Beneficiaries</b> |
|--------------------------|-----------------------------|---------------------------------|
| Fashion Design           | 1117                        | 100 %                           |
| Sanad Technology Centres | 610                         | NA                              |
| Enterprises Management   | 167                         | NA                              |
| Phone Repair             | 27                          | NA                              |
| <b>Total</b>             | <b>1921</b>                 | <b>NA</b>                       |

Source: Sanad Directorate, Muscat, Oman, 2005.

**Table 3: Name of the Companies Sponsoring the Trainees at Intilaaqah during 1997-2004.**

| <b>Sponsorships</b>     | <b>Number of Trainees</b> |
|-------------------------|---------------------------|
| Shell                   | 448                       |
| OLNG                    | 230                       |
| Bank Muscat             | 16                        |
| Oman International Bank | 11                        |
| National Bank of Oman   | 20                        |
| Others                  | 7                         |
| <b>Total</b>            | <b>732</b>                |

Source: Unpublished Data from Intilaaqah office, Muscat, January 2005

**Table 4: Training of Men and Women by Intilaaqah during 1997-2004.**

| <b>Year</b>  | <b>Male</b> | <b>Female</b>       | <b>Total</b> |
|--------------|-------------|---------------------|--------------|
| 1997         | 10          | 8                   | 18           |
| 1998         | 57          | 21                  | 78           |
| 1999         | 39          | 62                  | 101          |
| 2000         | 53          | 30                  | 83           |
| 2001         | 63          | 50                  | 113          |
| 2002         | 50          | 50                  | 100          |
| 2003         | 57          | 46                  | 103          |
| 2004         | 17          | 67                  | 84           |
| <b>Total</b> | <b>346</b>  | <b>334 (49.2 %)</b> | <b>680</b>   |

Source: Unpublished Data from Intilaaqah office, Muscat January 2005

**Table 5: Total Number of Persons Trained by Intilaaqah Program Region-wise during 1997-2004, their Entrepreneurship Status and No. of Job Created.**

| <b>Region</b>            | <b>Musandam</b> | <b>Dofhar</b> | <b>Al-Batinah</b> | <b>Adh-Dhahirah</b> | <b>Ad-Dakhilyah</b> | <b>Muscat</b> | <b>Ash-Sharqiyah</b> | <b>Total</b> |
|--------------------------|-----------------|---------------|-------------------|---------------------|---------------------|---------------|----------------------|--------------|
| Total Number of Trainees | 30              | 21            | 151               | 30                  | 83                  | 128           | 289                  | 732          |
| Drop-out                 | 0               | 0             | 3                 | 0                   | 0                   | 23            | 26                   | 52           |
| Total Number of Graduate | 30              | 21            | 148               | 30                  | 83                  | 105           | 263                  | 680          |
| Started Business         | 2               | 3             | 35                | 6                   | 27                  | 48            | 61                   | 182          |
| Employed                 | 14              | 8             | 35                | 15                  | 20                  | 39            | 102                  | 233          |
| Unemployed               | 13              | 5             | 60                | 6                   | 29                  | 18            | 87                   | 218          |
| Further Studies          | 1               | 3             | 15                | 2                   | 7                   | 0             | 10                   | 38           |
| Not Contacted            | 0               | 2             | 3                 | 1                   | 0                   | 0             | 3                    | 9            |
|                          | 30              | 21            | 148               | 30                  | 83                  | 105           | 263                  | 680          |
| Job Created incl. Owners |                 |               |                   |                     |                     |               |                      |              |
| Omanis                   | 5               | 6             | 57                | 8                   | 34                  | 73            | 69                   | 252          |
| Non-Omanis               | 0               | 3             | 26                | 1                   | 5                   | 45            | 51                   | 131          |

Source: Unpublished Data from Intilaaqah office, Muscat January 2005

# **RURAL ENTREPRENEURSHIP IN KENYA: PERCEPTION OF WOMEN ON ENTREPRENEURSHIP**

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## **Abstract**

This study aimed at determining the perception of village women on entrepreneurship success, opportunities and challenges. Women being the backbone of rural economies in developing countries and specifically in Africa, play a significant role to ensure their families' well being. This is seen in terms of providing food, shelter, health and education for the children. Being the majority (55%) of the rural population, their role is crucial in bringing about change in their communities. Most (95%) are engaged in providing for their families through subsistence farming and other agricultural activities supplemented by micro enterprises. Majority (90%) of these women are engaged in these activities out of necessity given that they have limited choices outside their traditional roles. The other reason was the need for financial independence.

The case study methodology was the key approach in this research. The researcher identified and conducted face-to-face interviews and Focus Group Discussions with the women leaders and representatives. The study focused on 50 women groups spread across Mt. Elgon and Bungoma Districts of Western Kenya. They represented Self-help groups operating at the grassroots level and engaged in various income generating activities. A total of 50 women participated in the study. The key research questions for the study examined the perception of the respondents on the following: reasons for engaging in business, success factors, opportunities available for starting micro-enterprises, and the challenges facing women micro-entrepreneurs.

## **Introduction**

Rural entrepreneurship has become more of a way of life and an 'engine' for economic transformation among the rural poor. It is offering hope for the disadvantaged members of society, the majority of whom are women. As they engage in micro enterprises, they operate under what has come to be known as the Informal Sector; a sector with near nil government regulations and policies. Studies however, have shown that women owned and operated enterprises have tended to remain micro with little growth if any. Here in Kenya for instance, it is fairly evident that the woman especially in the rural areas, appear to be marginalised especially with regard to main stream entrepreneurship interventions. The cultural believe that women belong to the kitchen is still strong among most rural people; and anyone who goes against this norm is viewed as an 'outcast' and may be married off as a second wife or may never be married at all.

Apparently, from anecdotal evidence, it has not always been easy for rural women to find suitable jobs that will allow them to balance family responsibilities and employer requirements. Education, training and relevant experience also appear to have been impediments to employment in addition to family expectations. Hence many women are attracted by the idea of self-employment which allows them flexible hours to take care of both the home and business fronts. Micro and small-scale enterprises represent an important means of earning income for the rural women in Kenya (GOK, 1992). They provide a means of livelihood, employment and income to alleviate poverty conditions.

The number of women in entrepreneurial roles has increased significantly over the last three decades. In the 1990's for instance, their overall share of Micro and Small-scale Enterprise Sector in Kenya grew over 70 percent (GOK, 1999); and women being the majority beneficiaries and implementers. These entrepreneurial women however, appear to still lag behind their male counterparts in terms of enterprise growth, income and in general competitiveness. For most women entrepreneurs, going into business was to get a steady source of income and to fend for their families (Karanja, 1996). These women were mainly housewives whose lifestyles have been largely focused on household chores. Many women entrepreneurs were either pushed into business by their spouses or are victims of circumstances such as losing key bread winners in the family. Hence for most of them, business is a necessity rather than an opportunity. This study aimed at determining the woman entrepreneurs perception on entrepreneurship success, opportunities and challenges.

Despite the hurdles faced in operating enterprises, especially in the rural areas, women appear to have managed to pull through and provide basic (sometimes secondary) necessities for their families. Indeed a few of those successful rural women entrepreneurs are seen as role models in the community for their hard work and perseverance. As a result some of them have been invited to give public talks/lectures in the schools and in special gathering in the community. They have also made great efforts in the development process through the formation of self-help and income-generating groups. Studies have shown that success of these women depends largely on the existence of an enabling environment and also on the social and economic factors prevailing at the time (Otunga, et al. 2001). The level of education, training, age and access to means of production also play a major role.

There are a number of financial and non-financial interventions currently in place to support these entrepreneurs (Manen and Koimburi, 2004). They include: micro-loans, business development services, marketing services, and government policies and regulations (GOK, 1996). Most of these interventions however, are only common in urban areas and have not had much impact in most of rural Kenya.

Keino and Ngau (1993) pointed out the changing societal norms and economic environment as some of the reasons for the emerging roles of women. They argued that the traditional gender division of labor has drastically changed and that today women have to work to provide for their households. Food has been identified as the immediate need of most rural households in Kenya. While searching and engaging in activities such as micro-enterprise and other income generation activities to fill this gap, rural women have largely to contend with social, economic and environmental challenges often with scarce resources. Kibas (2001) in the study on the impact of women operated enterprises found that women are now emerging as key players in the economic transformation of their homes. As regards their characteristics, most have hardly gone beyond primary education and have no or very limited training. As regards marital status, 80% are married and have families. A number of these women have absentee husbands, who often work far away from their homes; the rest of the women population are either single mothers, separated or widows.

In a study conducted in Western Kenya, it was evident that these women have only their basic necessities in mind when starting a venture; however, other additional reasons emerge as the business progresses. The purpose of this study was to determine the perception of rural women on entrepreneurship success, opportunities and challenges. Specifically, the study sought answers to the following questions: why are women engaged in business? What are the success factors and opportunities? And what are the challenges in operating micro

enterprises in rural settings? The rural setting was selected because of the size of the Kenyan population which lives outside urban settings; it is estimated to be over 65% of the total population. The significance of the findings of this study is that the government and other key players in development, can now package appropriate interventions specifically aimed at the issues raised by the rural women entrepreneurs.

### **Methodology**

The case study was the primary method of study. Through the case study and blended with descriptive approaches, the researcher gained a rich understanding of the context of rural entrepreneurship. Village self-help groups, which are largely composed of women (90%), were seen as 'cases' that represented a wider population of individuals engaged in micro enterprise to bridge an economic and social gap. The descriptive methodology enabled the researcher to capture a clear picture of how women in the rural environment perceived and engaged in entrepreneurial activities. As noted in Saunders et al (2000), these methodologies are seen as being appropriate for this type of study where the researcher needs to capture an accurate picture of the events as they occur.

The population of interest consisted of all women groups operating in rural areas of Mt. Elgon and Bungoma Districts of Western Kenya. The total population of these organizations in the area of interest was approximated to be over 200 registered and active self-help groups and Community Based Organization (CBOs) in the area of interest. Most (over 95%) of the rural women are engaged in providing for their families through subsistence farming and other agricultural activities supplemented by petty trade or micro enterprises. Agriculture, which is practiced mainly for home consumption, takes various forms such as; keeping chicken, growing vegetables, and tending the family gardens among others. They are also engaged in small-scale horticulture for the market place. A few women keep livestock as part of the family assets as well as savings. Most have hardly gone beyond primary education and have none or very limited training. As regards marital status, 80% of women are married and have families. A number of these women have absentee husbands, who often work far away from their homes; the rest of the women population are either single mothers, separated or widows.

A multi-stage sampling process was used to select the 50 respondents for the study. Through purposive sampling and using a list provided by the Non Government Organizations (NGOs) serving in the region, 50 (25%) women groups were identified to participate in the study. The groups sampled came from different parts of the two districts of interest and covered all the sectors of the economy, which included farming, livestock, chicken rearing, trade and cottage manufacturing. Prior to the sampling, a survey was done with the respective NGOs in the region in order to get a picture of the status of rural entrepreneurship in the area. Preliminary discussions were also made with some of the leaders of the groups before holding in depth Focus Group Discussions with the representatives of the sampled groups.

The researcher conducted face-to-face interviews and Focus Group Discussions with the sampled women group leaders and representatives from the 50 selected self-help groups. The key research questions for the study examined the perception of the respondents on the following aspects: reasons for engaging in business and success factors, opportunities available for starting micro-enterprises and the challenges facing women micro-entrepreneurs. Data was analyzed using qualitative methodologies. This was mainly content analysis. The aim was to establish the patterns, trends and relationships of gathered data on

the perception of rural/village women on entrepreneurship success, opportunities and challenges (Mugenda and Mugenda, 1999). The objective was to understand the women's interpretation and perception of the role of engaging in entrepreneurship activities.

### **Why engage in business and entrepreneurial activities?**

The study found that the key reasons why most women venture into income generation activities such as operating micro and small businesses include: the need to provide items such as food, clothing, education and health care for the family, and to help in the development of the community, among others. Most women also stated that they were engaged in entrepreneurial activities because they wanted to be self-reliant; being self-employed so as to be kept busy and gainfully occupied. They wanted to rely less on their spouses for financial support and up-keep. Studies have also shown that women tend to be more considerate and committed to providing for their families even when it means "toiling like beasts of burden" in fetching firewood, digging, drawing water and cooking, while the husbands do little with no regard to what the family will eat.

Table 1 gives a summary of the reasons provided by the respondents as regards why they were engaged in entrepreneurial activities. Leading among the reasons was, Family Welfare with 20 (45.5%) respondents. This reason included the ability to provide for the family adequately – good shelter, secure home, and education for the children. This reason was followed by the need to be self-employed as indicated by 12 (27.27%) respondents. Self-employment was expected to create some autonomy, generate income, and hence alleviate poverty.

Table 1 about here

From these findings, a pattern seems to emerge. Three key reasons are given why a woman would engage in business or income generation activities. On top of the minds of the rural women, is survival of the family, being occupied by engaging in self-employment and the need to develop the community and the economy. Profit motive did not feature much – only one respondent indicated it as a reason for going into business.

This study found that most entrepreneurial activities operated by the women in the rural area included: operating small retail outlets (often in temporary locations), selling of second hand clothes (*mitumba*) and the marketing of surplus food crops. Few were engaged in farming as a business. This rotated around the practice of agriculture on subsistence. The surplus was then sold to generate income for the family.

### **Success Factors**

Several factors were perceived to be contributing to the success of micro-enterprises in rural Kenya. These include: availability of capital, market opportunities, suppliers of inputs, availability of other resources and good planning. Table 2 provides an analysis of the success factors that would contribute to starting and managing an income generating project as stated by the respondents.

Table 2 about here

## *Capital*

Availability and accessibility of capital for both business start-up and business growth was most common with 6 (27.27%) respondents. It is worth noting that capital requirement for most women operated businesses was fairly low at the micro-enterprise level. It was also ranked first as a critical factor since few women in rural areas can access bank loans. Commercial banks have conditionalities that have often been found to be discouraging; for example the requirement of collateral as security for the bank loans. Most women operating micro-enterprises may not easily acquire loans from commercial banks due this requirement unless their spouses or parents act as sureties. The Co-operative bank and the 'village' banks have however, been in the forefront in innovative micro financing, which has assisted these entrepreneurs.

An emerging type of association has developed in many rural areas, known as the "Merry-go-round" or Rotating Savings and Credit (ROSCAs) Associations. These are usually informal groups that have emerged mostly among the women to fill the void of lack of capital and related social support (Alila, 1996). A group of women often ranging between 10 and 30 organize themselves to contribute money to each other in turns, with the aim of improving their welfare. Most of the money received from these associations usually ends up in the purchasing of household goods, paying school fees/tuition for the children, and in meeting other obligations. A number of respondents who belong to some of these groups stated that they had successfully invested the money in their micro-enterprises. Profits they earned were then largely used to pay off the 'soft loan' from the members.

Most of these women entrepreneurs used their personal savings for initial business start up. This came from previous savings for those who were employed. They also received support both in cash and in kind from their families including spouses, parents, and siblings to invest in the business. Some of the respondents indicated that they obtained their start-up capital from farm produce such as surplus crops, milk, poultry and cattle. A very low ( 2%) percentage of these women however, obtained their working capital from the co-operative bank in form of loans and advances. This low utilization of loans is either because of ignorance, lack of information about loan payments and repayments or because the cooperative banks were not available in some of the locations covered by the study.

## *Planning*

Surprisingly (knowing that these are rural women with limited knowledge) a number, 6 (27.27%), of respondents indicated good planning as one of the key success factors. Planning prior to and subsequently after the business start-up stage was stated as a success factor. Most of the respondents indicated that they had learned from others how to manage the resources in the micro-enterprise effectively. This covered setting objectives and standards, customer care, retention and motivation of staff. Planning to most of them involved preparing for a "rainy day" when it is too wet to do anything.

## *Availability of markets and other resources*

Markets and effective demand for the products and services offered were perceived to be important for the success of the enterprise. Markets were said to be crucial in the survival and take-off stages of the enterprise. Effective demand and good positioning of the products and services offered played a key role in the growth of the enterprise as stated by 5 (22.73%)

respondents. Availability of resources and suppliers were also ranked as important by a similar number of respondents.

### **Challenges facing Women Entrepreneurship**

Asked about the challenges facing rural entrepreneurs, the respondents gave various factors that were said to be posing challenges and impacting on the woman entrepreneur. They included: competition from well established male-dominated enterprises, lack of accurate information on markets, inadequate support mechanisms, finance for expansion, lack of risk-taking behaviour, domestic commitments, and stereotyping among others. Table 3 gives a summary of key challenges as perceived by the women entrepreneurs to be major hindrances to business growth and expansion.

Table 3 about here

Foremost were competition (markets) and information related factors, which were said to be major challenges as stated by 12(32.43%) and 11(29.73%) respondents respectively. Competition was seen in form of the size of the market share in the rural setting – most of these markets were not expanding and new competitors were also emerging; including mini-super markets with wide varieties of products for those who were engaged in selling household products.

Lack of information on the new markets and market segments, and the ever increasing demands by clients for variety also posed challenges to the rural entrepreneur; local entrepreneurs did not have adequate information on markets in which they were supplying their products. Inavailability of accurate information and lack of knowledge about business management were ranked 1<sup>st</sup> as key challenges. Information about the government procedures on micro and small enterprises were not easily available to the respondents. Inadequate resources and support mechanisms from spouses and others ranked 3<sup>rd</sup> with 4 (10.81%) respondents indicating that these were limitations.

The other challenges from the Focus Group Discussions that were seen to be affecting the success of rural micro-enterprises include: need for effective communication so as to negotiate/bargain favourably; management and effective control of debtors and proper record keeping; lack of appropriate skills, and family demands. Issues to do with domestic matters such as balancing a woman's role in the home and the enterprise expectations also featured as major challenges facing women.

In a number of cases, for those women entrepreneurs who sought trading licenses, they found the procedures rather bureaucratic and time consuming. Licenses were only available at the trade offices at the district headquarters. These offices are often far away, in some cases over 30 kilometers from the business location. This was also complicated by poor and unreliable public transportation system which often resulted in one wasting time traveling and waiting for the license to be processed.

The poor infrastructure, which covers the road networks and communication services in a large portion of the rural area of study, was a major obstacle for enterprise growth. It was reported that transportation became ineffective and inefficient due to impassable roads

(especially in wet seasons); hence most fresh produce from the farms often deteriorated before reaching the market – leading to heavy losses every season.

Entrepreneurship always involve some level of risk taking. For women in the area under study, gender stereotyped perception of self, lack of confidence and assertiveness appeared to have been major barriers. Most of the respondents in the Focus Group Discussions concurred that risk taking was a big hindrance and that engaging in the non-traditional and outside home activities were still being frowned at in the village. This was coupled with heavy domestic commitments, and resistance of social structure to change. Family resistance to change so as to allow the women to make major decisions and engage in business is a real obstacle and disincentive to business start-up and growth. The status of women in a patriarchal social structure, of which the area of study seemed to subscribe heavily to the norm, makes women dependent on males in their lives –husbands or fathers. It was also noted that other close male family members often made decisions for women; this usually tended to go against the independent spirit of entrepreneurship.

Lack of sufficient education and training for women was reported to be another impediment to micro-enterprise success. Culturally, and especially in the rural setting, the girl child was not given equal opportunity to study like the boys; hence they had limited education and training (if any) which tended to affect effective performance in later life. One respondent stated thus,

*“ We as women are more isolated socially; we lack previous work experience, and access to enterprise information and marketing facilities which the men entrepreneurs acquire. The excessive demand on our time as wives, mothers and ‘managers’ of the home front due to our chores, make it nearly impossible to successfully operate an enterprise. It is only by God’s grace that we manage to survive. This is besides our position in the family and the structure of power relation; where women are treated as children with no much voice. One who ventures out there to follow the entrepreneurial spirit, often does so at the expense of her family.”*

One other challenge that was cited a number of times, was the responsibility of the entrepreneur to provide for the extended family members and relatives. Most micro-enterprise resources are not usually separated from personal finances and hence these family obligations are met from resources earned in the business. Enterprise income was often diverted to pay tuition, medical expenses services and other expenses on behalf of the members in the extended family. Their demands tended to drain the savings and income made by the business; since such finances would otherwise have been used in the enterprise for expansion and growth. Though some of them do assist in providing services in the enterprise (or in the family), the financial obligations in supporting them usually exceeds the services they provide.

## **Conclusion**

The study sought out answers to the following questions: Why are women in rural setting engaged in business? What are the success factors and opportunities? What are the challenges in operating a micro-enterprise in rural settings? Based on the findings of this study, the following conclusions can be drawn:

1. Women are less concerned with making money. They see entrepreneurship as a means of simultaneously meeting career needs and providing for the family. What they earn is mostly spent for the benefit of the entire family. Another key motivating force for women was to be self-supporting and somehow 'independent' from depending so much on the spouse.
2. Among the key success factors were that generally, women entrepreneurs in rural areas receive substantial family support at start-up and in the course of running their business. Such support is however, based mainly on social rather than economic consideration. Other factors include good planning, availability of markets and resources and suppliers.
3. A number of challenges face rural women entrepreneurs. They include: lack of information on the markets and sources of finance, competition, inadequate management skills, debtors management, domestic issues and cultural practices among others.

From the findings of the study, many rural women are unaware of credit sources and other business support services. They are therefore disadvantaged compared to their urban entrepreneurs.

### **Implications of the study**

The overall implication of this study is that since rural women entrepreneurs appear to be playing a major role in the economy, besides up-lifting the lives of their families, special effort is needed to develop rural entrepreneurship. Hence appropriate and sustained interventions targeted to the rural women entrepreneurs need to be developed and implemented. All the stakeholders, who include the Government, Non-Governmental Organizations, private/corporate sector firms, donor agencies and all the intermediary community-based organizations should be involved. The women entrepreneurs themselves will be expected to more specifically identify the areas of critical support and be involved in the development of suitable programs.

Specifically the following need to be addressed:

1. *Capacity building:* Women need training in functional areas such as finance, marketing, production and managerial skills. This assumes numeracy and literacy skills. Women's involvement in co-operatives requires literacy and education. Illiterate women are shy to join organizations. To become entrepreneurs in single or cooperative firms women first need to understand their own capabilities.
2. *Family Support:* A major strategy should be to promote the social and economic empowerment of women, as they constitute a vulnerable social category that is critical in sustainable development endeavors. Married women should be given support by their spouses in respect of finances, motivation, encouragement, advice and actual involvement in the running of business.
3. *Financial support:* Access to credit by women entrepreneurs at the level of small-scale enterprises, should be facilitated through programs and alternatives that go beyond the conventional collateral dominated credit security systems. The public sector and credit organizations should be sensitized on the value of gender-balanced participation in the informal sector enterprise.
4. *Policy and Regulations:* The government's role in enacting and implementing rural-entrepreneur friendly policies as regards licensing ( for example, having a one-stop shop

office closer to the communities), and security and respect of private property. Gender specific policies sensitive to women entrepreneurs needs need to be developed and implemented.

5. *Infrastructure:* The government together with the private sector and other stakeholders should be involved in improving and providing the road network, communication facilities and the needed utilities such as water, electricity and postal services.
6. *Further Research:* There is need for further social research in the area of culture and women entrepreneurship.

## APPENDIX: TABLES

**Table 1: Reasons for engaging in Business**

| <b>Reason why in business</b> | <b>Frequency</b> | <b>Percentage</b> |
|-------------------------------|------------------|-------------------|
| Family Well being             | 20               | 45.45             |
| Self employment               | 12               | 27.27             |
| Develop the economy           | 9                | 20.45             |
| To be responsible             | 2                | 4.54              |
| To earn Profits               | 1                | 2.27              |
| <b>Total</b>                  | <b>44</b>        | <b>100</b>        |

**Table 2: Success Factors**

| <b>Success Factors</b>                  | <b>Frequency</b> | <b>Percentage</b> |
|---|------------------|-------------------|
| Capital                                 | 6                | 27.27             |
| Good Planning                           | 6                | 27.27             |
| Market                                  | 5                | 22.73             |
| Availability of resources and suppliers | 5                | 22.73             |
| <b>Total</b>                            | <b>22</b>        | <b>100</b>        |

**Table 3: Key challenges facing women entrepreneurs**

| <b>Challenges</b>                      | <b>Frequency</b> | <b>Percentage</b> |
|--|------------------|-------------------|
| Information and knowledge availability | 12               | 32.43             |
| Competition (markets)                  | 11               | 29.73             |
| Lack of resources and support          | 4                | 10.81             |
| Effective Communication (bargaining)   | 3                | 8.11              |
| Debtors management and record keeping  | 4                | 10.81             |
| Domestic                               | 2                | 5.41              |
| Inflation                              | 1                | 2.7               |
| <b>Total</b>                           | <b>37</b>        | <b>100</b>        |

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FAMILY RESOURCE MANAGEMENT BY FAMILY BUSINESS  
IN CANADA, KOREA, AND THE UNITED STATES

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**ABSTRACT**

Family resource management practices of business owning families in Canada, Korea, and The United States are compared. U.S. respondents are 759 family managers in the 1997 National Family Business Survey. Canadian respondents are 65 family managers from Manitoba in the 1997 Canadian Family Business Survey. Korean respondents are 105 family managers interviewed in 2000 as part of a survey of owners of small to medium enterprises in Seoul. Chi squared statistics indicated country differences on each of the ten management practices. Mean responses on eight of the practices were significantly different between countries. Korean and U.S. means were different on all eight; Canada and Korea were different on four of the practices. Factor analysis of the management scale items yielded different patterns for Canada, Korea, and the United States. Both the number of managerial strategies and the types of strategies used varied in the three countries.

Key words: family resource management, business-owning families, family business, cross-cultural comparisons

## INTRODUCTION

While there is universal agreement that the ecosystems approach to family resource management is the most influential currently, questions have arisen about the broad applicability of the Deacon & Firebaugh (1988) ecosystems framework. Engberg (1996) has characterized the dominant approach in family resource management as technical and argued that a technical approach substantially restricts feasible actions in much of the world and should not be used in ethical practice. Zuiker, Stafford, Heck & Winter (1995) have questioned whether the Deacon & Firebaugh (1988) framework is better suited to employment management than to family management or to men's management rather than women's management. To the extent gender roles are more clearly defined and distinguished in less developed countries and nonwestern cultures, the questions raised by Zuiker *et al.* (1995) would, by implication, also raise questions about the application of the Deacon & Firebaugh (1988) framework to the situations in less developed countries. The purpose of the present paper is to compare the family resource management practices of business owning families in Canada, Korea, and the United States as measured by a scale based on the Deacon & Firebaugh (1988) framework. Such a comparison is an essential step in the assessment of the generalizability and usefulness of the Deacon and Firebaugh framework, in particular, and the ecosystems framework, more generally.

## REVIEW OF LITERATURE

Empirical research on family resource management in Canada, Korea and The United States provides little basis for making cross-cultural comparisons or drawing inferences about the applicability of the Deacon & Firebaugh (1988) framework to nonwestern cultures. At most we can compare results across two countries. The effects of resources on family resource management have been studied only in Korea.

The effects of gender have been studied only in The United States and Canada. In Canada, Duncan (2000) found that men and women spent different amounts of time on household management. In the United States, Zuiker *et al.* (1995) found that men and women managed families differently. Korean interviews on family resource management have been with women.

The effects of domain have been studied in Canada and the United States, and in both countries the effect of domain was tied closely to the effects of gender. In the United States women managed family and paid work differently, but men did not. In Canada the evidence for a domain effect on management was less direct. Women used home-based work and self employment to balance the demands of employment and family, but men did not, and women who had home-based employment spent more time in management than women who did not.

The effects of number of demands on family resource management have been studied in all three countries, but the same indicator variables have been used only in two countries. Results for number of demands were inconsistent between Korea and the United States and within Korea. In Korea, number of children had a negative relationship with family resource management, but in the United States number of children had a positive effect. In Korea, while number of children had a negative effect, wife's employment had a positive relationship with management. In the United States, number of demands had a consistent, positive relationship with family resource management. Number of children had a positive effect. So did being the family manager and the business manager rather than only the family manager. In Canada, number of demands was indicated by whether employment was home-based or office-based. Time spent in management increased with home-based employment for women.

The relationship between family resource management and satisfaction was researched in Korea and the United States. Again, the results are not comparable. In Korea style of management was related to satisfaction, but in the United States there was no relationship between the quantity or frequency of management and satisfaction. In Korea, morphostatic managers reported the highest levels of satisfaction with family life. In the United States, family resource management behavior did not have a significant effect on either satisfaction with how well children were doing or overall satisfaction with life.

No studies have used the same means of measuring management in more than one country. The current study does. The current study also has the advantage of being based on an internationally respected management framework. Consequently, the results of the current study will enlighten both the subject of cross-cultural differences in management and the subject of the cross cultural applicability of the framework used as the basis for the study.

## **METHOD**

### **The Family Resource Management Scale**

The current study uses the 1997 Family Management Scale, which is based on the Deacon & Firebaugh (1988) model. The 1997 scale is an updated version of the 1992 Household Work Scale (Heck, Winter, & Stafford, 1992) first developed as a summary measure of the practices described in the Deacon & Firebaugh (1988) model. The 1992 scale was developed as a summary measure of the entire set of behaviors covered by the term "family resource management" that could be administered via telephone interviews and used in causal analyses. As such the scale could not contain numerous items and had to be readily understood. The 1997 modifications were prompted by previous results that suggested the words used to operationalize the managerial behavior did not have the same meaning for women as they did for men. Other research suggested that the statement, "Each week you decide some way you can improve your life" in the 1992 scale was not satisfactory in operationalizing the concept of goal setting. Therefore, in the 1997 scale the wording of this item was changed to "Each week you decide something specific you can do for your

family.” The specific wording of the scale items and the managerial concepts they represent are presented in Figure 1. For each item, the leading statement was “These next items are about how you manage your household. Think of a scale from 1 to 5, where 1 means the statement is not at all like you, and 5 means it is exactly like you.” In pretests conducted by the Iowa Statistics Laboratory, a random sample of respondents did not have difficulty rapidly understanding and evaluating the family resource management scale items.

Scores on each of the 10 scale items were summed to give a total management score, which could range from 10 to 50. Higher scores on individual scale items denote more frequent use of the practice that conforms to the Deacon & Firebaugh (1988) model of family resource management and, therefore, are assumed to be associated with more effective management. It was assumed that the higher the score on the household management scale, the more extensive the management practiced by the respondent.

[Figure 1 about here]

## **Data**

The data for the United States are from the 1997 National Family Business Survey (NFBS). The NFBS contains data from both the family manager and the business manager from a nationally representative sample of business-owning families. To be eligible for inclusion, a household had to consist of two or more persons related by blood, marriage or adoption, at least one of who owned or managed a family business. The business owner had to work in the business at least 300 hours a year and have been in business for at least a year. Detailed information on prevalence rates can be found in Heck & Trent (1999). Detailed information on data collection methods and procedures can be found in Winter, Fitzgerald, Heck, Haynes & Danes (1998).

Data for Canada were obtained from a representative sample of 65 business-owning families in the province of Manitoba. Data were collected in 1997 simultaneously with the NFBS in the United States using the same definitions of business ownership and household as criteria for inclusion in the sample. The same interview schedule and procedures were used for the Canadian and the American samples. Both data sets were collected by the Iowa Statistics Laboratory.

Data for Korea were obtained from a representative sample of business owning families in the city of Seoul. Whereas, data from Canada and the U.S. were collected by telephone interviews, data from Korea were collected via face- to- face interviews in January, 2000. Only the family managers of business owning families were interviewed in Korea. They answered questions about both the family and the business. Korean respondents were selected from the small business directory published by the Korean Small Business Association. The 1997 NFBS served as the foundation for the interview schedule used in the 2000 Korean Family Business Survey. Questions from the NFBS were translated into Korean, administered in Korean. After the data were coded, both the interview schedule and the coded data set were translated back into English.

### *Samples*

The sample for the United States is 759 families who completed the family manager interview. Of those 259 were dual managers, managing both their families and a business. The remaining 500 were single role managers. In Canada 61 family managers completed the family interview. Of those, 17 were dual role managers and the remaining were single role managers. All 105 of the family managers in Korea had a dual role, also working in the family business with their spouses.

Several descriptive characteristics of the business-owning families ( $n = 925$ ) are shown in Table 2. The average age of the household manager was 45. The mean of educational level for the household manager was 14 years. Over half of the business-owning families owned home-based businesses (51%), they have resided in the community for 19 (19.3) years, and about 55% lived in a rural location (towns of 10,000 or less). Most of respondents (89%) owned their home.

On average, the number of children in the household was 1.40, the number of children present aged 0-5 in the household was .23, and the number of children present aged 6-17 in the household was .85, number of total children under 18 years old was 1.04. The average total family income was \$ 68,419, income from the family business was \$ 31,351, and family income from other sources was \$ 37,203. On average, the number of working persons in a household was 2.02. For the large majority (71.8%), the business was owned and managed by the first generation.

[Table 1 about here]

### **Analysis**

Frequency of responses for the 10 statements comprising the 1997 Family Management Scale were tested for independence using the chi square statistic. Also for each statement in the scale and the total management score the mean response was calculated. An F-test for difference in means for each item and the total management score was used to discover whether the three groups of managers differed significantly in their managerial activities. Pair-wise differences in means were tested for significance using the Scheffe and Bonferroni tests. Cronbach's alpha and a standardized item alpha were used to assess the reliability of the 1997 Family Management Scale for each of the three countries. Finally, factor analysis of the Family Resource Management was conducted separately for Canada, Korea, and the United States. While tests for independence and difference in means identified intercountry differences for each item and the total management score, principle components factor analysis with varimax rotation was used to discover underlying relationships among the items in the management scale and differences or similarities in the underlying relationships among the three countries.

## RESULTS

### Differences in Management Practice by Country

The results of tests for independence indicated systematic differences in response to the management items by country. The Chi Squared statistic for each item was significant at the .05 level or greater. Canadian home managers were as likely to reply with a four as with a five. Korean home managers were more likely to reply with a three or five rating rather than with a four. Americans were most likely to reply with a rating of five, and were more likely to reply with a four than with a three. According to the F tests, mean responses were significantly different for eight of the ten items in the management scale. Only the mean responses for demand clarification and resource assessment were not significantly different. According to the Scheffe and Bonferroni tests, mean responses for all eight of the other items were significantly different between Korea and the United States. There were fewer significant differences in responses between Canada and Korea. Canada and Korea had significantly different mean responses to the items for sequencing, standard setting, adjusting and demand responses. Mean responses were not significantly different between Canada and the United States.

[Tables 2 & 3 about here]

### Factor Analyses of the Household Management Scale

Factor analysis of the management scale items yielded different patterns for Canada, Korea, and the United States. Both the number of managerial strategies and the types of strategies used varied in the three countries.

#### Canada

Four identifiable factors resulted from the analysis of the Canadian data. Canadian household managers are plan oriented, goal oriented, action oriented or outcome oriented. Standard setting, demand clarification, resource assessment and checking comprised the planning orientation. Plan oriented managers know how they will judge the outcome of their managerial activities before they begin, they ensure that their goals are clear, and they know how much of their resources can be devoted to their goals. These managers also associate checking with these planning activities; checking appears to be focused on ensuring that goals are clear and resources are adequate.

Goal oriented managers emphasize goal setting, adjusting, and demand responses. These managers set goals and associate goals with how well they like the results. That is, how people feel about achievement of goals is important to these managers and adjusting – finding another way to accomplish the goal when plans are not progressing well – is the link between initially setting the goal and achieving satisfactory results. Resource issues do not appear to be a primary concern for these managers.

Action sequencing and actuating load together for action oriented managers. These managers emphasize getting things done. Their managerial activities are focused not on setting goals or monitoring resources and outcomes but on the actions themselves. Planning when to take action and taking action are the key strategies for these managers. Finally, monitoring resource changes is the only managerial activity to load on the factor that describes action-oriented managers. For these managers, the primary focus is on the effectiveness of their managerial activities. Unlike their goal-oriented counterparts, these managers do not appear to focus on satisfaction with goal achievement as much as efficiency of goal achievement.

## **Korea**

Three factors resulted from analysis of the managerial practices of Korean household managers. Korean managerial styles were identified as classic, goal oriented, or action oriented, but the goal oriented and action-oriented styles differ from those of their Canadian counterparts.

Classic managers use the planning activities of demand clarification, and resource assessment; the implementing activities of checking and adjusting; and the output activities of demand responses and resource changes to manage family life. Setting goals is not an emphasis for these managers; rather, it appears that the goals are already known and the focus instead is on being sure that the goals are clear and that resources are sufficient to meet goals.

Plans are checked and adjusted as necessary as they progress in order to achieve satisfactory outcomes. Satisfaction with both the extent to which goals are met and resource use in achieving goals are important to these managers.

The second managerial style evident among the Korean managers is a goal-oriented approach. Unlike Canadian goal oriented managers who associated goal setting with adjusting and demand responses, Korean goal-oriented managers pair goal setting and standard setting. For these managers, deciding which goals to pursue and how to judge if the goals are met drive management.

Finally, action-oriented managers focus on the managerial strategy of actuating. Korean action-oriented managers focus simply on taking action, whereas the Canadian action oriented managers paired putting actions in sequential order with taking action. For Korean action-oriented managers, it is the actions themselves that predominate.

## **The United States**

Analysis of the US sample yielded two identifiable factors. U.S. household managers can be described as process managers and technical managers. Process managers are focused on satisfaction with the outcome of managerial activities. These managers see close associations among the components of planning, standard setting and action sequencing; the implementing activities of checking and adjusting; and the output of demand responses. For these managers, satisfaction with the results is crucial, so standard setting, that is, having a good idea about how to judge the outcome of their managerial processes, is an important activity. Like the classic managers in Korea, these managers check their plans to see if everything is all right and make adjustments if necessary in order to achieve a satisfactory outcome.

In contrast, production managers monitor resource changes, not demand responses. These managers are concerned with the effective use of resources, not feelings of satisfaction with the output. Production managers associate goal setting, goal clarification, resource assessment and actuating with resource changes. They think plans through so that goals are clear and required resources are identified. Taking action is associated with these activities as well. Production managers have a clear focus on resources.

[Table 4 about here]

## **DISCUSSION**

Consistent differences between pairs of countries were found. There were differences in frequencies, means and factor loadings. Before discussing cultural differences in family resource management, it is necessary to acknowledge the possibility of other explanations for the differences among countries reported in this article. In particular, sample characteristics and measurement error may partially explain differences in results. In the middle section the meaning of cultural differences in management will be discussed. Finally, implications for future research will be discussed.

Several differences in sample characteristics may be related to the differences in means between countries. The Korean families were all dual earner; in fact, both spouses worked in the family business. Only Korean women were interviewed; both family information and business information were provided by women who managed the family and worked in the business. In the United States only 25 or 34 percent of the sample were dual role holders. In Canada, 17 or 28 percent were dual role holders. Previous studies of family management by business owning families in the United States found that dual role holding by the family managers was associated with more extensive management. In the absence of cultural differences, the larger proportion of dual role managers in the Korean sample would have explained higher management scores for the Korean sample. However, most often Korea had the lowest score not the highest. A potential explanation for this result will be discussed under measurement error.

The Korean respondents were all urban; the sample was drawn only from Seoul. The United States and Canada had large proportions of the samples drawn from rural locations. The greater distances between houses in rural areas may be associated with more extensive management. However, rural incomes are lower than urban incomes in the United States, and lower income may lead to substitution of labor for capital in the form of more extensive management. Therefore, differences in the urban/rural composition of the samples may be responsible for some of the observed differences in mean scores.

Finally, the Korean respondents all owned first-generation family businesses and all were very small businesses. In the United States most, but not all, of the businesses were very small. In Korea, only 13.3% of the respondents owned a home-based business. In the United States and Canada the proportion was much larger. In the United States 55.9% of the respondents and in Canada 61.8% owned home-based businesses. The managers of families with home-based employment in the (Heck, Winter & Stafford, 1992) reported lower management scores, whether dual or single role holders, than the managers of business owning families in the 1997 NFBS, whether dual or single role holders (Duncan, Zuiker & Heck, 2000). In the absence of cultural differences, these previous results would imply higher management scores for Korea rather than lower scores.

One other possible explanation for the differences in results between Korea and The United States and Canada is measurement error. In both the United States and Korea there is evidence of response bias, a tendency to give the same response to the next question as given to the last questions. Interestingly, there may be a cultural difference in the preferred answer rather than the extent of the bias. Koreans most frequently responded with a neutral three; whereas, Americans most frequently responded with a five, exactly like me. The preponderance of neutral responses is found in other Korean survey results. To some extent, the bias toward a neutral response may be mitigated in this study by the use of a Korean interviewer who interviewed the respondents in Korean. The difference in preferred response may be cultural. Americans may be more likely to think they are supposed to say they manage. The question that needs to be asked is whether the observed differences are cultural differences in management practice or cultural difference in perception of the desirability of managing a family.

The remaining explanation for differences between countries is culture. Assuming the observed differences are real and attributable to culture rather than sample characteristics, is the Deacon and Firebaugh systems model of family resource management more applicable to Western cultures than to Eastern cultures? Possibly the answer is yes. The model was developed in a Western culture, and is an outgrowth of empirical studies of management practices of Ohio family managers thought to be managing well by their friends and neighbors. Other cultures were not included in the development of the model. On the other hand, the perennial, persistent problems of families are universal and techniques that make the work of families more efficient should be applicable across cultures. The environment and amount of change the families encounter may be very different from one country to another. Consequently, the prevalent management practices and routines may be different from place to place.

Taken together, these results strongly suggest that further international comparisons of the managerial practices of business owning families are warranted. Relational analyses that control for sample characteristics would help determine to what extent cultural and sample characteristics are responsible for the observed differences in managerial behavior. It is also important to control for the environments of these families in future research. It would also be valuable to identify attributes of the cultures that explained differences in management practice, assuming the differences are found in the future to be attributable to culture.

Another direction for future research suggested by these results is use of different model of family resource management. Stafford & Avery (1991) suggested a family resource management model that would be more broadly applicable than the Deacon & Firebaugh (1988) model yet was consistent with the family systems model on which Deacon & Firebaugh (1988) based their model. To date this model has not been used in empirical research. Perhaps use of their model to guide measurement of managerial behavior patterns would facilitate cross- cultural research. More consistent results might lead to less controversy about the relevance and applicability of western management techniques to nonwestern cultures and the techniques used in developed economies to less developed economies.

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FIGURE 1

Family Resource Management Concepts <sup>a</sup> and Corresponding Questionnaire Items

| Management concepts  | Questionnaire Items <sup>b</sup>   |
|----------------------|--|
| <b>Input</b>         |  |
| Demands              |  |
| Goal setting         | Each week you decide something specific you can do.  |
| <i>Events</i>        |  |
| <b>Resources</b>     |  |
| Throughput           |  |
| Planning             |  |
| Standard setting     | Before starting a complex task, you have a firm idea about how to judge the outcome.   |
| Demand clarification | When planning a task, you think the plan through so that your goal is clear before you begin doing the task.                 |
| Resource assessment  | Before you begin a job, you figure out how much of your time, money, and energy that you can devote to this particular task. |
| Action sequencing    | You think about when to do a task, and not just how much time it will take.  |
| Implementing         |  |
| Actuating            | When there is a task to be done at home, you wait until the last minute to do it. <sup>c</sup>                               |
| Controlling          |  |
| Checking             | As you work, you check whether things are going as you want them to.   |
| Adjusting            | When things are not going well, you figure out another way to do it.   |
| <b>Output</b>        |  |
| Demand responses     | When a task is done, you think about how well you like the results.  |
| Resource changes     | You are pleased if the work just gets done; you do not spend time thinking about how effectively it was done. <sup>c</sup>   |
|                      | You are pleased if the work just gets done; you do spend time thinking about how effectively it was done. <sup>d</sup>       |

<sup>a</sup> Management concepts refer to definitions used in Family Management: Principles and Applications, by Ruth E. Deacon and Francille M. Firebauth, Boston: Allyn and Bacon, 1988.

<sup>b</sup> Actual items are listed. The leading statement was: These next items are about how you manage your household. Think of a scale from 1 to 5, where 1 means the statement is not at all like you and 5 means it is exactly like you. Items were not asked in the order listed.

<sup>c</sup> This item was reverse coded in descriptive statistics and the factor analysis results.

<sup>d</sup> This item of Korean data was not reverse coded in descriptive statistics and the factor analysis results.

**TABLE 1**

**Descriptive Statistics for Selected Characteristics of Business-Owning Families**

| Variables                                | <u>Canada ( n = 61 )</u> |            |         | <u>U.S. ( n = 759 )</u> |           |         | <u>Korea ( n = 105 )</u> |           |         |
|--|--------------------------|------------|---------|-------------------------|-----------|---------|--------------------------|-----------|---------|
|  | Mean                     | S.D        | Percent | Mean                    | S.D       | Percent | Mean                     | S.D       | Percent |
| Family size                              | 3.52                     | 1.299      |         | 3.46                    | 1.33      |         | 3.97                     | .89       |         |
| Age of household manager (years)         | 44.44                    | 9.02       |         | 44.85                   | 10.45     |         | 45.33                    | 7.55      |         |
| Education of household manager (years)   | 13.15                    | 2.15       |         | 13.96                   | 2.24      |         | 13.53                    | 2.05      |         |
| Number of children in the household      | 1.48                     | 1.27       |         | 1.40                    | 1.27      |         | 1.83                     | .78       |         |
| Total family income                      | 99,347.75                | 405,858.54 |         | 68,419.66               | 122576.27 |         | 52,532.63                | 66,109.92 |         |
| Family income from family business       | 16,943.27                | 17,734.82  |         | 31,351.31               | 38039.13  |         | 30,833.46                | 35,958.05 |         |
| Family income from other sources         | 83,640.36                | 412,117.35 |         | 37,203.93               | 117391.59 |         | 21,699.17                | 42,686.24 |         |
| Number of working persons in a household | 2.10                     | 1.12       |         | 2.02                    | 1.17      |         | 2.27                     | .54       |         |
| Years in community                       | 23.62                    | 11.94      |         | 19.36                   | 14.35     |         | 8.44                     | 8.24      |         |
| Household with other income              |                          |            | 72.1    |                         |           | 68.1    |                          |           | 70.5    |
| Home ownership                           |                          |            | 91.5    |                         |           | 89.1    |                          |           | 75.2    |
| Rural location (10,000 town or less)     |                          |            | 59.0    |                         |           | 54.9    |                          |           | 0.0     |
| Home based business                      |                          |            | 61.8    |                         |           | 50.9    |                          |           | 13.3    |
| First generation business                |                          |            | 68.9    |                         |           | 71.8    |                          |           | 100.0   |
| Dual role holder                         |                          |            | 27.9    |                         |           | 41.2    |                          |           | 100.0   |

**TABLE 2**

**Frequency of Responses on Family Resource Management Scale Items within Each Country**

| Management concept   | Frequency of Responses<br>(n, %) |          |          |          |                    |                          |          |          |          |                    |                       |           |           |           |                    | $\chi^2$ | Probability |
|----------------------|----------------------------------|----------|----------|----------|--------------------|--------------------------|----------|----------|----------|--------------------|-----------------------|-----------|-----------|-----------|--------------------|----------|-------------|
|                      | Canada ( n = 61)                 |          |          |          |                    | Korea ( n = 105)         |          |          |          |                    | U.S. ( n = 759)       |           |           |           |                    |          |             |
|                      | Not at all<br>Like me            |          | Somewhat |          | Exactly<br>like me | Not at all<br>like<br>me |          | Somewhat |          | Exactly<br>like me | Not at all<br>like me |           | Somewhat  |           | Exactly<br>like me |          |             |
| 1                    | 2                                | 3        | 4        | 5        | 1                  | 2                        | 3        | 4        | 5        | 1                  | 2                     | 3         | 4         | 5         |                    |          |             |
| <b>Input</b>         |                                  |          |          |          |                    |                          |          |          |          |                    |                       |           |           |           |                    |          |             |
| Goal setting         | 7(11.5)                          | 9(14.8)  | 15(24.6) | 8(13.1)  | 22(36.1)           | 15(14.3)                 | 4(3.8)   | 64(61.0) | 9(8.6)   | 13(12.4)           | 93(12.3)              | 76(10.0)  | 176(23.2) | 141(18.6) | 273(36.0)          | 75.330   | .000***     |
| <b>Planning</b>      |                                  |          |          |          |                    |                          |          |          |          |                    |                       |           |           |           |                    |          |             |
| Standard setting     | 3(4.9)                           | 2(3.3)   | 20(32.8) | 22(36.1) | 14(23.0)           | 6(5.7)                   | 5(4.8)   | 57(54.3) | 19(18.1) | 18(17.1)           | 24(3.2)               | 46(6.1)   | 140(18.4) | 291(38.3) | 258(34.0)          | 76.258   | .000***     |
| Demand clarification | 3(4.9)                           | 2(3.3)   | 17(27.9) | 27(44.3) | 12(19.7)           | 3(2.9)                   | 0(0.0)   | 42(40.0) | 21(20.0) | 39(37.1)           | 41(5.4)               | 49(6.5)   | 156(20.6) | 200(26.4) | 313(41.2)          | 39.978   | .000***     |
| Resource assessment  | 4(6.6)                           | 4(6.6)   | 21(34.4) | 22(36.1) | 10(16.4)           | 4(3.8)                   | 4(3.8)   | 36(34.3) | 30(28.6) | 31(29.5)           | 54(7.1)               | 69(9.1)   | 164(21.6) | 254(33.5) | 218(28.7)          | 18.087   | .021*       |
| Action sequencing    | 7(11.5)                          | 9(14.8)  | 20(32.8) | 8(13.1)  | 17(27.9)           | 1(1.0)                   | 1(1.0)   | 27(25.7) | 31(29.5) | 45(42.9)           | 61(8.0)               | 73(9.6)   | 169(22.3) | 190(25.0) | 266(35.0)          | 27.704   | .001**      |
| <b>Implementing</b>  |                                  |          |          |          |                    |                          |          |          |          |                    |                       |           |           |           |                    |          |             |
| Actuating            | 4(6.6)                           | 16(26.2) | 17(27.9) | 12(19.7) | 12(19.7)           | 15(14.3)                 | 13(12.4) | 46(43.8) | 17(16.2) | 14(13.3)           | 93(12.3)              | 104(13.7) | 213(28.1) | 124(16.3) | 225(29.6)          | 26.990   | .001**      |
| Checking             | 5(8.2)                           | 0(0.0)   | 8(13.1)  | 27(44.3) | 21(34.4)           | 2(1.9)                   | 7(6.7)   | 32(30.5) | 31(29.5) | 33(31.4)           | 18(2.4)               | 30(4.0)   | 108(14.2) | 262(34.5) | 341(44.9)          | 34.649   | .000***     |
| Adjusting            | 0(0.0)                           | 1(1.6)   | 7(11.5)  | 19(31.1) | 34(55.7)           | 2(1.9)                   | 4(3.8)   | 30(28.6) | 34(32.4) | 35(33.3)           | 17(2.2)               | 23(3.0)   | 77(10.1)  | 240(31.6) | 402(53.0)          | 34.744   | .000***     |
| <b>Output</b>        |                                  |          |          |          |                    |                          |          |          |          |                    |                       |           |           |           |                    |          |             |
| Demand responses     | 0(0.0)                           | 1(1.6)   | 4(6.6)   | 20(32.8) | 36(59.0)           | 7(6.7)                   | 11(10.5) | 47(44.8) | 19(18.1) | 21(20.0)           | 24(3.2)               | 21(2.8)   | 66(8.7)   | 199(26.2) | 449(59.2)          | 148.096  | .000***     |
| Resource change      | 10(16.4)                         | 5(8.2)   | 15(24.6) | 10(16.4) | 21(34.4)           | 2(1.9)                   | 1(1.0)   | 17(16.2) | 28(26.7) | 57(54.3)           | 102(13.4)             | 103(13.6) | 137(18.1) | 177(23.3) | 240(31.6)          | 41.158   | .000***     |

|                         |               |               |               |
|-------------------------|---------------|---------------|---------------|
| Total scale mean        | 37.180 (4.96) | 36.543 (5.78) | 38.432 (6.09) |
| Cronbach's alpha        | .5327         | .7589         | .6962         |
| Standardized item alpha | .5741         | .7707         | .7195         |

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*Note.* Sum of percentages for each item may not equal 100% due to rounding.

\*  $p < .05$  \*\*  $p < .01$  \*\*\*  $p < .001$

**TABLE 3**

**Means and Standard Deviations of Family Resource Management Scale Items for Canada, Korea, and U.S**

| Management concepts  | Canada (n = 61) |      | Korea (n = 105) |      | U.S. (n = 759) |      | F-test for differences |             |
|----------------------|-----------------|------|-----------------|------|----------------|------|------------------------|-------------|
|                      | Mean            | S.D  | Mean            | S.D  | Mean           | S.D  | F-Value                | Probability |
| Input                |                 |      |                 |      |                |      |                        |             |
| Goals setting        | 3.48            | 1.41 | 3.01            | 1.10 | 3.56           | 1.38 | 7.640                  | .001***     |
| Planning             |                 |      |                 |      |                |      |                        |             |
| Standard setting     | 3.69            | 1.03 | 3.36            | 1.01 | 3.94           | 1.02 | 15.591                 | .000***     |
| Demand clarification | 3.70            | 0.99 | 3.89            | 1.01 | 3.92           | 1.16 | .976                   | .377        |
| Resource assessment  | 3.49            | 1.06 | 3.76            | 1.04 | 3.68           | 1.19 | 1.052                  | .350        |
| Action sequencing    | 3.31            | 1.34 | 4.12            | 0.90 | 3.69           | 1.26 | 9.182                  | .000***     |
| Implementing         |                 |      |                 |      |                |      |                        |             |
| Actuating            | 3.20            | 1.22 | 3.02            | 1.19 | 3.37           | 1.36 | 3.582                  | .028*       |
| Checking             | 3.97            | 1.11 | 3.82            | 1.02 | 4.16           | 0.97 | 6.075                  | .002**      |
| Adjusting            | 4.41            | 0.76 | 3.91            | 0.97 | 4.30           | 0.93 | 8.854                  | .000***     |
| Output               |                 |      |                 |      |                |      |                        |             |
| Demand responses     | 4.49            | 0.70 | 3.34            | 1.12 | 4.35           | 0.97 | 51.551                 | .000***     |
| Resource changes     | 3.44            | 1.46 | 4.30            | 0.91 | 3.46           | 1.40 | 18.030                 | .000***     |
| Total scale          | 37.18           | 4.96 | 36.54           | 5.78 | 38.43          | 6.09 | 5.418                  | .005**      |

\* p<.05 \*\* p<.01 \*\*\* p<.001

**TABLE 4**  
**Factor Loadings for Family Resource Management Scale for Canada, Korea, and U.S.**

|                                | Factor loadings for Canada<br>(n = 61) |                  |                    |                     | Factor loadings for Korea<br>(n = 105) |                  |                       | Factor loadings for U.S<br>(n = 759) |                      |
|--------------------------------|--|------------------|--------------------|---------------------|--|------------------|-----------------------|--------------------------------------|----------------------|
|                                | Factor 1                               | Factor 2         | Factor 3           | Factor 4            | Factor 1                               | Factor 2         | Factor 3              | Factor 1                             | Factor 2             |
|                                | Plan<br>Oriented                       | Goal<br>Oriented | Action<br>Oriented | Outcome<br>Oriented | Classic<br>Manager                     | Goal<br>Oriented | Actuation<br>Oriented | Process<br>Manager                   | Technical<br>Manager |
| Input                          |  |                  |                    |                     |  |                  |                       |                                      |                      |
| Goal Setting                   | 0.04614                                | <b>0.75165</b>   | 0.08760            | 0.13849             | 0.06851                                | <b>0.79934</b>   | -0.17758              | 0.26542                              | <b>0.40299</b>       |
| Planning                       |  |                  |                    |                     |  |                  |                       |                                      |                      |
| Standard setting               | <b>0.85171</b>                         | -0.00960         | 0.06439            | -0.07717            | 0.16984                                | <b>0.87396</b>   | 0.03991               | <b>0.59082</b>                       | 0.41335              |
| Demand clarification           | <b>0.81038</b>                         | -0.07376         | 0.26061            | 0.20799             | <b>0.65975</b>                         | 0.27774          | 0.14880               | 0.42073                              | <b>0.53205</b>       |
| Resource assessment            | <b>0.60888</b>                         | 0.10094          | 0.52016            | 0.05574             | <b>0.53325</b>                         | 0.44482          | 0.22390               | 0.38857                              | <b>0.53832</b>       |
| Action sequencing              | -0.29036                               | 0.17869          | <b>-0.74217</b>    | 0.24199             | <b>0.71937</b>                         | 0.00882          | 0.22349               | <b>0.57054</b>                       | -0.22768             |
| Implementing                   |  |                  |                    |                     |  |                  |                       |                                      |                      |
| Actuating                      | -0.04812                               | 0.23073          | <b>0.78898</b>     | 0.22875             | 0.05356                                | -0.05953         | <b>0.88734</b>        | -0.15276                             | <b>0.63248</b>       |
| Checking                       | <b>0.66367</b>                         | 0.36748          | -0.27889           | 0.23344             | <b>0.72996</b>                         | 0.06565          | -0.33277              | <b>0.62788</b>                       | 0.31727              |
| Adjustment                     | 0.14470                                | <b>0.56610</b>   | -0.17851           | -0.56003            | <b>0.78524</b>                         | 0.15237          | -0.16383              | <b>0.66070</b>                       | 0.07775              |
| Output                         |  |                  |                    |                     |  |                  |                       |                                      |                      |
| Demand responses               | -0.00668                               | <b>0.82064</b>   | 0.05287            | -0.06232            | <b>0.56381</b>                         | 0.24908          | -0.26506              | <b>0.66845</b>                       | 0.08120              |
| Resource changes               | 0.22447                                | 0.09439          | -0.02548           | <b>0.81015</b>      | <b>0.58125</b>                         | 0.04045          | 0.17301               | -0.00701                             | <b>0.61428</b>       |
| Eigenvalues                    | 2.35                                   | 1.80             | 1.64               | 1.21                | 3.08                                   | 1.77             | 1.18                  | 2.37                                 | 1.85                 |
| Percent of variation explained | 23.53                                  | 18.04            | 16.37              | 12.11               | 30.79                                  | 17.73            | 11.80                 | 23.74                                | 18.49                |

*Note:* Highest factor loading for each management concept denoted by numbers in boldface type

**SMALL AND MEDIUM ENTERPRISES PLANNING:  
EVIDENCE FROM AUSTRALIA**

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**Abstract**

This paper explores business planning by small and medium enterprises (SMEs) owners dedicated to management development in Australia. Planning in large organizations has been studied extensively but with little applied to SMEs. Research has shown that planning pays and there is a renewed focus on planning by SMEs. The success and growth of SMEs is of utmost importance to world economies. Business planning has been considered as a management undertaking that can lead to success and growth. This research investigates types of business plans that are important for SMEs and factors that influence planning and the key issues and concerns of management in planning. In undertaking the study it was expected that those who do engage in formal management processes would be more of planners than those who do not engage in the same. A total of 350 structured questionnaires were sent to the respondents by mail and 156 usable responses were received indicating a response rate of 44.6%. Results from this study indicated that some key management issues are more relevant to SMEs and therefore would be helpful to entrepreneurs and SME managers to undertake them as opposed to others in their business planning. The results also indicated that not all entrepreneurs view business planning as being important. The size of an enterprise, level of education of the entrepreneur and type of industry an enterprise is in was found to greatly influence the level of planning while age of an enterprise did not have an influence on planning.

## INTRODUCTION

Small and medium enterprises (SMEs) form significant sectors in most world economies and therefore their development is regarded as an important issue for most governments. The significance of the sector is due to the contribution made to job and wealth creation in the world economies (Hodgetts & Kuratko, 2001). According to the International Labour Organization the sector accounts for over 40 percent of private sector employment. In Australia, SMEs produce about one-third of total Gross Domestic Product of the economy (Meredith, 2000) and represent about 85.5% of all Australian enterprises including public trading and general government organizations (Office of Small Business, 1999). In the United States of America, small enterprises employ 57 percent of the private sector workforce and produce approximately 45 percent of the nation's gross national product (Helms & Renfrow, 1994). Contributions to world economies by SMEs include provision of opportunities for innovation and breeding grounds for new business ventures (Meredith, 1988), producing national output and exports and reducing rural-urban migration through decentralization and employment generation (Kiriri, 2002).

Although SMEs are a vital part of most economies, there has been much concern about the high failure rate of SMEs mostly attributed to management issues. This has led researchers to examine causes of the high SME mortality and suggest possible solutions to success. For the success of any attempt to prescribe a diagnosis to SME problems there is a need for researchers to understand the pertinent activities engaged by entrepreneurs and contrast them with those that ideally would contribute to the success of SMEs. Business planning has been identified as one factor that would contribute to good management practices and thus lead to success of SMEs.

## LITERATURE REVIEW

Most studies on planning have focused research on larger organizations and as such, have assumed SME owners automatically work with planning models and theories which are not based upon or formulated specifically for SMEs (Shuman, Shaw & Sussman, 1985). However, researchers who have studied SMEs business planning have characterized SME planning behavior as unstructured, irregular, and comprehensive, and as incremental, sporadic, and reactive (Sexton & Auken, 1985). SME knowledge on strategic planning has been argued to be inadequate and not popular amongst owners/managers because SMEs have neither the time, nor staff to invest in planning (Robinson & Pearce, 1984). Primary objective of most SME planning has been found to be related to financial obligations either debt financing, refinancing of current debt or to obtain venture capital (Singhvi, 2000). In his survey of SMEs in UK Singhvi found that 70% of the surveyed companies prepared a business plan primarily for financing needs. Other reasons that he found out were when seeking expansion of current business and developing exit strategies. This is contrary to the expectation that planning would be used to assist in operations and management of an enterprise.

SME planning is influenced by various factors including enterprises' size, age, industry type and education level of entrepreneur or key managers. Over the years researchers have noted a firm's size as a primary influence of business planning. From a meta-analysis conducted by Schwenk and Shrader (1993), it was observed that firm size and stage of development were critical factors in planning. As firms grow and diversify, it becomes progressively more difficult for management to maintain intimate knowledge of industry and business conditions and to exercise control through informal procedures and hence the need for more structured decision making

frameworks incorporating planning (Chae & Hill, 2000). Small firms and those at the earlier stages of growth differ in planning with large firms in later growth stages as a result of difference in resources, specialist expertise and impacts on the market place (Gibson & Cassar 2002). Firm size is measured using several dimensions, which include number of employees, sales turnover (Berman, Gordon and Sussman, 1997) and asset value. Of these the most commonly used and easier for researchers to obtain and validate is the number of employees (McMahon, 2000; Kiriri, 2002). However, it is advisable to use sales turnover as a second measure as it would help overcome misleading employee related size measures as a result of use of independent contractors and part time staff (Gibson & Cassar, 2002).

A firm's age or the length of time the business has been in operation has also been found to influence planning. Risseeuw and Masurel (1994) reported that planning intensity decreases slightly with increasing firm age suggesting that firms that are in the early life cycle stages may show high planning intensity as a result of uncertainty of the future and in an effort to secure financing for the start up phase. Previous research has also found differences in planning behaviors among various industries (Berman, Gordon & Sussman, 1997; Glen & Weerawardena, 1996) suggesting that firms in some industries would include more planners than in others. Gibson and Cassar (2002) found support for this though a weak one in that retail, accommodation and cafes industry appeared less likely to have a business plan. The decision-makers level of education has also been found to greatly influence the levels and incidence of planning. Research by Lowe and Clemens (1991) in Australia found that the incidence of planning was greater when the major decision-makers' education level was high. This is supported by Lee and Matthews (1999) who argue that education is positively related to business

planning. Recent research by Kiriri (2002) and Gibson and Cassar (2002) in Australia give more credence to this. Both studies found that decision-makers with a tertiary qualification were more inclined to be planners than the others. Of interest, Gibson and Cassar (2002) observed that of those with tertiary degree, the likelihood of planning was higher if the qualification was business related.

While some researchers have hailed planning as important to the success of any enterprise, others have argued against it especially long term planning. Planning has been accused of stifling creativity and eliminating true vision and synthesis from the process of change and yielding to too much rigidity. Management theorists such as Henry Mintzberg argue that planning by its nature is prone to devolving into an overly rigid focus on analysis and quantification becoming innately inflexible and incapable of predicting crucial market shifts or encouraging adaptation to current market conditions (Mintzberg, 1994). While some researchers have called the planning-performance relationship tenuous, others have concluded that planning may not be necessary at all while others have argued that planning may actually hinder firm performance (Lumpkin, Shrader & Hills, 1998).

Researchers who have undertaken studies on SME planning formality have drawn conflicting conclusions with some claiming that formal planning provides structures for decision making, helping SME managers take a long-view that benefits their firms. Others conclude that formal planning has no potential pay-off for SMEs because it is a heady, high-level, conceptual activity suited solely to large firms and therefore has no benefits for financial performance of SMEs (Schwenk & Shrader, 1993). Informal planning is prevalent in most SMEs but for most firms,

growth brings with it increasing pressures to formalize the planning process (Chae & Hill 2000). In order to address growth pains brought about by evolution and revolution crises in firm's growth stages, formal planning becomes cardinal.

Empirical support for the usefulness of planning has been mixed. Berman, Gordon and Sussman (1997) found a positive relationship between formal planning and financial performance of firms and concluded that firms that plan produce better financial results than firms that do not plan. As generally agreed planning is a good management practice and firms that don't plan are not as effectively managed, as they could be (Gibson & Cassar 2002). Nevertheless, other studies have found no relationship between planning and performance in small firms arguing that due to limited resources, firms in the early stages of growth are more likely to enhance performance through informal application of strategic decision-making practices than through formal business planning (Schwenk & Shrader, 1993; Lumpkin, Shrader & Hills, 1998). There is however some reported increased interest in planning among SMEs (Kuratko & Hodgetts, 1998).

### **SME BUSINESS PLANNING IN AUSTRALIA**

Planning practices by SMEs in Australia has tended to be similar to other developed economies of America, Canada, and Japan. According to a survey conducted in Australia by Goodwin and Hodgett (1991), it was found that 82 percent of all SMEs responding stated that they do prepare a plan. According to Goodwin & Hodgett (1991) planning in most SMEs in Australia is not influenced or dependent on the number of employees. Most SMEs in Australia that plan are found in the service sector where education levels may be higher and where the industry is rapidly changing to a greater extent than in the other sectors of the economy (Lowe & Clemens,

1991). A study by Kelmar (1996) found that majority of the firms surveyed were undertaking strategic planning activities though most performed these activities on an informal *ad hoc* basis. Kotey (1995) also found that the planning process in small firms as intuitive and informal, involving very little documentation of details of operations.

Most small business owners in Australia believed that undertaking business planning activities benefited their businesses through an increase in sales (Kelmar, 1996). However, Kotey (1995) in studying planning, enterprise performance and owner/manager personal values, concluded that owners/managers placed little emphasis on planning and where planning was undertaken, attention was focused on issues affecting the immediate survival of the business. In a study of planning performance versus planning comprehensiveness of small firms in Australia, Devenish and Fisher (1994) found that firms that undertook strategic planning tended to be larger than those that did not.

### **TYPES OF SME BUSINESS PLANS**

Different authors have suggested different types of plans for SMEs. English (1998) classifies business plans for SMEs as *strategic plans* concerned with creating a strong competitive advantage, meeting the demands for change and constructing a business strategy; *operating plans* concerned with day to day processes, procedures, workflow and efficiency; and *financial plans* representing the dollar quantification of strategic and operational plans. Stoner & Fry (1985) suggest two basic classifications of business plans for SMEs. *Working plans* designed to guide and control actual business operations which include strategic plans; tactical or operating plans and functional plans such as marketing, finance, manufacturing or personnel and *investments/financial plans* designed for the sole purpose of obtaining financing from banks,

government agencies, creditors and other sources of financing. Other researchers refer to specific plans based on *functional* areas of management for a planning enterprise. The business plans, which will be a focus of this study, include marketing/sales plan, organizational plans, human resource/people plans, succession plans, external financial plans, internal financial plans, feasibility plans and strategic plans.

## METHODOLOGY

Data for the analysis were collected from SMEs registered with Business Enterprise Centres (BECs) in Northern New South Wales, Australia. These are government-established agencies to assist in the start up and growth process of SMEs in New South Wales. Convenient non-sampling method was used to select the samples for the study as this allowed selection of respondent based on personal judgment. Use of convenient sampling allowed the inclusion of potential business firms and also allowed the inclusion of those who had been in business for a long period of time. Another consideration was the need to have a sample drawn from a cross-section of businesses in diverse industries. BEC managers in the region of study were allowed to select at least 30% of their members to participate including those who had attended business start up courses in readiness to launch their own businesses. A sample of 350 SMEs was selected from 10 BECs. In selecting the businesses from the region to include in the survey, the respondent firms had to fit into the definition of SMEs of the Australian Bureau of Statistics (ABS, 1999) as:

***Small business:*** Those businesses, which are not subsidiaries of another company and are neither public company, unincorporated cooperatives nor incorporated associations and employ *less than* 20 Full Time Equivalent (FTE) persons. ***Micro business:*** Consists of those small businesses

employing *fewer than 5* Full Time Equivalent (FTE) persons. **Medium business:** Consists of those businesses that are not small businesses, but employ *less than 200* people.

A pre-tested questionnaire was sent by mail. Evidence suggests that a mail survey compared to other methods, is relatively cheap, much information can be obtained very quickly without the problems of interviewer bias and variability inherent in face-to-face techniques, degree of respondent anonymity is assured and sensitive information can be easily gathered in this way, where specific data are requested and records and other sources can be sought for verification (Forsgren, 1989). The questionnaire contained two sections. The first section contained demographic information on the respondents and their enterprises while the second section included questions related to business planning practices. Respondents were asked to indicate:

1. Whether they engaged in planning or not.
2. For those who did plan a list of 8 business plans derived from a literature review on plans for SMEs was provided and the respondents had to select plans that they undertook.
3. All respondents were required to rate the importance of various business plans on a scale of 1-7.
4. A list of 17 business activities derived after a literature review were presented and the respondents were required to indicate how important the various key management concerns were for their businesses on a scale of 1 – 7 (from ‘not important’ to ‘extremely important’).

A total of 156 questionnaires were returned providing an overall response rate of 44.6%.

Descriptive analysis and multivariate tests were used in this study. Descriptive analysis provides means and percentages for the various computations. Multivariate analysis of variance is used to

test whether there is any significant difference between the ratings on importance of plans and factors influencing planning. Univariate tests are further used to show the significant difference between various types of plans and influencing factors.

## **RESULTS**

### **Characteristics of sample members and their enterprises**

The demographic profile of the 156 responding SMEs indicates that a wide variety of businesses participated in the study. The distribution of businesses and their owners' demographics represented a good cross-section of Australian SMEs as evidenced from studies conducted by the Australian Bureau of Statistics (ABS). There is no much difference in representation between this study conducted in the northern part of NSW and data representing the whole of NSW as conducted by the Australian Bureau of Statistics (ABS) in June 2001 (ABS, 2001).

In general respondents were well distributed across age and education. There is a noted male over representation (73.1 percent) compared to females (25.6 percent). This does not differ significantly with ABS data where male were 69.1 percent and female 30.9 percent of the respondents. The survey sample indicated that majority of the business owners/managers were mature aged with very few SME owners under 29 years (4.5 percent versus ABS 11.8 percent) while those between 30 – 50 and over 50 years were the majority with 60.9 percent and 32.7 percent respectively (57 percent and 31.2 percent for ABS data). Most of the respondents attained a high school level of education (44.2 percent against 39.3 percent from ABS data). However, those who had some college training either at TAFE or university were 54.5 percent of the total sample (60.7 for ABS data). Of the 156 respondents 78.2 percent were either business owners or partners while 19.2 percent were managers. It was a requirement that either a business

owner, partner or key manager involved in decision making in the business answer the questionnaire.

Most of the SMEs in the study were limited liability companies (40.4 percent), while partnership and sole proprietorship represented 32.1 percent and 22.4 percent. Most of the enterprises had been in business for more than 5 years (75.6 percent). The industry breakdown indicates an emphasis towards wholesale/retail business at 45.5 percent, with service enterprises representing 30.1 percent and manufacturing and construction enterprises at 14.1 percent and 5.8 percent respectively. Approximately 81.4 percent of the enterprises had less than 10 employees. Annual sales turnover levels were fairly evenly distributed with 17.3 percent having less than A\$ 100,000; 19.2 percent having between A\$100,000 and A\$ 300,000; 18.6 percent having between A\$300,000 and A\$ 500,000; and 39.7 percent with over A\$500,000.

### **Business Planning Status**

In determining respondents who had business plans and those without, a descriptive frequency analysis was performed. The results indicated that 116 enterprises (74.4%) undertook some business planning while 40 (25.6%) did not produce any business plans. In considering the actual business plans undertaken, an analysis of the survey responses as presented in Table 1 shows that 53.8% of the respondents undertook internal financial plans and 54.5% marketing/sales plans. About one-third prepared organizational, staffing and strategic plans. At the other end of the scale, only 13.5% engaged in succession plans, 20.5% in feasibility plans and 22.4% in external financial plans.

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Table 1 about here

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### **Importance of Various Business Plans**

Respondents were asked to rate importance of the 8 business plans on a scale of 1 – 7 (from ‘not important’ to ‘extremely important’) regardless of whether they engaged in planning or not. As presented in Table 2, majority of the respondents had the opinion that marketing/sales plan and internal financial plans were the most important of the eight alternatives. The respondents viewed succession plans and organizational plans as the least important.

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Table 2 about here

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### **Factors Influencing Planning**

A multivariate analysis of variance was performed to investigate influences on planning. The eight business plans were used as dependent variables while enterprise owner’s education level, industry, enterprise size and age were used as the independent variables. Preliminary testing conducted to check for multivariate assumptions noted no serious violations. The results indicated an overall significant difference between the importance of business plans and education level ( $p=.014$ ), industry type ( $p=.006$ ) and enterprise size ( $p=.001$ ). There was no significant difference in ratings the importance of business plans and age of the enterprise. Further, in order to investigate ratings on importance of specific business plans, a one-way analysis of variance (ANOVA) was undertaken. As evidenced in Table 3, the level of education attained significant differences with ratings of five business plans while type of industry and enterprise size each had two.

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Table 3 about here

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## **KEY MANAGEMENT CONCERNS (KMCs)**

In planning, various business activities are undertaken. In total, 17 key management concerns (Table 4) involved in planning were presented to the respondents who were required to indicate how important various key management concerns (KMCs) were for their businesses on a scale of 1 – 7 (from ‘not important’ to ‘extremely important’). The reliability of the scale was tested using the Cronbach alpha test and was found to be reliable with an alpha of .9394 (Hair et al. 1995). The responses on KMCs were subjected to a means analysis. The mean of each of the KMC was computed and ranked. Table 4 presents the key management concerns and responses on the importance of KMCs to their businesses ranking based on the highest means. The five most important KMCs ranked on means revealed that marketing, sales issues and financial issues were KMCs for most of the respondents. On the other hand, the least important activities included organisational structure, succession issues, market feasibility studies, manpower planning and outlining lines of authority and delegation.

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Table 4 about here

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### **Key Management Concerns – Factor Analysis**

The 17 KMCs variables were subjected to principal component analysis. The aim of conducting factor analysis was to summarize the 17 variables into a smaller number of factors for use in further multivariate analysis (Hair et al. 1995). Principal component analysis revealed the presence of three components with eigenvalues exceeding 1, explaining 52.1%, 8.3% and 6.8% respectively accounting for a cumulative variance of 67.2%. An inspection of the scree plot revealed a break and leveling of the plotting after the third component. By using Catell’s (1966) scree test three components were extracted and retained for further investigation.

To aid in the interpretation of the three components, a Varimax rotation was performed. Table 5 presents the rotated solution. The rotated solution revealed the presence of a simple structure with the three components showing a number of strong loadings, and all variables loading substantially on only one component. An examination of the components reveals some relationships between the variables.

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Table 5 about here

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Factor 1 loads heavily with activities related to finances and the future of the business. This factor can be seen to be a **financial and strategic construct**. Factor 2 loads heavily with activities related to personnel issues and organisational issues. This factor then is related to organisational of human resources and can be interpreted as a **human resource construct**. Finally, the 4 activities that loaded on factor 3 related to pricing, products, promotion, market research and competition, which are issues of concern in the marketplace. This factor can be seen to be more of a **marketing construct**. The three constructs were tested for reliability using Cronbach alpha coefficient. All the components were reliable as they attained the required alpha levels of above .5 with Coefficients ranging from .78 to .91 reinforcing the reliability of the constructs (Nunnally 1970).

### **Key Management Concerns Constructs and Planning Status.**

The three constructs derived from the principal factor analysis were subjected to a further multivariate analysis of variance (MANOVA) with the planning status variable (those with plans and those without). The essence of the MANOVA analysis was to assess whether there was any significant differences in means between those who plan and those who do not on the three key management concerns factor composites.

The MANOVA results revealed that **overall** there were significant differences ( $F= 9.420$ ,  $P=.000$ ) in means ratings on the 3 constructs between those who plan and those who do not plan. An investigation on the individual components revealed that all three constructs had significant differences in means between those who plan and those who do not (Table 6). Those who plan rated highly the business activities engaged in planning than those who do not plan and therefore the significant differences in their means. This implies that those who plan rated highly the constructs indicating planning as more important to their businesses than those who do not plan.

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Table 6 about here

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## DISCUSSION

As noted earlier 74.4% of the total respondents engaged in business planning. This is a high percentage but consistent with other previous studies on planning by SMEs in Australia.

Goodwin and Hodgett (1991) found that 82% of their total sample engaged in business planning. The high rate of planning can be attributed to the high education levels of the respondents (54.5% had at least a college education). In a study on planning by small firms in Australia, Lowe and Clemens (1991) found that education levels greatly influenced the levels of planning. From the analysis, the majority of the respondents engaged in marketing/sales plans (54.5%) and internal financial planning (53.8%). This could be attributed to the role played by these plans in the operations and survival of the enterprise.

Marketing/sales plans define enterprise customers and possible strategies to the achievement of set goals. In order to operate profitably and track down performance, internal financial plans are

widely undertaken by most enterprises as through them an entrepreneur can get information and guidance for making operational decisions about the business (Stoner & Fry, 1985). A study conducted in the United States of America by Shuman, Shaw and Sussman (1985) found that the areas in which most plans were prepared were marketing/sales 67.3 percent, operations 22.9 percent, finance (external) 4.2 percent and engineering 3.7 percent. Kiriri (2002) in a study on business planning found that activities related to marketing and financial operations and planning were rated as the most important key business activity entrepreneurs undertook. This gives credence to the finding that most entrepreneurs view marketing/sales plans and internal financial plans as the most important plans.

Due to the size and operations of most SMEs organizational plans are generally not viewed as important since they determine type and designs of organizational arrangements required in implementing other plans (Van de Ven, 1981), which may not be a priority to most SMEs. People/staffing plans were averagely rated which indicates that most SMEs find them of some importance. The least popular plans with the respondents were external financial plans (22.4%), feasibility plans (20.5%) and succession plans (13.5%). The reason could be that these plans are prepared at certain times/periods in the life of an enterprise. External financial plans are mostly prepared for the sole purpose of obtaining funds and presenting to shareholders and other stakeholders however, this is an exception for most SMEs. Potential entrepreneurs would ideally prepare feasibility plans before they begin business operations as well as existing entrepreneurs to evaluate the viability of a new enterprise, product or project. This would rarely occur during the lifetime of an enterprise. Succession plans are required for the succession of the business yet

most businesses do not plan for succession, which may lead to failure (Brown & Coverley, 1999; Hodgetts & Kuratko, 2001).

Consistent with previous research and as mentioned earlier, education levels are deemed to have influence on planning. Those who have a high level of education are therefore expected to be planners in contrast to those with a lower level of education. This can be inferred from the fact that most SME owners fear the formality of planning and do not think there are benefits to accrue from planning. Size of an enterprise also has influence on planning. It would be expected that the larger the enterprise, the more the resources to plan and increased situations that demand planning as a management tool. It would also be expected that smaller firms due to their size do not have time, staff, and expertise to undertake planning. The small enterprises may not recognize benefits accruing from planning and in most cases are a 'one man show'. Enterprise age on the other hand did not attain a significant level. Age is therefore not seen as a key influencer on planning. However, it would be expected that as a result of the learning/experience curve effects, older enterprises would be more of planners than the young.

An analysis of the key management concerns shows some relationship with the ranking of the most popular plans. Activities pertaining to marketing and finance were highly ranked by all the respondents. From the factor analysis of the key management concerns it was evident that those who plan attained a significant difference as opposed to the non-planners, which clearly delineates the key activities undertaken by planner's vis-à-vis non-planners.

The results from this research should form a background for further research on SME business planning. The fact that the respondents rated various business plans as important does not show or indicate what they meant by 'importance'. It should therefore be investigated further as to the value that the various business plans add to enterprises. Previous research has shown that business planning does pay and largely contributes to the success of SMEs but falls short of indicating what plans are ideal or important and contribute to the success of an enterprise. SMEs would have different planning needs depending on their stage of development/growth. Further research is also required to indicate what types of plans would be ideal to any planning enterprises at their different life cycle stages.

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**Table 1**  
**Business Planning Status**

| <b>Business plan</b>     | <b>No. of respondents</b> | <b>Percent</b> | <b>Rank</b> |
|--------------------------|---------------------------|----------------|-------------|
| Internal financial plans | 84                        | 53.8           | <b>2</b>    |
| External financial plans | 35                        | 22.4           | 6           |
| Marketing/sales plans    | 85                        | 54.5           | <b>1</b>    |
| Organisational plans     | 50                        | 32.1           | 5           |
| Staffing/people plans    | 52                        | 33.3           | 4           |
| Succession plans         | 21                        | 13.5           | 8           |
| Strategic plans          | 53                        | 34.0           | <b>3</b>    |
| Feasibility plans        | 32                        | 20.5           | 7           |

**Table 2**  
**Importance of Business Plans**

| <b>Business plan</b>            | <b>Mean</b> | <b>Rank</b> |
|---------------------------------|-------------|-------------|
| <b>Internal financial plans</b> | 5.6         | <b>2</b>    |
| <b>External financial plans</b> | 4.0         | 6           |
| <b>Marketing/sales plans</b>    | 5.8         | <b>1</b>    |
| <b>Organisational plans</b>     | 3.8         | 7           |
| <b>Staffing/people plans</b>    | 4.3         | 5           |
| <b>Succession plans</b>         | 3.5         | 8           |
| <b>Strategic plans</b>          | 5.0         | <b>3</b>    |
| <b>Feasibility plans</b>        | 4.9         | 4           |

**Table 3**  
**Importance of Business Plans and Factors Influencing Planning**

| Plans                     | Education |             | Industry |             | Turnover |             | Age   |      |
|---------------------------|-----------|-------------|----------|-------------|----------|-------------|-------|------|
|                           | f         | Sig         | f        | Sig         | f        | Sig         | f     | Sig  |
| <b>Overall</b>            | 1.990     | <b>.014</b> | 1.930    | <b>.006</b> | 2.044    | <b>.001</b> | 1.087 | .081 |
| <b>Internal financial</b> | 1.196     | .306        | 0.044    | .988        | 2.749    | <b>.031</b> | 0.773 | .835 |
| <b>External financial</b> | 0.277     | .758        | 1.170    | .324        | 2.062    | .090        | 0.902 | .649 |
| <b>Marketing / Sales</b>  | 0.262     | .770        | 6.350    | <b>.000</b> | 1.823    | .128        | 1.167 | .266 |
| <b>Organizational</b>     | 1.237     | .294        | 0.971    | .409        | 0.840    | .503        | 0.908 | .639 |
| <b>Staffing/people</b>    | 4.057     | <b>.020</b> | 0.782    | .506        | 4.452    | <b>.002</b> | 1.368 | .105 |
| <b>Succession</b>         | 3.315     | <b>.039</b> | 0.857    | .465        | 2.202    | .072        | 1.106 | .340 |
| <b>Strategic</b>          | 3.952     | <b>.022</b> | 0.262    | .853        | 1.992    | .100        | 1.181 | .251 |
| <b>Feasibility</b>        | 3.478     | <b>.034</b> | 2.686    | <b>.049</b> | 1.904    | .114        | 0.893 | .663 |

**Table 4**  
**Key management concerns (KMC)**

| KMC      | Key Management Concerns                                    | Means | Rank     |
|----------|--|-------|----------|
| <b>1</b> | Analysis of competition in your market                     | 5.355 | <b>2</b> |
| <b>2</b> | Setting price, products, advertising and promotional plans | 5.888 | <b>1</b> |
| <b>3</b> | Planning for business' building and equipment              | 4.960 | 7        |
| <b>4</b> | Planning for training and development of employees         | 4.987 | 6        |
| <b>5</b> | Outlining lines of authority and delegation                | 4.211 | 13       |
| <b>6</b> | Preparing profit plans, breakeven analysis and cash flows  | 5.250 | <b>3</b> |
| <b>7</b> | Conducting strategic planning                              | 4.940 | 8        |
| <b>8</b> | Undertaking business forecasting                           | 4.636 | 11       |

|           |   |       |          |
|-----------|---|-------|----------|
| <b>9</b>  | Preparing for a successor – planning for succession       | 3.623 | 16       |
| <b>10</b> | Preparing expenditure plans and budgets                   | 5.132 | <b>4</b> |
| <b>11</b> | Conducting market research                                | 4.474 | 12       |
| <b>12</b> | Sales forecast and planning                               | 4.842 | 9        |
| <b>13</b> | Establishing organisational structure/departmentalisation | 3.616 | 17       |
| <b>14</b> | Conducting market feasibility studies                     | 3.836 | 15       |
| <b>15</b> | Planning for manpower requirements                        | 4.092 | 14       |
| <b>16</b> | Long term growth options as diversification/sell off      | 4.717 | 10       |
| <b>17</b> | Preparing of financial projections and statements         | 5.079 | <b>5</b> |

**Table 5**  
**Rotated Component Matrix for key management concerns**

| <b>Factor/component</b> | <b>1</b> | <b>2</b> | <b>3</b> |
|-------------------------|----------|----------|----------|
| KMC8                    | .828     |          |          |
| KMC10                   | .753     |          |          |
| KMC7                    | .748     |          |          |
| KMC6                    | .745     |          |          |
| KMC17                   | .712     |          |          |
| KMC12                   | .640     |          |          |
| KMC4                    |          | .836     |          |
| KMC5                    |          | .801     |          |
| KMC15                   |          | .728     |          |
| KMC13                   |          | .665     |          |
| KMC9                    |          | .647     |          |

|       |  |      |      |
|-------|--|------|------|
| KMC3  |  | .577 |      |
| KMC2  |  |      | .849 |
| KMC11 |  |      | .675 |
| KMC1  |  |      | .647 |
| KMC14 |  |      | .512 |

Extraction method: Principal Component Analysis

Rotation Method: Varimax with Kaiser Normalisation

Where KMC is key management concerns 1 – 17 as presented in Table 5

**Table 6**  
**Key management concerns Constructs and Planning Status.**

| <i>Construct</i>        | <i>Plan status (means)</i> |         | <i>F=</i> | <i>P&lt;</i> |
|-------------------------|----------------------------|---------|-----------|--------------|
|                         | Plan                       | No plan |           |              |
| Overall                 |                            |         | 9.420     | .000         |
| Financial and Strategic | 5.309                      | 4.015   | 26.731    | .000         |
| Human Resources         | 4.486                      | 3.558   | 12.411    | .001         |
| Marketing               | 5.044                      | 4.436   | 6.731     | .010         |

## **Small business policy and entrepreneurship promotion – a comparison of the contextual framework in three European countries**

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Across the European Union there has been an increase in the number of programmes and initiatives aiming to promote small business and entrepreneurship (for a discussion of programmes and initiatives see Commission Européenne (1998), Commission of European Communities 01.03.2001). In line with this general trend, small business and enterprise creation are increasingly recognised as vital for European economies such as Germany, the United Kingdom and France and programmes and initiatives have been tailored to promote these issues in both national and regional economies.

To date, little research has focused on the framework conditions for small business and entrepreneurship and even fewer studies are of a comparative nature. This paper aims to fill this gap in the literature by drawing on the experience from international research into small business and entrepreneurship in the UK, Germany and France. The paper intends to kick off with a short exploration of the theoretical background to small business and entrepreneurship, followed by an account of the development of these related concepts in the three countries and a subsequent analysis of the key determinants that seem to impact upon the development of small business and entrepreneurship.

Little research has given consideration to the national differences in the socio-economic and political framework in which small business and entrepreneurship exist. The research reported upon has highlighted a number of key determinants which are responsible for the development, or rather the lack of development, of both the small business sector and entrepreneurship in the countries under question. Some of these factors may be rooted in the type of economy promoted by the individual countries, some of which may relate to the education system, some of which may relate to the role of the government. In the case of Germany we can see for instance that the social market economy laid the foundations for an active 'Mittelstandspolitik' which was adopted by the end of the 1950s (Lane 1995). In fact, the intellectual heritage of the social market economy in Germany can be traced to the Freiburg school of neoliberalism, a group of liberal economists who as early as the 1930s began to look for alternatives to the increasing market intervention of the Third Reich

(Smyser 1992, Willgerodt & Peacock 1989). In the post world war II period, economists such as Walter Eucken, Alfred Müller Armack and Ludwig Erhard thought neoliberalism to be a better solution to Germany's problems than the planned economies of the East and their views strongly influenced government policy makers (Peacock & Willgerodt 1989, Pickersgill & Pickersgill 1985, Sauer 1984, Wiseman 1989). Whilst steady growth, employment, high productivity and high incomes were important considerations, it was competition which became the focal point of his policies aiming at the promotion of small business and the development of an entrepreneurial spirit in the German economy (Sauer 1984).

Whereas in Germany the support framework for SMEs has developed against the backdrop of a relatively young social market economy, in the UK support for small business emerged as a response to the publication of the Bolton Report in 1971 and the framework of an enterprise culture as promoted under the Mrs Thatcher's administrations from 1979 onwards (Bannock & Albach 1991). Crucial to an understanding of the development of the enterprise culture in the UK is the recognition of the role of the Conservative administrations, in particular those led by Margaret Thatcher in the 1980s (Peck & Tickell 1992, Westhead & Moyes 1992). Stone (1991) and Wilson (1990) have noted that it was the Thatcherite governments that sought to change almost every facet of the post world war II economy and its management. The driving force was the strong belief that a thorough-going restructuring of the economy and revived economic growth could only be achieved by exposing the nation's industries, workers and social institutions to the full rigour of unfettered market forces (Martin 1989). This presented a significant departure from the philosophies of earlier years. In order to 'de-rigidify' the economic structures, government policies aimed to privatise public industries and services, curb trade union power, de-regulate markets, and promote individualism and self-reliance. In particular, the latter characteristics became extremely important for the development of an 'enterprise economy' which aimed to place explicit emphasis on the rejuvenation of small business (Burrows 1991a, Goss 1991). As Abercombie & Keat (1991) argue there were two pillars to Thatcherite economic ideology; the promotion of large multinational financial institutions and the small firm sector that epitomises individual entrepreneurship and innovation.

The trend to promote small business growth and entrepreneurship has also been continued during the second term of the UK government under Tony Blair and Harding (2003) argues

that entrepreneurship and innovation have become synonymous with the present UK governments policies towards productivity, regeneration and growth.

In comparison, the emphasis on small business and entrepreneurship is still a relatively recent domain in France and the research in this field has to date failed to mobilise the French scientific community (Fayolle 2000). In fact, interest in small business and entrepreneurship is underdeveloped in France (Girard 2002). In particular enterprise creation by Higher Education graduates is a very marginal phenomenon in France compared with countries such as the United States as highlighted by Fayolle (1999a,b) and Bechard (1994). According to the 'Observatoire des Pratiques Pédagogiques en Entrepreneuriat' (Observatory for pedagogical practices in entrepreneurship (OPPE)), there were only 60,000 people who were younger than 30 years old and had created their own company in 2001 (Lecherbonnier 2002). However, building upon the recent interest in entrepreneurship the new French government under Jacques Chirac and its Prime Minister (Premier Ministre), Jean-Pierre Raffarin, (former Minister for SMEs) aims to encourage interest in entrepreneurship and business start up in French society (Girard 2002), with the underlying aim being the optimistic intention to create one million enterprises over the next five years.

The research has shown that in all three countries certain key factors seem to have influenced the development of small business and entrepreneurship. In Germany the social market economy, the federalist system, a public-private partnership approach and the promotion of technology due to a strong engineering culture have certainly favoured the promotion of small business and entrepreneurship. In addition, there is the pressing need to find solutions to the economic problems of the Eastern part of Germany and a recession that has hit both East and West Germany that have added urgency to the promotion of small business and entrepreneurship. Conversely in the UK a laissez faire approach favouring an enterprise culture as well as a predominantly top-down approach to policy making with some input from the regions, as well as a focus on voluntarism, self-help and managerial solutions seem to have worked in favour of small business and entrepreneurship.

Examining the key determinants for the low interest in small business and enterprise creation in France the research has identified the role of the state in promoting large corporations as well as the nature of the education system which has aimed to train senior managers needed for the large state-run conglomerates as actual barriers. In addition, an attitude generally in

favour of public sector employment and a cultural background which seems to be anti-entrepreneurial seem to discourage small business and enterprise creation.

# **FINANCING STRATEGIES OF WOMEN SMALL BUSINESS OWNERS**

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## **Abstract**

Financing is a vital aspect of business start-up. Women small business owners may find this a particularly challenging task for a number of reasons. The literature categorises funding as external – in the form of loans, grants and venture capital funds and business angels - and internal from, for example, personal savings. Of these two types, external funding receives the greater research attention. A contested issue in the area of the financing of women's businesses is that of discrimination on the part of banks.

A great deal of the research on the financing strategies of women entrepreneurs uses a quantitative paradigm which demonstrates the prevalence of women's use of the various types of financing opportunities. This "reduced length paper" introduces data from a qualitative study of women entrepreneurs which shows not only the types of business financing chosen by women entrepreneurs but also attempts to provide an understanding of these choices with the use of their own explanations for this behaviour.

It is found that many of the women used varying types of personal funds, not because they experience discrimination in the loan application process but because they prefer to avoid debt. Use was made of the Government Enterprise Allowance Scheme. Loans were often from sources other than banks, and although banks were used by some, despite a very small amount of reported discrimination, this was a source about which dissatisfaction was expressed.

It is recommended that funding institutions create innovative funding solutions to accommodate women's preferences.

## **Introduction**

Business financing, particularly at the start-up phase, is an activity which is often cited as presenting particular challenges to women (Carter & Cannon, 1992; Carter. et al, 2003; Fay & Williams, 1993; Greene et al, 2001; Still & Guerin, 1991, Turner, 1993). The small number of previous studies which consider the demand side of the financing of women's businesses compare women entrepreneurs' financing choices with their human and social capital (Carter et al, 2003; Greene et al, 1997) or with the choices made by men (Johnson & Storey, 1993, Rosa et al, 1994).

A number of perspectives seek to explain why women-owned businesses may be unlikely to make use particularly of debt financing opportunities. The financing strategies of women starting up businesses are determined firstly by the amount of funding needed and secondly by the availability - or rather perceived availability - of different types of funding.

Discrimination against women in the financing of their businesses is well-documented in the case of the granting of business loans (Fay & Williams, 1993; Koper, 1993; Still & Guerin, 1991) and may restrict women's choice in this area. Thirdly, funding sources are chosen according to the preferences of the entrepreneurs themselves, which are established by learning including that from previous experience and upbringing (Coleman, 2000).

This "reduced length paper" draws on a wide-ranging, partly longitudinal, qualitative British study of women's entrepreneurship behaviour to introduce data on these choices and

their background in terms of the types of funding used, the reasons for these choices and the women's own preferences.

## **Background**

Research interest in women's entrepreneurship is increasing with the growth in women's entrepreneurship itself (Greene et al, 2001). In the UK currently approximately 26% of self-employed people are women and their businesses generate approximately £130 billion (\$250 billion) turnover (Smith, 2004). However, much of this academic interest has until recently been focused on women's circumstances and their motivations for starting up businesses, rather than *how* they go about this. Studies of the types of funding that may be used by women has generally viewed this activity from the supply side, that of the financial institutions, rather than the demand side of the women entrepreneurs themselves (Greene et al, 2001).

Business owners use a range of financing methods. These may be categorised as those from external sources such as loans from banks, other public institutions including government schemes, or individuals; grants from business start-up programmes established by government or large corporations; venture capital funds; business angels and trade credit and those from internally raised funds such as personal savings (Carter et al, 2003; Hooks, 2003). Of these two types, the external funding sources receive greater research attention, possibly due to their more visible and transparent nature and because there are two parties involved in the transaction. Carter et al describe a hierarchy of entrepreneurial financial strategies. At the bottom of this scale entrepreneurs fund their new businesses with personal savings, bank loans or government schemes (either singly or in combination). On the next rung as businesses grow they use a bootstrapping approach. Bootstrapping techniques involve using personal or internally generated funds, controlling costs and delaying capital expenditure and make use of, for example, retained earnings, leasing of equipment, advances from customers and second mortgages. These measures are taken in order to build the business to increase its attractiveness to external equity investors (Carter et al, 2003). The use of the hierarchical image suggests that there may be greater merit in the rungs above the bottom since capital is an important element in business success (Coleman, 2000).

Studies which compare male and female business owners vary as to whether women entrepreneurs feel discriminated against by lenders (Carter et al, 2003). This discrimination may be due to institutional perceptions that women lack the necessary motivation and ambition to succeed in business. Bank managers, who are usually men, are found to have 'little confidence' in women business owners and even when they do grant them loans often require a husband's formal agreement (Kaur & Hayden, 1993:103). Johnson and Storey (1993) point out that a finding that women do not suffer from discrimination at the hands of banks merely serves to illustrate that women who have been successful in starting up businesses do not seem to have suffered such discrimination. However, a study comparing bank debt according to firm size finds that small firms are the lowest users of this type of financing for reasons relating to a lack of established reputation – as these businesses are also by far the newest in the sample - which may lead to rejection in the loan application process due to a low credit rating (Hooks, 2003). As women's businesses tend to be smaller than those owned by men, they are more likely to suffer this form of discrimination (Coleman, 2000; Greene et al, 2001). Women have also been found to start businesses with less initial capital funding than men (Rosa et al, 1994, Greene et al, 2001).

Haines et al's (1999) conclusion from their comparison of a number of characteristics of men and women who have been successful in business loan applications is that there was no bias against women. They attribute earlier research findings that banks discriminate against women to faulty research design.

Whereas claims of bias on the part of banks usually depend on accounts related after the event, Fay and Williams (1993) report an experiment to test whether women suffer discrimination in the granting of business loans. Men and women were found to be equally likely to receive a loan where both were graduates; although the level of education was felt to be more crucial for a woman than a man; where education had ended at High School level a woman's application was found to be less likely to be successful. Two experiments carried out by Buttner and Rosen (1992) showed, however, that women were not discriminated against at all in loan applications.

An important effect of the prevalence of the belief that banks discriminate against women in the granting of business loans is that it may act as a deterrent to some women against seeking such funding (Haines, Orser & Riding, 1999; Johnson & Storey, 1993, Richardson & Hartshorn, 1993). The focus of Greene et al (2001) on the gendered nature of success in gaining venture capital provides a similar image of perceived discrimination by investors against women entrepreneurs for reasons of small firm size and also the choice of industrial sector – women tend to start businesses in the service and retail sectors whereas venture capitalists prefer to invest in IT, medical and communications businesses. Nelton (1998) reports on US schemes designed to make venture capital more available to women entrepreneurs and to encourage them to access it. One of the contributors confirms these sectoral and firm size barriers by advising that in order to succeed in acquiring such funds firms must be “high-growth, high-profit business[es]” in which venture capitalists see a potential to achieve a “substantial multiple” of their investment (p. 4).

Personal savings account for a large amount of the capital available to women starting up businesses. This may be a result of experiences of discrimination, women's rejection of debt capital as they are risk averse and prefer to avoid responsibility for large loans or because characteristics of their businesses such as small size or being in sectors with low barriers to entry may make funding affordable from personal resources (Coleman, 2000; Greene et al, 2001).

This qualitative study discusses women's financial strategies alongside their explanations for these choices, problems encountered and observations made at later interviews after an interval of three years.

### **Research Design and Methodology**

Data for this paper is drawn from a partly longitudinal, qualitative, empirical study of women entrepreneurs carried out in the English region of East Anglia, between 1995 and 2000.

A total of 149 women business owners returned questionnaires detailing business and personal information. This material was used to form the illustrative sample of forty-eight women entrepreneurs who took part in the interview stages of the study. They had started up businesses between 1958 and 1996.

The first wave of semi-structured interviews took place in two groups in 1995-6 and 1997. These extremely wide-ranging interviews lasted from thirty-five minutes to two and a half hours, with a usual time of approximately one and a half hours. The interviews were recorded both as field notes and on audio tape.

Amongst a number of topics, the women explained in depth the issues surrounding their financing decisions. This may be analysed in the context of their experience of discrimination on the part of banks (Kaur & Hayden, 1993), perspectives on debt and to business risk in general (Coleman, 2000) as well as other aspects of their experience such as previous start-up ventures (Carter et al, 2003), motivations to start up businesses and attitudes to business growth (Carter & Cannon, 1992), levels of education (Carter et al, 2003; Fay & Williams, 1993), likelihood to have written a formal business plan (Carter & Cannon, 1992) and the types of networking relationships, advice and training they had used (Lloyds Bank, 1997; Marlow & Strange, 1994; Travers, Pemberton & Stevens, 1997). This paper focuses on the issue of financial strategies and the reasons for these choices. Three years later the first interviewees took part in a second interview. With the aid of a written “summary” of the first interview provided by the researcher, the participants refreshed the data and reflected on some of their earlier concerns. (See Knowles, 2002 for a fuller discussion of the longitudinal aspect of the study.)

### **The Findings**

These women’s businesses had been started up and sustained using a variety of personal sources, grants and debt capital. Venture capital and business angels were used by only a very small number of the women. Twenty-five (52%) of the women used personal funds at start-up. In seventeen of these cases this money covered all the costs of establishing the business. Reasons for using one’s own personal funds varied. Two of these women started up by working at home so that there was no noticeable financial outlay.

Molly Poulter<sup>1</sup> started a book shop in 1988 with two women partners who both later left the business. Each of the women contributed £3,000 of personal funds. A bank offered a £5000 loan but this was not used. Molly commented:

“It was a very sensible way to start. We started with the minimum that we could get away with so we didn't pay interest to anyone and we didn't borrow and we bought things when we could afford it and we're still doing that.”

Despite the wish not to pay the additional costs associated with loans, Molly and her partners had made strenuous efforts to obtain a loan in case it might be needed:

“The banks we negotiated with went round and round in circles. [We tried] all of them [laughs]. Two or three times. We ended up with Barclays because they gave us the best deal. We got two years' free banking. You go to one and you say ‘Well, X has offered me’ so they undercut that and you build up. It's absolutely incredible, I don't think people realise.”

In contrast to Molly’s positive experience, when Christine C. started a financial business with her husband their decision to use personal funds was fuelled partly by a poor relationship with their bank:

“We used our own resources. We don't even have a bank account actually.” [laughs]  
We did have but we fell out with banks. They charge too much so we just run a building society account. We fell out with the bank because they wanted to charge us bank charges. And when we had an account with four, five figures in it we felt that they should be paying *us*.” [laughs]

Many of the women specified the source of their personal funds such as redundancy (severance) payments (three cases), the sale of a house (three cases) or land in the case of a horticultural business located on a family farm. Some had purposely saved money from earnings in order to be able to start up businesses. Fay T. had received advice about available loans before starting up her software training business in 1989 but did not follow up these opportunities. She saved £1000 for equipment plus enough money to live on for a year. She said:

“You have to know yourself. I can’t bear debt – it would take me down as an individual. ”

A participant running a secretarial business shared this view that debt was to be avoided:

“I had no wish or desire to borrow. It doesn’t sit with me personally.”

Another woman who had saved money that she was prepared to risk in the business start-up was Alma P. Commenting on her budget of £3,000 for her domestic employee agency, which was located in her own home, she said,

“I was prepared to risk that amount; if it was all gone I would have to pack the business in.”

Although Alma encountered no problems in this as she cut costs by working at home and was able to afford “the basics that any business would need”, the benefit of hindsight showed her ten years after her 1985 start-up that this had been a much greater risk than she had thought at the time.

Christine attributed the survival of her business in partnership with her husband when many “went to the wall a few years ago” to the fact “that we had the house [including business premises], we didn't have [business] rent to pay, and we didn't have bank loans”. This factor in business success was cited by a number of women and is rarely mentioned in other in other studies.

The concept of personal funds was extended in a number of ways by the women. Firstly, as we have seen, many worked from home. Seventeen (35%) lived and worked in the same premises. Secondly, women would continue to work elsewhere for a short period during the initial start-up period.

Thirdly, women would take very small salaries from the businesses. Molly Poulter was one of the extreme cases of this as she took no income at all from the book shop. Molly appeared untroubled by the lack of financial reward for her work, after all before starting up the book shop she had worked for seventeen years in an important role as a volunteer, only succeeding in recruiting her replacement by raising funds to create a paid post. In the book shop she was in a similar predicament: the business was very successful with her unpaid at the helm but, aged sixty-three at our second interview, she was hoping to retire and a successor would expect to be paid. In that interview Molly spoke of closing the shop if no-one came forward to take over.

One of the benefits of the longitudinal aspect of the study was that not only could the development of the participants’ businesses be followed but also it provided an opportunity to correct erroneous data. In the case of Mrs Brewster, the owner of four businesses in the catering and retailing sectors, her main concern at the beginning of the second interview (which took place after she had sold one of her businesses) was to amend what had been written in the “summary” of her first interview. She had mentioned that her husband was a

farmer and that she helped with his clerical work but it was not clear that she was not taking a salary out of her own businesses:

“ ...I mean if you said to me, ‘does your money come from the business’, I would say, ‘yes’. Because it comes from the farm. But we don’t actually draw any salary or any money whatsoever out of Grange House, the Motel or Hintons, it comes from the farm. We thought that was a better, you know, then you don’t take from every one. We take so much per month out of the farm.”

A second important form of non-debt financing in this study is grant aid. The Enterprise Allowance Scheme (EAS) was a government programme (now no longer in existence) set up in 1982 (a time of high unemployment in the UK) with the objective of assisting the business start-ups of unemployed people who might be deterred by the consequent loss of unemployment benefits in the early period before the business had become sufficiently profitable to pay them an income. The allowance was set at £40 per week for up to a year. To be eligible applicants had to be unemployed and receiving state benefits for at least thirteen weeks and able to invest at least £1000 in the business (Industrial and Commercial Training, 1982). At prima facie this scheme seems to discriminate against especially married women as in many cases they are ineligible for unemployment benefits in their own right. However, in a study comparing the financing of businesses owned by men and women, Carter and Rosa (1998) found that women were more likely to use the EAS than men. They attribute this frequency to the women’s subordinate position in the labour market, the fact that more of them had previously been unemployed and, most tellingly, their youth, which suggests that they were unlikely to be the sort of married women against whom the EAS discriminated.

Although the EAS was mentioned as a source of start-up funding by five of the participants in this study there is no way of knowing how many women might have started up in business but for their ineligibility for these means to do so.

One recipient of the EAS also used a number of other types of funding to finance her start-up in a children’s clothing business. She was the only member of the sample to benefit from the Prince’s Youth Business Trust (PYBT). It was this latter type of funding that gave Patti T. the impetus to start her business in 1993 as she had been hoping to use her extensive training in clothing design to join a large fashion house. However, at a time when the PYBT was offering assistance to people up to the age of twenty-five<sup>2</sup>, Patti, aged twenty-five knew that she should take this chance to start up a business as there was no sign of a job offer. She received a PYBT market research grant of £250 which did not commit her to starting a business, a PYBT loan of £2500 at a lower interest rate than a loan offered by a bank, and a £2500 grant from the Livewire organisation (supported by Shell Oil) as a result of being placed 4<sup>th</sup> in a national competition for new businesses. Additionally, her overheads were reduced as she was able to work at her parents’ house and she took a very small salary out of the business. The competition prize boosted Patti’s confidence in her ability to set up a viable business but initially she had been very fearful about accepting the PYBT loan,

“I had no money, no collateral, no car. If the business failed I couldn’t pay the loan back. I didn’t open a business bank account for a month because I was scared about paying back the money. Someone from PYBT phoned me to ask why I hadn’t cashed the cheque.”

Patti returned to the subject of financing the business in the second interview three years later, still at her parents' house. Her very first statement on being asked if there had been in major changes in the business since the first interview was the following:

“The biggest one is that I don't own the company any more. We're Fashionistas *Ltd*. I own forty-nine percent and I sold the rest to an investor .... I needed money for production, which is still a major problem but this was the only way of doing it because I had no collateral. I couldn't get loans from banks.”

Patti had worked hard; she was exporting to many parts of the world and had moved production abroad to cut costs. However, another aspect of business financing had not changed. Asked whether she was now taking a salary from the business, Patti said:

“I have been until recently but we're at a bad time of year waiting for retailers to pay us and they're not. What they're doing at the moment is paying us in small quantities, dripping us a bit at a time.”

Debt financing in the form of loans and mortgages was used by eighteen (38%) of the sample. This number includes four who used loans from family members, twelve who used banks, and one who used a small loan from Norfolk County Council. Mrs Brewster's start-ups in 1958 and 1965 were financed by borrowing from a family trust fund and a loan from “an individual” (unknown to her) which was arranged by a solicitor. The start-up costs of Anne B's business, which was started as a Management Buy-Out, were paid back to the previous owner over a period of time. This financial arrangement like three others used the entrepreneur's home as security. A further two of the participants would have lost their homes if they had defaulted on mortgages on business premises where they also lived. Two of the women, who had started businesses in 1985 and 1989 respectively, reported that far from discriminating against women, banks made gaining access to loans extremely easy for “this was the boom 1980s, banks were giving money away hand over fist” (Interview 41) and “at that time banks were throwing money at businesses” (Interview 25). However, relationships with banks were not always good even for the business owners who accepted the responsibility of a loan. Geraldine B, the food manufacturer, was extremely unhappy with hers. She said that she felt as though her “hands and feet were tied by the bank”.

Not all those who were not using bank loans had decided against them from the outset. Una G. was running a recycling business. At start-up in 1991 she was hoping to use a loan to double the funds she had gained from the sale of her previous business. The six banks that she tried either rejected her application or offered terms that she was unwilling to accept due to what she perceived as prejudice that was wider ranging than simple sex discrimination:

“Unfortunately because the financial institutions consider recycling to be a bunch of greenies who've just got together for the afternoon, *and* I was the wrong sex, they weren't really prepared to lend me any money. But as it turns out I'm not really bothered about it.”

Varied bootstrap funding techniques were used at different phases of businesses. There was no suggestion that these strategies were used, as implied by Carter et al (2003) to enhance the attractiveness of the business to future equity investors. Many of the women entrepreneurs in the study were able to avoid debt by using these techniques at the very outset in a number of ways. When Sarah C. started an upholstery business in 1994 in a

partnership with another woman and two men, the contributions of personal funds from all four partners were augmented by income from existing contracts that had been won while the group was searching for premises. Sarah was aware that the company would need further financing to fund expansion and was considering joining forces with a similar business to work collaboratively. She commented: "None of the partners is very keen on banks." The two Suffolk magazine publishers in the study were also able to use bootstrapping techniques from the beginning. Lydia V., starting up in the grounds of her own home in 1989, found that the business financed itself "from day one". Eleanor J. had an overdraft facility at the bank but did not need to use it as the first quarter's rent in 1996 was paid from business income. Felicity S., starting out in a software writing business in 1989 found that an existing contract provided all the financing needed. Bootstrapping was used by a larger number of the entrepreneurs to fund later business needs. Lynette O started her children's clothing business with money raised from the sale of her house and her later, slow expansion was paid for with cash earned by the business.

In some cases bootstrapping would not provide enough for later financial needs of the entrepreneurs. Belinda S provided the most striking example of discrimination on the part of a bank. She applied for a bank loan of £12000 to buy out her partner and purchase some computers. She was refused the loan after being subjected to a series of interviews, which included questioning on whether she was planning to start a family,

"In the end they offered me £5,000, which was just pointless, and my husband went out and got a private loan for ten grand and that was what saw me through."

The final type of financing in Carter et al's (2003) hierarchy is equity finding. This was very rarely found in the study. The businesses were mostly very small and as we have seen in the case of Patti T, acceptance of external funding was considered almost as the loss of one's business. Frankie P's perspective was different, possibly because her housewares business had gone through a number of legal formations since start up in 1986. Her original partner retired in 1991 and was bought out, the resulting sole trader business became a limited company in 1993 and then a new director joined in 1997. During the course of this a business angel made a 22½% investment in 1992. Frankie experienced no problems with this at all.

The second interviews which took place three years later showed that financing strategies had no bearing on future business survival and success.

## **Discussion**

This study contributes to the research which demonstrates the heterogeneity of women's entrepreneurship experience. Women may be distinguished according to their beliefs and practices in the area of business financing. Many of the women entrepreneurs used a number of financial sources in combination at start-up and later. The most prevalent form of financing was personal funds, which in some cases entailed using large amounts of savings or working at another job alongside their entrepreneurial activities. Many women seemed to choose to sacrifice themselves in terms of risking money saved, working harder or forgoing a salary in order to nurture their business. In this way some of the women appeared to adopt a caring relationship to their business which promoted its survival at any cost to the owner. Focused comparative research on businesses owned by both genders would demonstrate whether this attitude is part of a uniquely women's way of business ownership. Personal funding was used as an alternative to debt or to reduce the amount of a

loan that might otherwise be required. This finding suggests that some women entrepreneurs are debt averse, in concurrence with previous research which has found that women are less likely to use business loans than men (Coleman, 2000). Debt was avoided for reasons of a personal dislike of owing money or to free the business from what was seen as a burden.

Some the participants were able to access grant funding. One of them was well provided with grants and a low-cost loan. Her reluctance to accept the loan suggests that she was instinctively a debt avoider.

The issue of sex discrimination on the part of banks was rarely addressed. Only one woman felt that she had experienced this. Others spoke of poor relationships with banks that were associated not with gender but with the fact that these institutions showed more concern for their own profit than for individual circumstances so that they levied bank charges on large accounts or made business customers feel that their hands and feet were tied.

Despite the possibility that many married women would be ineligible for such aid; the EAS was a popular form of non-debt external funding (Carter & Rosa, 1998). This was seen as a risk-free financing strategy.

Bootstrapping strategies were used at start-up as well as in later phases of businesses.

Business angels and venture funding were used by a very small proportion of the sample. These types of external funding were viewed differently depending on perspective. One participant described the experience of having sold 51% of her business to an investor in tones of regret in the second interview; a second accepted the contribution of a business angel as part of the changeable nature of her business.

A benefit of the longitudinal aspect of this research is that business survival and success may be tracked and compared with financing strategies used: there was no foundation for an assumption that a willingness to use debt funding or external investors would lead to an enhanced likelihood of survival or greater success. However, the findings that many women entrepreneurs are averse to the perceived risks of using loans and that going without a salary is perceived as an acceptable financing strategy indicate that there is scope for banks and other loan making institutions to introduce creative financing strategies that would ease the burden of business financing for such women.

## **Endnotes**

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<sup>1</sup> The names of all participants and their businesses have been changed to ensure their anonymity.

<sup>2</sup> This has now risen to thirty years.

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# ONLINE AUCTION ENTREPRENEURS: SOME EXPLORATORY RESEARCH INTO POSSIBLE PARADIGMS FOR ONLINE AUCTION PROCESSES AS AN ENTREPRENEURIAL TOOL

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## Abstract

This paper examines one emerging facet of entrepreneurial approaches, that of the online auction. Online auction sites such as eBay are rapidly becoming a hub of entrepreneurial activity. Ebay boasts 105 million users in 150 countries. At any one time there are 25 million listings on eBay, with 3.5 million new ones added every day. An eBay survey of its sellers, estimates 430,000 people make a large part of their income from eBay. The popularity of online auctions is well documented, but the behaviour pattern for many would-be sellers and buyers is not. A host of entrepreneurial side businesses are also emerging to list items on behalf of third party sellers. German-based *Dropshop* is an example, with an initial 2004 public listing raising €9 million. This paper investigates the emergence of online auction entrepreneurs, with particular emphasis on the nature of online auction selling. A case is presented that above average recommended retail prices for goods are achievable in an online auction environment, providing potential entrepreneurs with unique opportunities.

## Introduction

The global marketplace is changing rapidly, and in turn the definition of entrepreneurship continues to evolve. Alstete (2002) suggests that definitions need to precisely describe who creates new business opportunities for the manufacture of goods and services. Shane and Venkataram (2000, p.220) define the field of entrepreneurship as:

The scholarly examination of how, by whom, and with what effects opportunities to create future goods and services are discovered, evaluated, and exploited (Venkataram, 1997). Consequently, the field involves a study of sources of opportunities; the processes of discovery, evaluation, and exploitation of opportunities; and the set of individuals who discover, evaluate and exploit them.

A significant increase in the study of entrepreneurship has yielded specific qualities or factors related to entrepreneurs that identify them in greater society (Alstete 2002). Alstete further proposes that much literature examines established or failed entrepreneurs, but little focuses on nascent or potential entrepreneurs who may or may not proceed to start a business based on their perception. The characteristics of established or would-be entrepreneurs may not be the same factors that motivate nascent or potential entrepreneurs. What effect has the emergence of changing economic, social and technological conditions had on the desire of individuals to establish new businesses?

It is argued in this article that the online auction phenomenon has provided opportunities for potential (and established) entrepreneurs to exploit the technology in new and innovative ways that would not have been possible in an offline environment. Colombo and Delmastro (2001) established that in addition to a desire for higher incomes, Internet based entrepreneurs wanted to innovate and work independently of corporate cultures. To-date research interest has focused on the technological entrepreneur rather than the exclusively Internet based (cyber) entrepreneur (Carrier and Raymond, 2004). In this context exploratory research into the activity of online auction entrepreneurs would seem appropriate. The popularity of auctions is evident in terms of users (buyers and sellers) and because of the diversity of complimentary, support and peripheral services they have spawned.

There are a large variety of online auctions falling into two broad categories. Third party auction sellers such as eBay, Amazon and Yahoo! auction goods for others (either individuals or corporate), and direct auction sellers create their own auctions online via their company web sites (Halstead and Becherer, 2003). Many large retailers and catalogue firms are using direct auctions to unload merchandise and drive sales. As the use of the Internet for online purchases continues to grow, interest in both types of auction sites is also growing rapidly. Third-party auction houses accounted for 15 percent of all consumer e-commerce spending in the first six months of 1999, or US\$1.5 billion (Oberndorf, 1999).

It could be argued that direct auction houses have adopted their bricks and mortar business models to incorporate advantages offered by e-commerce to enhance their existing businesses. Third-party auctions on the other hand have attracted many first time sellers, or 'would be entrepreneurs'. More than 41 million people shopped on eBay in 2003, listing a billion items and spending US\$24 billion (Alterio, 2004). As technology laggards continue to adopt the Internet, it is realistic to predict that even greater rates of spending growth will be realised. Pinker, Seidmann and Vakrat (2003) identified that research is needed to characterise the behaviour of participants in online auctions and to measure their 'response to actual market conditions and rules' (p. 1481). To this end, sales data collected by examining winning bids placed on goods offered for sale by an individual eBay user are presented later in this paper as an example of a possible pricing scenario. No claim is made that the data presented is typical, but a need for further research is indicated. Because eBay so dominates the third party auction landscape an overview of its development follows, before the pricing scenario example is presented.

### **The eBay phenomenon**

eBay has emerged as the premier third-party auction house with listings from every country in the world, and an increasing number of country specific sites (such as eBay USA, eBay Canada, eBay UK, eBay Australia). From humble beginnings, eBay is the undisputed third-party auction leader which has spawned the growth, replication and entrepreneurial activity that is now associated with online auctions.

eBay was founded by Pierre Omidyar in 1995. In the book, *The Perfect Store: Inside eBay* (Cohen, 2002), it is alleged Omidyar developed eBay as a result of a dinner table conversation. His fiancée Pam Wesley a PEZ-dispenser collector sought fellow collectors in California, and Auction Web was born. Having interviewed Omidyar,

Cohen believes that the real reason for the development was that the timing was right. By the mid 1990s, the popularity of newsgroups was being overtaken by the emergence of the World Wide Web. Omidyar, like every other programmer of the time, was constantly looking for new uses for the Internet, and the idea for an auction came from a variety of sources, not just the PEZ dinner conversation.

What is significant, is that Omidyar at the time was a potential entrepreneur, not a wannabe.. 'Auction Web' the original auction site was hosted on eBay.com, Omidyar's personal web page. In *The Perfect Store: Inside eBay*, it is claimed that Auction web was only started as a hobby, so costs were kept to a minimum. The page was hosted for US\$30 a month, and also included other pages: one for a biotechnology company Omidyar's fiancée worked for at the time, and a tongue-in-cheek 'tribute' to the Ebola virus and Ebola outbreaks.

Omidyar kept Auction web free throughout 1995, but was forced to introduce fees in 1996 as his Internet Service Provider started charging US\$250 a month for hosting. The site was getting so much traffic it was slowing down the ISPs system. Omidyar introduced fees to pay for the web hosting, not knowing if people would be prepared to pay. In time, the other home pages were removed and Auction Web became eBay. Based largely on user trust, and later public peer review, Auction Web broke even after a month and has been the industry standard ever since. eBay is the fastest growing company of all time. There has been controversy over the sale of various items on eBay from time to time. People have tried to auction organs (kidney), towns and even brides. Many cheap imitations of goods are also sold, and are difficult to monitor, making fraud an issue.

The Wikipedia (Wikipedia.com) entry for eBay states that revenue is generated from sellers, who pay a 1.25% to 5.25% premium on the final bid price of each item, a fee based on the starting price and from advertising. It does not handle the goods, nor does it transact the buyer-seller payment, except through its subsidiary PayPal. Instead, much like newspaper 'wanted' advertisements, sellers rely on the buyer's good faith to make payment, and buyers rely on the seller's good faith to actually deliver the goods intact. To encourage fidelity, eBay maintains, rates, and publicly displays the post-transaction feedback from all users, whether they buy or sell. This way, the buyer is encouraged to examine the seller's feedback profile before bidding to rate the trustworthiness. Sellers with high ratings generally have more bids and may also receive higher bids.

There are now hundreds of auction sites, world wide. Some are successful but many have failed or have been taken over. eBay is so dominant in the market that it is difficult for other players to compete for buyers and sellers and more importantly for user confidence and trust. After only a decade, online auctions have become a fact of life for many people, and opportunities for entrepreneurs abound.

### **A pricing scenario**

As there are millions of listings at any one time on eBay, many factors would influence the outcome of each auction. In order to explore the possible effect of online auctions on price, one seller was selected and the final value of goods sold was collated for a 60 day period. The seller was known to the researcher and all cost and final monetary values were made freely available. A descriptive profile of the seller is

presented in table 1. New books were chosen as a product category to avoid the effect of one-off sales, as the same title could be relisted and sold repeatedly. Many other product categories, such as CD's, DVD's, cameras, and computers could equally have been used.

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Table 1 about here

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The average auction price achieved for 15 different titles is shown in table 2. Each title was sold between two and five times over the 60 day period. 75% of titles consistently sold for more than the recommended retail price. Book cost price is achieved by deducting 40% from the retail price, therefore every title would have made at least a modest profit. The 63 books returned 132% of the total recommended retail price.

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Table 2 about here

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### **Internet auction buyers**

Internet auctions allow buyers to participate in auctions 24 hours a day, providing instant gratification and the ability to interact with the seller (Hoffman and Novak, 1996). Many early shoppers visited auction sites looking for collectables, but increasingly, it is for mainstream items such as motor vehicles or even houses (Alterio, 2004). The thrill of the auction is a historic phenomenon. People have a perception they will be able to purchase items for the lowest possible price. Although bargains are certainly attainable, Alterio concludes that, "one of the thrills for eBay users is the bidding process". Comments from users interviewed by Alterio include, "I think you get emotionally wrapped up in it"; "my mother couldn't be happier"; "imagine shopping for groceries and having the cashier congratulate you on 'winning' your bag full of milk, apples and toilet paper"; and, "Jennifer can be competitive". The motivation for Internet auction buyers is obviously complex and each case is different. Buyers range from passionate collectors, to pragmatic bargain hunters, to users who see online auctions as a "participation sport".

### **Internet auction sellers**

Retailers, manufacturers and liquidators are increasingly using online auctions to sell returned, demonstration or refurbished stock. Dell regularly sells demonstration and repackaged computers, monitors and other goods in Australia on Greysonline.com. At the time of writing, eBay Australia had listed 450 computers, 2,596 cameras and accessories, 350 mobile phones and 4,638 books.

Halstead and Becherer (2003) cited the following reasons for sellers using Internet auctions:

- To unload discontinued, returned, damaged or overstocked goods (Collett, 2000; Reda, 2000)
- To test prices in order to see what the market will bear (Collett, 2000)
- To acquire new customers (Machlis, 1998) and keep new customer acquisition costs low (Warner, 2000)

- To sell quality, designer goods at a discount, appealing to the ‘price-only’ shoppers (Warner, 2000).
- To generate excitement about an online site and to involve customers in an interactive sense (Oberndorf, 1999).
- To connect buyers in real time (Reda, 2000)
- To complement traditional brick and mortar businesses and enhance retail store values (Colombo, 2000)
- To give seasonal products a broader year-round appeal (Lewis, 2000)

Halstead and Becherer (2003) found that online auction sellers clearly vary in terms of company size and scope. Less than 15 percent of the smallest online auction sellers (<US\$25,000 p.a.) reported selling on Internet sites other than eBay whereas in direct contrast only 15 percent of the largest sellers (> US\$250,000) were found to use eBay exclusively. Freedman (2000) found that in addition to large corporate sellers, auction participants included *microbusinesses*, a class of small enterprises or entrepreneurs who have “successfully manoeuvred the online marketplace”. These microbusinesses could be a single individual operating out of a home using third-party auctions or their own auctions. It was further suggested by Freedman that these microbusinesses could pose a real threat to small online businesses because of low cost structures and rapid response times.

Halstead and Becherer (2003) propose an Internet “hierarchy of distribution commitment”, for small businesses with auction sales as a first step, followed by catalogue or wholesale distribution (or both), then the addition of other Internet sites. This hierarchy may be plausible for *would-be* or *established entrepreneurs*, but would it be plausible for *potential* entrepreneurs who may be happy operating microbusinesses? This *hierarchy of distribution commitment* hypothesis should be the subject of future research. What is clear is that online auction sites are being used actively by entrepreneurs, and they are the exclusive realm of thousands of *potential entrepreneurs*.

### **Complimentary, support and peripheral services**

In a very short period of time, online auctions have spawned a host of support and peripheral entrepreneurial activity. They range from copy-cat online auction hosts to software, financial services, forums, newsletters, books and recently a return to ‘bricks and mortar’ stores.

### **Third party auction sites**

The main auction sites are eBay, Amazon, CNet, MSN Auctions and Yahoo. There are hundreds (perhaps thousands) of small niche or general interest auction sites. Stuff.com.au is a general purpose auction site that still has a faithful Australian following. Auction sites for collectors are common, with names like stampsatauction.com, playle.com, bearauction.com. It is not easy to gauge how successful these sites are. Ftpplanet.com/ lists about 75 different auction sites. eBay dominates the online auction market, to the extent that the viability of many small auction sites would surely be questionable. Some failed sites are for sale, or in the case of uAuction.com just the domain name is for sale for US\$50,000.

eBay is also actively acquiring competitors. On June 22, 2004, eBay acquired Baazee.com an Indian auction site for US\$50 million; in September 2004, the Korean Internet Auction Company (IAC) was acquired for about US\$300 million.

Some firms or government organisations develop their own auction sites. In Australia, an example is [governmentauctions.com.au](http://governmentauctions.com.au). The site is prominent in Australian search listings, but most states are not represented, and in essence it was a gateway to private auction companies that were selling government motor vehicles. Whether companies should conduct their own auctions or not is unclear. There would be a potential benefit in terms of brand identification, but it could also blur the line between fixed price retail and an open cry auction. Although Dell is a prominent seller on [greysonline.com.au](http://greysonline.com.au) there is obvious separation between Dell and Greys, which may suit the Dell's marketing strategy.

### **Financial services**

When eBay was started in 1995, it was not clear that commerce would ever be trusted on the Internet. Cohen (2004) cites a 1995 study by the Pew Research Centre that reported that only eight percent of Americans felt comfortable using a credit card online. Besides establishing trust and confidence in the auction process, there was an obvious need for secure payment services for domestic, national and international transactions. Early payments to Auction Web involved the posting of cash or cheques via the postal service, and it is arguable that the rapid growth of online auctions may not have been possible without the emergence of alternative secure online payment methods. Most corporate sellers have secure credit card payment facilities, but it is the 'microbusinesses', both buyers and sellers, that have benefited by the availability of flexible, cheap online payment options.

Paypal, the best known international payment service was founded in December 1998. It now has 27 million members, largely from eBay which acquired the company in October 2002. Paypal has members from 38 countries, with support for five currencies, and a current turnover of US\$2.5 billion a quarter. Alternative payment methods are also available. In Australia, there is [paymate.com.au](http://paymate.com.au) which can be used to settle Australian auctions. While good for Australian auctions, Paymate cannot be used to settle international auctions, so its use is limited. The other main method of payment is Bidpay by Western Union. Bidpay allows for direct deposit to bank accounts in the United States, or international money orders can be delivered in the rest of the world.

A variety of alternative payment methods have also been developed, including eCash, eZidbit, and smart cards. There have been many attempts by entrepreneurs to develop e-commerce payment solutions, but most have not found ready acceptance. As eBay dominates the online auction market, Paypal dominates online payment. Some sellers place restrictions on purchases from international buyers, but it is likely that their reasons would be based on logistics or parochial attitudes rather than a lack of payment options.

## **Software solutions**

Fully integrated auction software is available for between US\$100 and US\$1,000. XAuction.com provides a full featured auction suite for US\$500. An inspection of several Xauction customer sites provides evidence that the software worked well, but the sites had limited listings and appear to experience limited traffic. Calcruising.com is a good example of a unique motor vehicle site that is well presented with listings, but limited interest as expressed by live bids. Search of Google for auction software solutions returns a wide variety of products from sniper programs to total shop front and multiple auction listing engines. Examples include shopping cart solutions, integrated auction/web page design, auction trackers, classified advertising and auction software. Buyers often make last minute bids, a practice called 'sniping'. Sniping programs are also popular; they are designed to bid on a user's behalf near the end of an auction, usually at five second intervals. Sniping programs include Bidnapper, Auction Sniper, Action Sentry and Just Snipe. Just Snipe does not require downloading and it allows five free snipes a week, or unlimited snipes and extra features such as tracking for US\$5 a month.

As the use of online auctions continues to grow, the communication performance of sites will affect all parties involved in them (McAdam, 2001). Current online auctions are slow moving. To compete with face-to-face auctions some auction sites are using Webcast techniques but these are still unicast (one sender to one receiver) and are restricted by bandwidth. Some researchers are advocating research into multicast-based auctions with an expectation of improved performance (Liu, Wang and Fei, 2003).

## **Books**

There are many books and newsletters devoted to online auctions. Newsletters such as [www.auction-sellers-resource.com](http://www.auction-sellers-resource.com) and [www.auctionservices.com](http://www.auctionservices.com) are provided free, and the sites also offer items for sale: a range of books, software, and other auction products and services. A search of Amazon.com revealed 227 matches for books on eBay, and 80 matches for online auctions. At the time of writing the five top selling titles listed on Amazon.com were -

- 1) eBay for Dummies, Fourth Edition by Marsha Collier.
- 2) eBay Secrets : How to create Internet auction listings that make 30% more money while selling every item you list [DOWNLOAD: PDF]  
by Steven Ellis White, Bryon Krug – \* note that this title was only available to download as a PDF file.
- 3) How to Sell Anything on eBay . . . and Make a Fortune! by Dennis Prince
- 4) Starting an eBay Business for Dummies by Marsha Collier
- 5) The Official eBay Bible by Jim Griffith

## **Bricks, mortar and virtual service opportunities**

Despite the large number of people who use online auctions, many do not own a computer, are not connected to the Internet, do not want to learn or do not trust e-commerce. Many businesses are emerging to fill this gap. Reasondropshop.com is a store in Sacramento U.S.A. that lists items on eBay on behalf of sellers, and there are stores opening throughout the world. Some like *Reasondropshop*, or German based *Dropshop* are physical stores while others are virtual. Fraud is relatively common online, so trust is very important to users of auction sites. As stores develop healthy peer online reviews, it is expected that this would contribute considerably to the level of trust and business growth.

Many new ways to use online auctions are and will continue to evolve. The Chicago Department of Cultural Affairs presented “The Great Chicago Fire Sale”, the first charitable eBay auction organized by a municipality, in December 2004. Auction items included Chicago related objects, one-of-a-kind experiences and special services. Some donated items included an original 1960s Playboy Bunny costume; a dinner party prepared by Art Smith, personal chef to Oprah Winfrey; a 2 night stay in the Presidential Suite at the Sofitel Chicago Water Tower; a cow from the acclaimed “Cows On Parade” public art exhibition; a opportunity to dye the Chicago River green for St. Patrick’s Day; and a painted sewer manhole cover. All of the items along with detailed descriptions were available on [www.thegreatchicagofiresale.org](http://www.thegreatchicagofiresale.org) (see figure 1). An inspection of the Chicago fire sale in progress indicated that it was a huge success. At the time of viewing (13 December 2004) 234 items were listed, and most had bids. The highest bid at the time was \$7,000 for a wedding for up to 100 guests.

## **Discussion and implications**

The online auction marketplace presents a challenging and exciting environment for existing and potential entrepreneurs. The availability of new technology and the increased accessibility of Internet connectivity are shaping a new economy with different methods of distribution, marketing, selling and arranging work. Attributes of this new economy include collapsing boundaries between firms, suppliers, customers and competitors (Hartman et al., 2000; Morino, 1999). Any new form of commercial activity tends to attract entrepreneurs, and online auctions are no exception. “What sets netpreneurs apart is not that they are different from other entrepreneurs, but that they are operating in a universe of transforming change. As pioneers of the new networked society, they are both defining and learning new ways of doing business” (Morino, 1999:).

What appears to be different about Internet entrepreneurs is their need for constant innovation and experimentation which may not be present in other groups of entrepreneurs. This paper also questions the notion that auction sites are only the realm of price sensitive bargain hunters. The nature and accessibility of online auctions is particularly attractive to potential entrepreneurs, partly because of the ease of entry and low cost of participation. Further research is needed to explore and determine differences between cyberentrepreneurs and other entrepreneurs as there is currently a gap in entrepreneurship theory and practice.

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## Tables for inclusion

| <b>Table 1 Descriptive profile of the ebay seller</b> |                        |                     |                                       |
|---|------------------------|---------------------|---------------------------------------|
| <b>Enterprise</b>                                     | <b>Date registered</b> | <b>Annual gross</b> | <b>Product offered</b>                |
| Book seller   | Dec 2000               | A\$35,000           | New books, specifically equine titles |

| <b>Table 2 eBay seller book sales 60 day period (Jan-Feb 2005)</b> |           |              |               |                        |                            |          |
|--|-----------|--------------|---------------|------------------------|----------------------------|----------|
| Book   | No. Sold  | RRP \$       | RRP \$ Total  | Av. Ebay Sale price \$ | Ebay Total \$              | % of RRP |
| 1  | 6         | 8            | 48            | 17.63                  | 105.78                     | 220.4    |
| 2  | 5         | 50           | 250           | 78.72                  | 393.60                     | 157.4    |
| 3  | 4         | 30           | 120           | 30.00                  | 120.00                     | 100.0    |
| 4  | 5         | 15           | 75            | 21.60                  | 108                        | 144.0    |
| 5  | 5         | 20           | 100           | 22.50                  | 112.50                     | 112.5    |
| 6  | 5         | 20           | 100           | 19.30                  | 96.50                      | 96.5     |
| 7  | 5         | 20           | 100           | 14.76                  | 73.80                      | 73.8     |
| 8  | 2         | 18           | 36            | 12.38                  | 24.76                      | 68.8     |
| 9  | 5         | 20           | 100           | 15.52                  | 77.60                      | 77.6     |
| 10   | 5         | 20           | 100           | 17.92                  | 89.60                      | 89.6     |
| 11   | 5         | 20           | 100           | 21.39                  | 106.95                     | 107.0    |
| 12   | 3         | 22           | 66            | 29.33                  | 87.99                      | 133.3    |
| 13   | 4         | 2            | 8             | 22.38                  | 89.52                      | 1118.8   |
| 14   | 2         | 40           | 80            | 62.03                  | 124.06                     | 155.1    |
| 15   | 2         | 30           | 60            | 81.53                  | 163.06                     | 271.8    |
| <b>Total</b>   | <b>63</b> | <b>\$335</b> | <b>\$1343</b> | <b>\$467</b>           | <b>\$1773.72</b>           |          |
|  |           |              |               |                        | <b>Total = 132% of RRP</b> |          |
|  |           |              |               |                        |                            |          |

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## **Macroeconomic Aspects of Small Business Development in Poland**

### **Abstract**

With the fall of Communism in the former Soviet Union, a number of countries have been faced with the prospect of transforming from a command economy to a market-oriented one. This paper is a preliminary investigation of entrepreneurial activity and economic development in the Polish economy. Entrepreneurial activity is believed to be the fundamental force in the transformation of economies in former communist countries towards free markets.

The transformation in Poland has been facilitated by the privatization of state owned enterprises and the development of the private business sector. The foreign direct investment (FDI) in Poland, which have played important role in the privatization and restructuring of the Polish economy has been discussed and macroeconomic indicators of economic performance within Poland, the European Union Countries (euro-zone) and Central and Eastern Europe have been analyzed.

Macroeconomic aspects of small business development in Poland examined in the paper include: number and size of business firms in private sector in Poland, share of the private sector, particularly small and medium size firms in gross domestic product (GDP), their share in total output of the economic sectors, national employment, and foreign trade.

The study shows that small business development plays a very important role in the process of transition from a command to a market oriented economy in Poland. Growth of free enterprise in Poland constitutes an important factor in economic development, stimulating output, creating employment and expansion in the foreign trade in the Polish economy.

## **Introduction**

This paper deals with the transformation from a centrally planned economy to market oriented economy in Poland and examines macroeconomic aspects of small business development in the Polish economy.

Development of the private business sector in Poland constitutes an important component of economic development and is an essential factor in creating employment in the Polish economy. In order to analyze small business development in Poland, it is important to understand the following issues: transformation of a centrally planned economy to a market oriented economy, macroeconomic changes related to economic growth, replacement of the command mechanism with market mechanism and privatization of the Polish economy ([www.parp.gov.pl/publikzam.php](http://www.parp.gov.pl/publikzam.php)).

This study assumes that the number of registered small business firms in the economy is a key measure of entrepreneurial activity and that the growth in the number of private firms indicates growth in entrepreneurial activity (Adrangi, Allender, and Anderson 2003). Entrepreneurial activity constitutes an important ingredient in the process of economic development and transformation from central planning to market oriented economies. This transformation has been facilitated by the privatization of small and medium state-owned companies and a liberal law on establishing new firms that has allowed for the development of the private business sector.

Part one focuses on assessing the transition period and includes: the foreign direct investment (FDI) in Poland, which have facilitated the privatization and restructuring of the Polish economy, macroeconomic indicators in the Polish economy with the focus on high unemployment rate, and macroeconomic indicators within the European Union Countries (euro-zone) and the Central and Eastern Europe.

Part two concentrates on macroeconomic aspects of small business development in Poland and examines: number and size of business firms in private sector in Poland, share of the private sector, particularly small and medium size firms in gross domestic product (GDP), their share in total output of the economic sectors, national employment, and foreign trade. This part compares the dynamic growth of GDP with the growing number of firms in the private sector indicating a link between growth in the number of private business firms in the Polish economy and the level of economic growth measured in terms of real GDP.

## **ASSESSING TRANSITION**

### **Transformation from a command into a market oriented economy**

State-owned enterprises were the dominant players in the socialist economies during the command era. The main economic problems related to the command era included inefficiencies in production methods, stagnation of production rates, poor quality of the

items produced, high pollution rates and lack of technological innovation. Transition is the process of replacing of one economic system with another. The command system in Central and Eastern Europe dates from the end of World War II. In the 1980s, the command economies of Eastern Europe collapsed, culminating in the 1989 fall of the Berlin Wall and Germany re-unification; in 1991 Cold War was over (Case & Fair, 2004). Changes in Poland's economy began in 1980 with the Solidarity movement, followed by the implementation of martial law in 1981. Privatization took place as state owned firms were converted to private ownership. Poland was the first of the former socialist countries to begin recording positive economic growth. Foreign investment was flowing into the country and thousands of entrepreneurs started new businesses. Capital flows typically take the form of foreign aid, portfolio investment and foreign direct investment (FDI). Foreign direct investment deserves special attention as a major component of capital flows in Poland.

The past decade has been Poland's most successful in 300 years. Poland is strategically integrated with NATO and, on May 1, 2004, became a member of the European Union together with the Czech Republic and Hungary ([www.eurunion.org](http://www.eurunion.org)). The membership of Poland in the European Union has been important for political as well as economic reasons. The government's determination to enter the EU has shaped most aspects of its economic policy and new legislation.

Poland is one of the largest economies in Central and Eastern Europe with a mostly Roman-Catholic population of 38.6 million, a relatively high GDP per capita (US\$9,410) that is comparable to that of the Czech Republic (US\$12,900) and Hungary (US\$11,200). The top priorities in Polish economy are the competitiveness of exports, the problem of high unemployment and soaring budget deficit, the development of financial markets, monetary and fiscal institutions.

There are a variety of indicators assessing transition outcomes in the Polish economy. Analysis will be limited to the main macroeconomic indicators with a focus on GDP, unemployment, and inflation.

### **The Importance of foreign direct investment (FDI) in the Polish Economy**

Foreign direct investment (FDI) has increased in the past twenty years, to become the most common type of capital flow, needed for the stabilization and economic growth of the Polish economy in the transition period. Foreign capital is seen to facilitate the privatization and restructuring of the economy. The privatization process has required large supply of capital, very often not available for the domestic companies. Poland has identified the positive effects of FDI on the transformation process of the economy.

Governments, many of which have formal FDI promotion programs and provide substantial incentives for foreign companies, have officially encouraged FDI. The last decade in Poland has made it clear that foreign direct investment have created employment, increased productivity and exports and led to transfers of knowledge and technology to the host countries ([www.regeringen.se/sb/d/1284/a/29424](http://www.regeringen.se/sb/d/1284/a/29424)). The Figure 1

presents FDI in Poland between 1993 and 2002. The highest amount of FDI has flown to Poland between 1998 and 2001 and it amounted about 35 billions of US dollars.

X-----

Figure 1 ... about here  
Foreign Direct Investment in Poland (in billions US\$)

X-----

Analyses of percentage share of the foreign countries in total foreign direct investment in Poland (2002), indicates significant contribution of France (20%), the USA (15%) and Germany (14%). Other European countries such as: the Netherlands, Italy and the U.K. participated respectively 9%, 7%, and 5% in total FDI. Multinational companies accounted for 5% of the total FDI in Poland. The remaining countries: Sweden, South Korea, Russia, Belgium, Ireland, Denmark, Cyprus, Switzerland, Austria, Norway, Japan, Greece and Portugal contributed to the total FDI between 4% to 1% ([www.paneurasian.com/di.pdf](http://www.paneurasian.com/di.pdf)).

The Table 1 shows total capital flow for the selected front-running transition economies: Poland, the Czech Republic and Hungary. The size of FDI flowing to the transition economies was impressive. FDI in Poland between 1989 and 2001 accounted for 3.6% of GDP. FDI per capita in Poland was relatively low in comparison with the Czech Republic and Hungary because of high population number.

X-----

Table 1 ... about here  
Foreign Direct Investment (FDI)

X-----

## **GDP per Capita and Economic Growth in Poland**

As the centrally planned economy began to collapse, state control of economic activity collapsed and decentralization of decision making occurred. GDP per capita and the economic growth are important indicators for judging transition. The most characteristic aspect of economies in transition has been the initial collapse of output and its slow recovery. During the early years of transition, the decline of economic activity in all transition economies was significant. The collapse of the Polish economy was modest and recovery relatively fast (Gregory & Stuart, 2004). Growing GDP per capita between 1990 - 2000, indicates an increase in the standard of living in Poland (Figure 2) and analysis of real GDP between 1995 -2001, also shows a dynamic increase in domestic output by 29.7% with a declining rate of economic growth from 6% to 1.3% (Table 2).

X-----

Figure 2 ... about here  
Gross Domestic Product per capita (1990 - 2000)

X-----

X-----  
Table 2 ... about here  
Real GDP and Economic Growth Rate  
X-----

### **Unemployment Rate in Poland**

Unemployment was theoretically nonexistent during the command era and became an important problem during transition period. It is known that there was *hidden unemployment* during the command era. It was difficult to dismissed workers, whether productive or not. The job was guaranteed by the law. The central issue during the transition era has been the movement of labor from the inefficient state sector to the emerging private sector. As a result of this process, the unemployment rate increased significantly. Liquidation of state own firms, and the direct or indirect transformation from state owned firms to private ownership contributed to the high unemployment rate in Poland. Other factors influencing unemployment rate relate to the introduction of the market economy and modern technology; inefficient private enterprises go out of business and new technologies require more skilled labor and lead to structural unemployment in the industry sector in Poland. Between 1990 and 2004 the unemployment rate in Poland increased from 0.3% to 20% (Figure 3). Very high unemployment has been a serious problem in Poland. The transition economies have developed systems of unemployment compensation, however, inequality and poverty have become a great threat.

X-----  
Figure 3 ... about here  
Unemployment Rate in Poland 1990 – 2004  
X-----

### **Inflation rate in Poland**

During the command era, prices were set by the state. In the early period of transition prices were released from state control. In the early 1990s, prices increased sharply as a result of a market imbalance. Centrally planned economies have been characterized as *economies of shortages*. With the transition to a market economy, the prices of goods and services in short supply were pushed upward. Another important factor that fueled inflation during the early years of transition was the devaluation of currency that led to an increase in exports and financial inflows of loans, grants and direct foreign investments. Between 1989 and 1990, the consumer price index increased from 351.1% to 685.8%, causing the highest inflation rate during the transition period, called *hyperinflation* or *shortage inflation* (Figure 4). To stabilize the economy and decrease the inflation rate a radical strategy called *shock therapy* was introduced (Kolodko, 2003). It resulted in

further institutional changes and government decentralization, increased private ownership, reconstruction of the banking system and stock exchange development.

X-----

Figure 4 ... about here  
Consumer Price Index 1980 – 2003 (previous year = 100)

X-----

### **Comparison of macroeconomic indicators within the European Union Countries**

Comparison of macroeconomic indicators in Poland with the European Union (euro-zone) countries in 2002 (Table 3), shows that GDP in Polish economy is growing faster than in the EU countries (1.3% versus 0.9% average), while inflation rate remains below the EU inflation rate (1.9% versus 2.2% average). However, unemployment rate in Poland is much higher than average unemployment rate in the EU (18.1 versus 8.3) and the budget deficit as a percentage of GDP is much above the EU average (5.6% versus 2.2%).

Comparison of macroeconomic indicators (Table 4) shows that Poland has the highest unemployment rate (18.1%) among the Central and Eastern European Countries, the lowest economic growth rate (1.3%) and relatively low inflation rate (1.9% versus the record high 23.7% in Rumania and 15.1% in Russia).

X-----

Table 3... about here  
Poland vs. European Union Countries (euro-zone) in 2002

X-----

X-----

Table 4... about here  
Poland vs. Central and Eastern European Countries in 2002

X-----

## **MACROECONOMIC ASPECTS OF SMALL BUSINESS DEVELOPMENT**

### **Number and Size of the Small and Medium Business Firms in Poland**

During the early years of transition, many entrepreneurs started private businesses. This study assumes that the number of registered small business firms in the economy is a key measure of entrepreneurial activity. The growing number of private firms indicates growth in entrepreneurial activity. Entrepreneurial activity constitutes an important ingredient in the process of transforming Central and Eastern Europe from centrally planned to market oriented economies (Mueller & Goic, 2002). In early 90's Poland, DDR, the Soviet Union and the Czech Republic reached relatively high levels in private enterprise development. Transitioning economies, particularly Poland, show tremendous

dynamics in small business development. The numbers of small business firms registered in Poland during 1991 and 2004 increased from 1,200,000 to 4,736,000 (Table 5).

X-----

Table 5 ... about here  
Number of Firms in Private Sector in Poland; 1991 – 2004  
X-----

Poland is acknowledged as the leader in Eastern Europe in privatization and in the movement to a market oriented economy. Micro, small and medium size business firms (1-249 employee) constitute 99.8% of all the private firms in Poland (Table 6). The most common form of business firm in Poland is the micro firm (1-9 employee). Micro firms constitute 95% of all the firms in the private sector.

X-----

Table 6 ... about here  
Number and Size of Firms in Private Sector in Poland in % (1999-2002)  
X-----

### **Share of Private Sector and Small and Medium Business Firms in GDP**

Transitioning economies focus on the creation of markets through a process of privatization. Privatization is the replacement of state-owned property with private property and the transformation of ownership from government to private hands. The development of small business enterprises represents an important aspect of the transition process.

To assess the success of privatization efforts, the extent to which economic activity has been privatized must be examined and the share of private sector output in national output must be determined. In 1992 less than half of the output was derived from the private sector whereas in 2000, the share of the private sector in the total output increased to 70% in Poland, 80% in Hungary and 80% in the Czech Republic.

Micro, small and medium firms (1-249 employees) play a critical role in the national economy in Poland, generating about 48% of the Gross Domestic Product (Table 7). The micro firms (1-9 employee) accounts for about 30% of the national output, showing an increasing share in GDP between 1999 and 2002, while small (10-49 employee) and medium firms (50-245) demonstrate a decline in GDP during this period. This leads to the conclusion that the smallest firms, micro firms, show sustained growth in comparison with other categories of firms in Poland.

X-----

Table 7 ... about here  
Share of Private Sector in GDP in Poland (%): 1999-2002  
X-----

## Share of Small and Medium Firms in Total Output of the Economic Sectors

The percentage share of small and medium firms in total output of the economic sectors in Poland indicates that, they generate between 91,1% and 99,1% of total output in education, retail and repairs, real estate and other, as well as in health. They contribute respectively 87.9% and 83.0% to the total output in construction as well as in hotels & restaurants. The industry sector (mining, manufacturing, electricity, gas, water) as well as transport and communication are still dominated by public sector and small and medium firms generate respectively only 40.8% and 44.9% of the total industry output (Table 8).

X-----

Table 8... about here

Share of Small and Medium Firms (1-249) in Total Output of Economic Sectors in Poland 2001

X-----

## Economic Growth and the Growth of the Private Business Firms

Economic growth in the Polish economy seems to be a strong indicator of entrepreneurial activity. This is consistent with the Schumpeterian view that entrepreneurial activity and economic growth are closely linked (Mueller & Goic, 2002).

Dynamic growth in real GDP in Poland has been compared with the growth of the registered private business firms in Poland between 1995 and 2005 (Figure 5). The results indicate a link between growth in the number of private business firms in the Polish economy and the level of economic growth measured in terms of real GDP.

X-----

Figure 5... about here

Economic Growth vs. Growth of Registered Business Firms

X-----

## Share of Private Sector and Small and Medium Firms in Employment

Dynamic development of the private sector in the Polish economy constitutes the most important factor generating employment in the economy. The private sector accounts for 72,5% of employment in Poland while the public sector constitutes 27.5% ([www.stat.gov.pl](http://www.stat.gov.pl)). Micro, small and medium firms (1-249 employee) constitute the base of employment in the Polish economy, generating employment of about 62.16%. The structure of employment in the firms employing 1-249 units of labor in 2001 was as follows: micro firms employed 14.72%, small firms 20.85% and medium firms 26.58% of the national employment (Table 9).

X-----

Table 9 ... about here

Employment in Private Sector in Poland (%)

X-----

According to the government of Poland, it is necessary to encourage entrepreneurship and create the conditions for the acceleration of economic development and the improvement of job opportunities. In *Entrepreneurship-Development-Work* ([www.parp.gov.pl](http://www.parp.gov.pl)) the government presents its strategy to develop entrepreneurship which it sees as the basic source of both economic growth and the creation of new jobs. The package provides for actions to eliminate formal barriers to the establishment and running businesses and facilitate the growth of employment

### **Share of Small and Medium Firms in Foreign Trade.**

Centrally planned economies were isolated from the global markets and world competitive forces. The sudden transition of the late 1980's forced the transition economies to adapt to the global environment. The most dramatic example of such change is the development of the European Union. Joining the European Union has been an important goal for the transition economies of Central and Eastern Europe ([www.eur.union.org](http://www.eur.union.org)). During the command economy there was no mechanism for the inflow of foreign capital because of the lack of financial markets. There was absence of a convertible currency during the command era, leading to the dominance of barter arrangements functioning through state trading organizations.

Table 10 includes share of private firms in foreign trade between 1999 and 2001 and illustrates important role of small and medium firms in Polish export and import. In 2001, small and medium firms participated 44% in export and 59.4% in import. The large firms accounted for 56% in export and 40.6% in import. Increase in the value of export characterized foreign firms only. Export of Polish firms showed declining tendency.

X-----  
Table 10 ... about here  
Share of Private Firms in Export/Import in Poland  
X-----

### **Summary**

This paper discussed the transformation from a centrally planned economy to market oriented economy in Poland and examined macroeconomic aspects of small business development in the Polish economy.

The foreign direct investment (FDI) have played important role in facilitating the privatization and reconstruction process of the Polish economy during transition period. Analyzes of macroeconomic indicators identify the unemployment rate in Poland (18%) to be a critical issue in the Polish economy and to be one of the highest rate among the European Union Countries (euro-zone) and the Central and Eastern Europe.

**The research found that private business enterprise development plays an important role in the acceleration of economic growth.** Poland shows tremendous dynamics in small business development. The private sector continues to facilitate economic growth and employment in Polish economy, constituting about 70% of GDP and generating 72,5% of employment in the country.

The paper showed the increasing share of the private sector, particularly small and medium size firms in the Polish economy and has proved the key role of small and medium firms in macro economy of the country. The private sector now constitutes the basic source of GDP and the base of employment in Poland. Micro, small and medium business firms in Poland (1- 249 employee) constitute 99% of all the firms in private sector, accounting for about 48% of GDP and create about 62% of employment in the national economy.

The smallest business firms, micro firms (1- 9 employees), account for 95% of all the firms in private sector, 30% of GDP, and 14% of the employment in the private sector. Micro firms show an increasing share in GDP between 1999 and 2002, and sustained growth in comparison with other categories of firms.

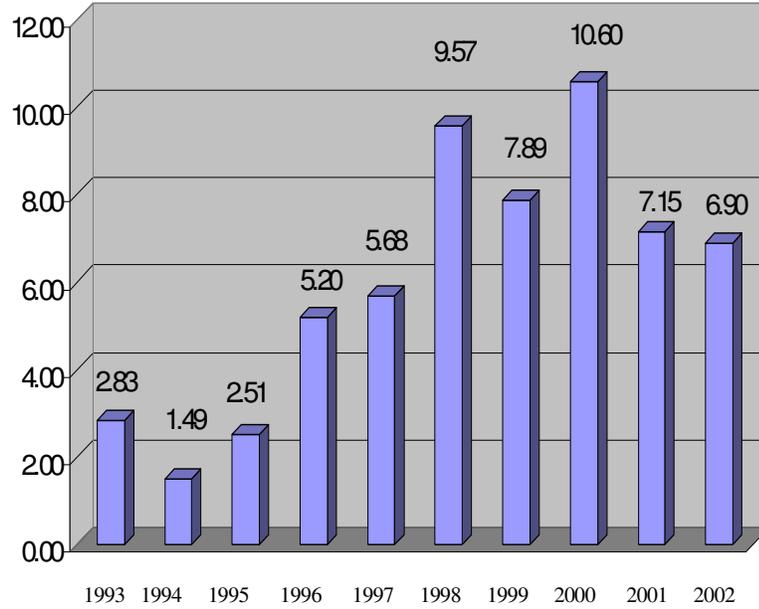
This paper showed the results of the globalization process and the strong involvement of small and medium firms in foreign trade. The membership of Poland in the European Union has been important factor in foreign trade development. In 2001, small and medium firms participated 44% in export and 59.4% in import while large firms accounted for 56% in export and 40.6% in import.

The study confirmed that small business development plays a very important role in the process of transition from command to market oriented economy in Poland. Growth of free enterprise in Poland constitutes an important factor in economic development, stimulating output, creating employment and expansion in the foreign trade in the Polish economy.

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Source: [www.paneurasian.com/di.pdf](http://www.paneurasian.com/di.pdf)

Figure 1: Foreign Direct Investment in Poland (in billions US\$)

Table 1: Foreign Direct Investment (FDI)

|                | FDI (1989-2001)<br>(million \$) | FDI (\$ per capita) | FDI(% of GDP)<br>2001 |
|----------------|---------------------------------|---------------------|-----------------------|
| Poland         | 34,426                          | 890                 | 3.6                   |
| Czech Republic | 26,493                          | 2,570               | 8.5                   |
| Hungary        | 21,869                          | 2,177               | 4.3                   |

Source: EBRD, Transition Report Update (Paris: EBRD, May 2002)

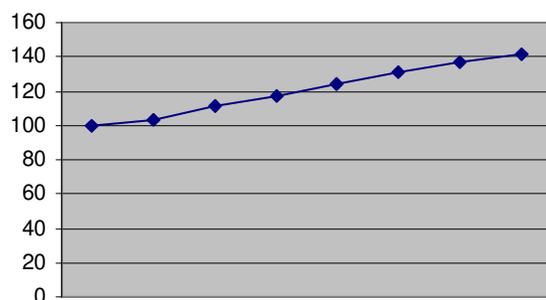


Figure 2. Gross Domestic Product per capita (1990 - 2000)

Source: Polish Official Statistics

[www.stat.gov.pl/english/servis/polska/2001/rocznik19/dypkb.htm](http://www.stat.gov.pl/english/servis/polska/2001/rocznik19/dypkb.htm)

Table 2: Real GDP

| year | GDP<br>1995 = 100% | Economic growth rate (%) |
|------|--------------------|--------------------------|
| 1995 | 100,0              | -                        |
| 1996 | 106,0              | 6,0                      |
| 1997 | 113,2              | 7,2                      |
| 1998 | 118,6              | 5,4                      |
| 1999 | 123,5              | 4,4                      |
| 2000 | 128,4              | 4,9                      |
| 2001 | 129,7              | 1,3                      |
| 2002 | -                  | -                        |
| 2003 | -                  | 1,3                      |

Source: Polish Official Statistics [www.stat.gov.pl](http://www.stat.gov.pl)  
 Poland Economy – 2003, [www.theodora.com/wfb2003/poland](http://www.theodora.com/wfb2003/poland)

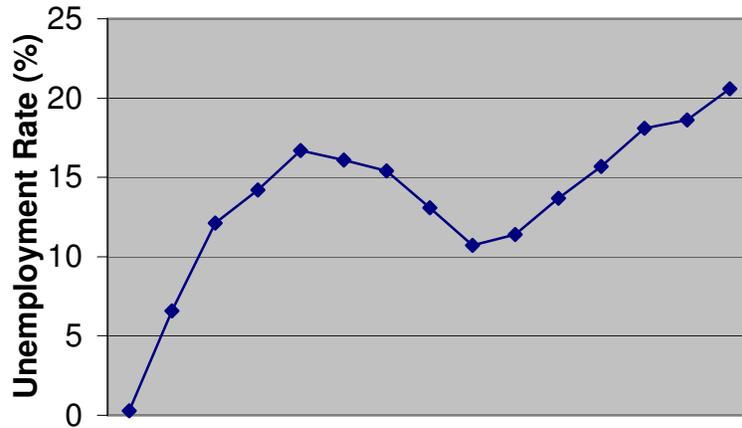


Figure 3: Unemployment Rate in Poland 1990 – 2004  
 Source: Polish Official Statistics [www.stat.gov.pl](http://www.stat.gov.pl)

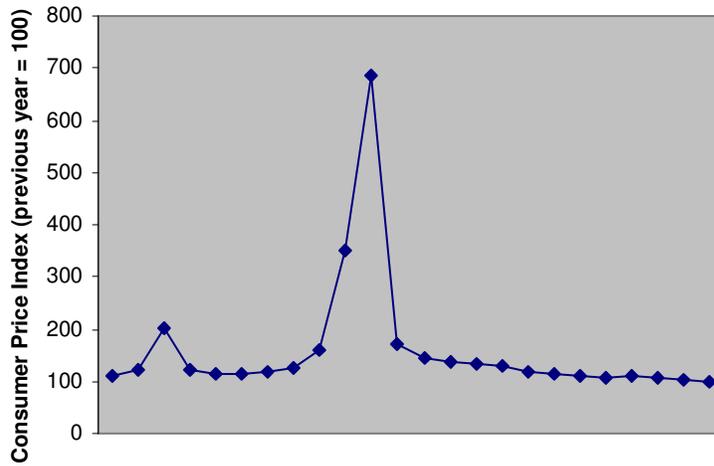


Figure 4: Consumer Price Index 1980 – 2003 (previous year = 100)  
 Source: Polish Official Statistics [www.stat.gov.pl](http://www.stat.gov.pl)

Table 3: Poland vs. European Union Countries (euro-zone) in 2002

|                                   | GDP        | UNEMPLOYMENT | INFLATION  | DEFICIT as % of GDP |
|-----------------------------------|------------|--------------|------------|---------------------|
| <b>European Union (euro-zone)</b> | <b>0,9</b> | <b>8,3</b>   | <b>2,2</b> | <b>-2,2</b>         |
| Denmark                           | 1,6        | 4,5          | 2,4        | 2,0                 |
| Finland                           | 1,6        | 9,1          | 1,5        | 4,7                 |
| France                            | 1,2        | 8,7          | 2,3        | -3,2                |
| Greece                            | 4,0        | 9,9          | 3,7        | -1,2                |
| Spain                             | 2,0        | 11,4         | 3,6        | -0,1                |
| The Netherlands                   | 0,3        | 2,7          | 3,9        | -1,1                |
| Ireland                           | 6,0        | 4,4          | 4,7        | -0,3                |
| Germany                           | 0,2        | 8,2          | 1,4        | -3,6                |
| Portugal                          | 0,5        | 5,1          | 3,7        | -2,7                |
| Sweden                            | 1,9        | 4,9          | 2,0        | 1,3                 |
| Great Britain                     | 1,8        | 5,1          | 1,3        | -1,3                |
| Italy                             | 0,4        | 9,0          | 2,6        | 2,3                 |
| <b>POLAND</b>                     | <b>1,3</b> | <b>18,1</b>  | <b>1,9</b> | <b>-5,6</b>         |

Source: European Commission, Directorate-General for Economic and Financial Affairs. Spring 2003. Economic Forecasts. Makroekonomiczna sytuacja Polski 2002. Page 17.

Table 4: Poland vs. Central and Eastern European Countries in 2002

| COUNTRY        | GDP        | INFLATION  | UNEMPLOYMENT |
|----------------|------------|------------|--------------|
| Belarus        | 4.5        | 3.2        | 3.0          |
| Bulgaria       | 4.4        | 5.8        | 16.9         |
| Croatia        | 6.5        | 2.2        | 21.6         |
| Czech Republic | 2.5        | 1.8        | 9.8          |
| Estonia        | 4.5        | 3.7        | 12.5         |
| Lithuania      | 5.9        | 0.3        | 10.9         |
| Latvia         | 5.0        | 1.9        | 7.6          |
| <b>POLAND</b>  | <b>1.3</b> | <b>1.9</b> | <b>18.1</b>  |
| Russia         | 4.2        | 15.1       | 7.8          |
| Romania        | 4.7        | 23.7       | 8.0          |
| Slovakia       | 4.0        | 3.4        | 17.4         |
| Slovenia       | 2.5        | 7.7        | 11.3         |
| Ukraine        | 4.1        | -0.6       | 3.8          |
| Hungary        | 3.1        | 5.4        | 5.5          |

Source; *Rzadowe Centrum Studiow Strategicznych. Ocena sytuacji spoleczno-gospodarczej 2002. Makroekonomiczna sytuacja Polski 2002. Page 18*

Table 5: Number of Firms in Private Sector in Poland; 1991 – 2004

| Year | Number of businesses |
|------|----------------------|
| 1991 | 1,200,000            |
| 1994 | 2,031,972            |
| 1995 | 2,099,577            |
| 1996 | 2,379,949            |
| 1997 | 2,552,649            |
| 1998 | 2,792,697            |
| 1999 | 3,013,876            |
| 2000 | 3,182,877            |
| 2001 | 3,374,956            |
| 2002 | 3,521,189            |
| 2003 | 3,520,000            |
| 2004 | 4,736,000            |

Source: Polish Agency for Enterprise Development [www.parp.gov.pl](http://www.parp.gov.pl)

Table 6. Number and Size of Firms in Private Sector in Poland in % (1999-2002)

| year | Private Sector | Firms            | Micro | small | medium | large (250+) |
|------|----------------|------------------|-------|-------|--------|--------------|
|      | All firms      | 1 - 249 employee | 1-9   | 10-49 | 50-249 |              |
| 1999 | 100.00         | 99.79            | 95.08 | 3.75  | 0.96   | 0.21         |
| 2000 | 100.00         | 99.80            | 95.19 | 3.69  | 0.91   | 0.20         |
| 2001 | 100.00         | 99.80            | 95.01 | 3.88  | 0.91   | 0.20         |
| 2002 | 100.00         | 99.82            | 95.05 | 3.91  | 0.86   | 0.18         |

Source: Polish Agency for Enterprise Development, [www.parp.gov.pl/01.php](http://www.parp.gov.pl/01.php)

Table 7. Share of Private Sector in GDP in Poland (%): 1999-2002

| year | Private sector | Firms            | micro | small | medium | large (250+) |
|------|----------------|------------------|-------|-------|--------|--------------|
|      | All firms      | 1 – 249 employee | 1-9   | 10-49 | 50-249 |              |
| 1999 | 70.4           | 48.2             | 25.0  | 13.0  | 10.2   | 22.2         |
| 2000 | 69,4           | 48.6             | 30.6  | 8.4   | 9.6    | 20,8         |
| 2001 | 68.2           | 48.3             | 31.0  | 8.3   | 9.0    | 19.9         |
| 2002 | 68.7           | 48.6             | 32.4  | 8.1   | 8.1    | 20.1         |

Source: Polish Agency for Enterprise development, [www.parp.gov.pl/03.php](http://www.parp.gov.pl/03.php)

Table 8: Share of Small and Medium Firms (1-249) in Total Output of Economic Sectors in Poland 2001

| SECTORS   | %    |
|---|------|
| Private sectors   | 70,8 |
| Industry (mining, manufacturing, electricity, gas, water) | 40,8 |
| Construction  | 87,8 |
| Retail and repairs  | 92,4 |
| Hotels and Restaurants                                    | 83,0 |
| Transport & Communication                                 | 44,9 |
| Financial Services  | 75,0 |
| Real Estate & Other                                       | 91,4 |
| Education   | 99,1 |
| Health  | 91,2 |
| Other Services  | 84,4 |

Sources: GUS, Zakład Badan Statystyczno-Ekonicznych

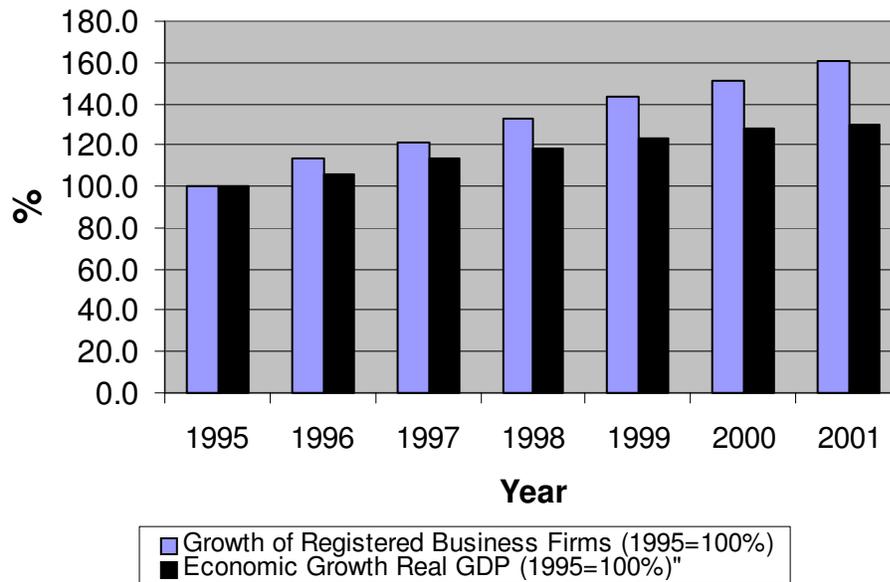


Figure 5. Economic Growth vs. Growth of Registered Business Firms

Source: Polish Official Statistics, [www.stat.gov.pl](http://www.stat.gov.pl)

Poland Economy, [www.theodora.com/wfb2003/poland](http://www.theodora.com/wfb2003/poland)

Table 9. Employment in Private Sector in Poland (%)

| year | Private Sector |                           |              |                |                  |              |
|------|----------------|---------------------------|--------------|----------------|------------------|--------------|
|      | All firms      | Firms<br>1 – 249 employee | micro<br>1-9 | small<br>10-49 | medium<br>50-249 | large (250+) |
| 1999 | 100.00         | 57.69                     | 13.77        | 17.49          | 26.44            | 42.31        |
| 2000 | 100.00         | 59.57                     | 14.42        | 18.07          | 27.08            | 40.43        |
| 2001 | 100.00         | 62.16                     | 14.72        | 20.85          | 26.58            | 37.84        |

Source: Polish Agency for Enterprise Development, [www.parp.gov.pl/05.php](http://www.parp.gov.pl/05.php)

Table 10: Share of Private Firms in Export/Import in Poland

| % export |        |               | micro | small | medium | large  |
|----------|--------|---------------|-------|-------|--------|--------|
| year     | all    | firms (1-249) | 1-9   | 10-49 | 50-249 | (250+) |
| 1999     | 100.00 | 47.7          | 13.16 | 12.02 | 22.52  | 52.30  |
| 2000     | 100.00 | 46.1          | 13.20 | 11.59 | 21.32  | 53.90  |
| 2001     | 100.00 | 43.9          | 10.77 | 11.46 | 21.68  | 56.09  |

| % import |        |               |       |       |        |        |
|----------|--------|---------------|-------|-------|--------|--------|
| year     | all    | firms (1-249) | 1-9   | 10-49 | 50-249 | (250+) |
| 1999     | 100.00 | 65.4          | 21.42 | 20.40 | 23.61  | 34.57  |
| 2000     | 100.00 | 61.3          | 20.29 | 18.98 | 22.02  | 38.72  |
| 2001     | 100.00 | 59.4          | 17.82 | 18.96 | 22.59  | 40.64  |

Source: Polish Agency for Enterprise Development [www.parp.gov.pl/10.php](http://www.parp.gov.pl/10.php)

**CONSULTING AND ADVISING A NEW BUSINESS START-UP BY  
APPLYING LESSONS LEARNED FROM THE APPRENTICE REALITY  
SIMULATION**

Paper presented to:  
International Council for Small Business  
Dr. Michael Rubach  
ICSB 2005 Competitive Paper Chair  
University of Central Arkansas

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## **TITLE**

“CONSULTING AND ADVISING A NEW BUSINESS START-UP BY APPLYING LESSONS LEARNED FROM THE APPRENTICE REALITY SIMULATION”

## **EXTENDED ABSTRACT**

Reality television shows such as *The Apprentice* are extremely popular and challenge individuals and teams to compete against each other for the ultimate prize of working with Donald Trump. Using *The Apprentice* television show as a template for a classroom project, students were able to learn first hand how to develop a marketing plan and organize a promotion. How do simulations such as this provide a sufficient learning experience and can the students who participate in the simulation be successful when they are called upon to advise and consult a business in the real world?

## **THE APPRENTICE CLASSROOM SIMULATION**

To gain real life work experience is sometimes difficult for college students, especially if that work experience involves making a decision that has a direct impact on the individual sales force, the business, and the community. To give college students a real life experience, two car dealers offered a challenge to twenty college students. The first challenge was to see which team could generate the most BUZZ during a one-week promotion. The second challenge was to see which team could gather the most donated food for the local food pantry. The title of the simulation was the *Chadron Apprentice Challenge*.

The *Chadron Apprentice Challenge* has a competitive side. The challenges involve car dealerships in towns approximately 50 miles apart. To add a competitive flair the student teams competed against each other. Student teams were in complete control of the promotion, the sales staff and advertising. (Subject to final approval by the owner for legal reasons). These students used a combination of the courses they had taken in business including; advertising, management, marketing, accounting, and communications.

### **CHALLENGE ONE:**

Two teams of five-members each participated in local version of *The Apprentice Challenge* to see which team could generate the most BUZZ for a car dealership. The dealership has locations in two neighboring towns 45 miles apart. Each team was given a budget of \$2000 and the opportunity to work with a professional advertising agency. The teams individually generated a marketing and advertising plan for a one-week period. (The plan was approved in advance by the dealership to meet legal requirements).

The teams used a combination of radio; print, flyers, and a car give away promotion. One team took pictures of young children on Santa's knee and gave them away. Both team had to stay under their initial budget.

The two teams were given only one week to plan the advertisements, get the copy approved, cut radio ads and gain the commitment of the sales staff. Once the promotion started the teams worked directly with the sales staff of both dealership locations. (Typically this was a slow time of year for the dealerships and employee moral was a bit low since the majority of the income for the sales staff is generated from commissions). The students were surprised just how attentively the sales staff listened to them and how eager the staff was to try something new.

After a one-week promotion the results were totaled and the students met with the owner to see which team won. To give this challenge the feel of a real life experience and to capitalize on the success of a popular television series we had the students meet in a formal boardroom to hear the results and to see who would be fired. The owner was so impressed that neither team was fired; he gave each member of the winning team a fifty-dollar bill. This was really unexpected by the team and very appreciated since it was Christmas. He also invited the teams to manage a complete month long advertising campaign in the spring.

The results of the promotion were fantastic. The sales were more than double the previous period in both locations. The sales staff was excited and motivated to try new things. John Miskimins owner of Miskimins motors stated, " I did not believe that our sales force would

actually listen to the young college students since none of them had ever sold cars, but I was wrong”. “Not only did the students get a first hand experience on how a business works, but our employees got re-energized and learned some new ideas from the students”. “This is a great “Win-Win” project and I can’t wait to do it again”.

### **CHALLENGE TWO:**

The second *Apprentice Challenge* was similar in design as the first project. In the second challenge two student teams developed advertising and promotion campaigns to see which team could bring in the most food for the two local food pantries. The car dealer gave the students a budget of \$1,000 for each team. The teams offered a variety of promotions to generate donations. One team offered an oil change to all customers who brought in a new toy and a discount on service to all customers who brought in food. (This promotion was part of the \$1,000 budget) To additionally help the promotion team took pictures of young kids sitting on Santa’s knee in exchange for a food donation.

Jamie Eisenbarth owner of Eisenbarth motors stated; “The challenge was really exciting for the us to see how the new generation of college students are using what they learn in the classroom and how they apply it to a real world experience”. “This was an unusual project since we were not directly selling anything and it is hard to get people to come into a store to give a donation, but these students really did a good job”.

At the conclusion of the food pantry drive the two teams had managed to accumulate enough food to go all the way around a basketball court “five” times. Not only did this project help the local food pantries restock their supply but it also gave several families food for the holidays, some young kids some new toys and there was a much joyous Christmas for many.

**RESULTS:** The *Apprentice Challenge* was designed to be a positive learning experience. Both dealerships received a lot of foot traffic associated with the promotions. The top teams were treated to a cash award or steak dinner by the dealerships. For the hard work by the teams the dealerships received a lot of good press and set record for sales in both locations, which the owners believe, had a direct affect on the promotion done by the two teams. The student teams received the chance to work with an advertising agency, to work as a competitive team setting, to develop a project and see the results. Who was the true winner? The community food pantry was restocked and several families had a much joyous Christmas.

## **APPLYING THE LESSONS LEARNED**

A new business heard about *The Apprentice Challenge* and asked the team to develop a marketing plan and theme for a new restaurant and bar they planned to open. The owners had no prior experience in running a business and needed a substantial amount of assistance. They also wanted to make sure that their investment

At the initial meeting the owners they were not sure what theme the new business should have. Should it be a bar that served good food or a restaurant that served alcohol with a bar in it? Another concern of the owners, should the new business have a smoking or non-smoking atmosphere. A group ten students, from the original apprentice groups, took on the challenge and met with the owners who gave the team an overview of what they “wanted” to do and asked the team to see if their plan was feasible within the community.

The ten students were divided into two five-member teams. One team did an analysis of a new bar serving good food while the other looked at a restaurant that served alcohol. The first step for both groups was to complete a SWOT analysis. In the SWOT analysis each group analyzed all competing businesses and a summary was completed. The results revealed that each business scenario had positive and negative aspects.

Step two was to develop a survey to help determine what the community wanted. Since there were positive and negative aspects with both scenarios the goal was to see which business type would be the best for the owners and the community. The teams worked

together to develop a survey instrument that would give results that both teams could use. By using one survey form saved time and made the results easier to compare.

Just over three hundred community people were surveyed. The community survey included a range in age from 18 to over 50. The teams then analyzed the data. Initially the owners had thought that college kids spent all of their non-school time at the local bar. The results gave a slightly different result. The legal drinking age is twenty-one and the majority of the traditional college community not legally able to drink alcohol until they are in their junior or senior year.

The survey revealed that these young students wanted to go out for an evening of fun and not be restricted entry to the bar because of their age. The results indicated that 83% wanted to have a restaurant that served good food at a reasonable price and one that also had a small bar similar to Outback, TGI Fridays, Applebee's and others.

The majority 77% also wanted a non-smoking restaurant. Other results of the survey gave the owners an indication of the dollar amount customers would be willing to spend for an evening out. Using this information the two teams recommended to the owners that the new business be a "Fun" non-smoking restaurant that served good food at a reasonable price. They also recommended that the theme have a sports bar atmosphere with several televisions and tables as well as a bar.

With a single theme identified and armed with the survey data and with additional information provided by the owners on operating expenses the combined group developed a break-even analysis and business plan for the new restaurant.

The Apprentice Challenge puts a new twist on the traditional service-learning concept. Students still learn by doing, but the Apprentice Challenge adds the competitive nature of a real world experience and challenges students to compete, not just participate. The challenge also allows some flexibility, each project and is individually focused on a particular theme and students get involved with a local business.

**AN EXAMINATION OF MANAGERS' ENTREPRENEURIAL ACTIONS  
AND JOB SATISFACTION**

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**ABSTRACT**

Through the development and extension of theories and scholars' subsequent empirical analyses of significant, theoretically grounded research questions, the knowledge about corporate entrepreneurship (CE) and its successful use continues to advance. Moreover, the literature suggests important relationships between the corporate environment, managers' entrepreneurial behavior and successful implementation of corporate entrepreneurship actions. In an attempt to test some of those relationships, we describe an empirical study of 523 managers that examines the relationships among the antecedents to managers' entrepreneurial behavior, a decision to implement entrepreneurial actions, and resulting job satisfaction and reinforcement practices.

## INTRODUCTION

Increasingly, organizations are committing to the position that entrepreneurial actions are essential if they are to first survive and then achieve competitive success in a world that is being driven by accelerating change (Barringer & Bluedorn, 1999; Lyon, Lumpkin & Dess, 2000; Ireland et al., 2001). Entrepreneurial actions do not occur in a vacuum; rather, they take place within the context of the organization's full array of actions (Dess, Lumpkin, & Covin, 1997). Establishing an internal environment in large, established organizations that elicits and nurtures entrepreneurial actions is challenging and requires appropriate decisions (Sathe, 1985). However, as we demonstrate in this study, entrepreneurial actions are a product of organizational antecedents. Furthermore, we argue that managers' entrepreneurial actions can be a source of competitive advantage for a firm over its rivals (Floyd & Wooldridge, 1994).

### Role of Managers in Corporate Entrepreneurship

Managers at all organizational levels have critical strategic roles to fulfill for the organization to be successful (Floyd & Lane, 2000; Ireland, Hitt & Vaidyanath, 2002). According to Floyd and Lane (2000), top-, middle-, and first-level managers have distinct responsibilities with respect to each subprocess. Top-level managers have *ratifying*, *recognizing*, and *directing* roles corresponding to the competence definition, modification, and deployment subprocesses, respectively. According to Floyd and Lane (2000), middle-level managers have *championing* roles corresponding to the competence definition subprocess, *synthesizing* and *facilitating* roles corresponding to the competence modification subprocess, and *implementing* roles corresponding to the competence deployment subprocess. In examining the role of first-level managers, they are often the catalysts behind autonomous entrepreneurial initiatives. In Floyd and Lane's (2000) model, first-level managers have *experimenting* roles corresponding to the competence definition subprocess, *adjusting* roles corresponding to the competence modification subprocess, and *conforming* roles corresponding to the competence deployment subprocess.

### Organizational Antecedents

Research has examined the organizational antecedents that affect (either by promoting or impeding) the breadth and depth of entrepreneurial actions that are taken within the firm at a point in time to pursue CE (Zahra, 1991; Zahra & Covin, 1995; Zahra, Nielsen & Bogner, 1999). The research literature has been developing our understanding of organizational antecedents of entrepreneurial actions (Kuratko, Montagno, & Hornsby, 1990; Hornsby, Kuratko, & Montagno, 1999; Ireland, et al 2003). An integrated review and analysis of the literature demonstrates a grouping of five major categories or dimensions that are considered antecedents to entrepreneurial actions. These dimensions are: (1) *the appropriate use of rewards* to elicit and then support entrepreneurial actions; (2) *managerial support*, which indicates the willingness of managers, especially top-level executives, to facilitate and promote entrepreneurial actions; (3) *available resources*, including the time required to continuously engage in entrepreneurial actions; (4) *a supportive organizational culture*, which is a culture that is organic rather than mechanistic in nature; and (5) *work discretion (autonomy and risk taking)*, the ability or willingness on the part of managers, based upon their job descriptions, to take risks in the pursuit of innovation and to tolerate and learn from failures.

## **Job Satisfaction and Entrepreneurial Actions**

An individual's job satisfaction could have a mediating effect on the ability of a CE environment to spur entrepreneurial actions or performance. While the relationship between job satisfaction and performance has been a persistent "chicken and egg" question, recent research suggests that job satisfaction and performance are moderately related and mutually influence each other (Judge, Thoresen, Bono & Patton, 2001). Several recent studies examined the viability of the job satisfaction-performance relationship. These studies support Harter, Schmidt and Hays' (2002) contention that the relationship is more complex and that the analysis suffers from poor measures of both constructs. Furthermore, the research suggests that many variables may mediate and or moderate the relationship.

### **Purpose of the Study**

The purpose of this study is to investigate the relationship between the organizational antecedents that create a corporate entrepreneurial environment, as identified in Hornsby et al. (1999; 2002; and Ireland, et al 2003), and the entrepreneurial actions taken by managers. Also of interest in this study is the relationship between the existence of a corporate entrepreneurial environment and a manager's perceptions of job satisfaction. Specifically, the following hypotheses are offered:

**H1a, b, c, d, e:** The perceptions of a corporate entrepreneurial environment will be positively related to job satisfaction.

**H1a:** Management support will be positively related to job satisfaction.

**H1b:** Work discretion will be positively related to job satisfaction.

**H1c:** Rewards/reinforcement will be positively related to job satisfaction.

**H1d:** Time availability will be positively related to job satisfaction.

**H1e:** Organizational boundaries will be positively related to job satisfaction.

**H2a, b, c:** Job satisfaction will be positively related to entrepreneurial actions.

**H2a:** Job satisfaction will be positively related to the number of new ideas suggested.

**H2b:** Job satisfaction will be positively related to the number of ideas implemented.

**H2c:** Job satisfaction will be positively related to the number of unofficial improvements implemented.

**H3:** Job satisfaction will mediate the relationships between perceptions of a corporate entrepreneurial environment and entrepreneurial actions.

The model we will test and the hypotheses stated above are shown in Figure 1.

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Insert Figure 1 about here  
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## **METHOD**

### **Sample**

The sample for this study was taken from approximately 670 managers who participated in continuing education and training programs for managers conducted by a large Midwestern

university. Participation in the survey was voluntary and approximately 80% of those eligible (530 individuals) chose to do so. Seven surveys were incomplete and were discarded, leaving a usable sample of 523. The average age of the respondents was 39.6 years, 75% were male, average organizational tenure was 12.2 years, and the average time in their current positions was 4.5 years. 30% described themselves as first level managers; 45%, mid-level managers; and 13%, senior-level managers. (12% declined to respond to this item)

## Measures

The Corporate Entrepreneurship Assessment Instrument (CEAI) (Hornsby, Kuratko, & Zahra, 2002)) was used to measure the organizational factors that foster corporate entrepreneurial activity within a company. Top management support for corporate entrepreneurship was measured by 19 items ( $\alpha = .90$ ), work discretion was measured by 10 items ( $\alpha = .87$ ), rewards/reinforcement was measured by 6 items ( $\alpha = .73$ ), time availability was measured by 6 items ( $\alpha = .77$ ), and organizational boundaries was measured by 7 items ( $\alpha = .63$ ). For each of these five scales, the participants responded to a 5-point Likert scale with responses ranging from “strongly disagree” to “strongly agree.” Job satisfaction was measured by the Minnesota Job Satisfaction Questionnaire (Weiss, Dawis, England & Lofquist, 1967) ( $\alpha = .88$ ). A 5- point Likert scale was used with the responses ranging from “very dissatisfied” to “very satisfied.” Entrepreneurial actions were measured by items developed by the authors. Each action was measured by a single item in which the respondents were asked (1) the number of new ideas suggested, (2) the number of new ideas implemented, and (3) the number of improvements implemented without official organizational approval. In each case the participants were asked to respond with number of these actions that had occurred over the past six months.

## RESULTS

### Measurement model

In order to test our hypothesized model, we formed manifest indicators as described by Bishop, Scott, Goldsby, and Cropanzano (2005) and subjected them to a confirmatory factor analysis (CFA). We formed 4 manifest indicators from the management support items, 3 from the work discretion items, 2 each from the rewards/reinforcement, time availability, and organizational boundaries items, and 4 from the job satisfaction items. Using a covariance matrix derived from these indicators we estimated a measurement model. The results indicate that the model fit the data well:  $\chi^2_{(104)} = 210.57$ , root mean square error of approximation (RMSEA) = .044, non-normed fit index (NNFI) = .99 and comparative fit index (CFI) = .99. The model shown in Figure 2 shows the measurement and structural portions of the model.

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Insert Figure 2 about here  
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### Structural model

We tested our hypotheses by estimating the model shown in Figure 2. Again, the model fit the data well:  $\chi^2_{(152)} = 280.78$ , root mean square error of approximation (RMSEA) = .040, non-normed fit index (NNFI) = .99, and comparative fit index (CFI) = .99. Since  $\gamma_{12}$  and  $\gamma_{13}$  were

significant, hypotheses 1b and 1c, respectively, were supported, while hypotheses 1a, 1d, and 1e were not supported because  $\gamma_{11}$ ,  $\gamma_{14}$ , and  $\gamma_{15}$  were not significant. See Figure 3. Hypotheses 2a, 2b, and 2c were supported since  $\beta_{21}$ ,  $\beta_{31}$ , and  $\beta_{41}$  were all significant. Hypothesis 3 received partial support because the indirect effects of work discretion on the number of new ideas ( $\gamma_{12}\beta_{21} = .039 \pm .035$ ), the number of ideas implemented ( $\gamma_{12}\beta_{31} = .056 \pm .035$ ), and the number of unofficial improvements ( $\gamma_{12}\beta_{41} = .056 \pm .035$ ) were significant as were the indirect effects of rewards/reinforcement on the number of new ideas ( $\gamma_{13}\beta_{21} = .056 \pm .051$ ), the number of ideas implemented ( $\gamma_{13}\beta_{31} = .080 \pm .052$ ), and the number of unofficial improvements ( $\gamma_{13}\beta_{41} = .080 \pm .052$ ). The indirect effects of the other 3 exogenous variables on the entrepreneurial actions were not significant. Their values were not calculated because the direct effects of the exogenous variables on job satisfaction were not significant.

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Insert Figure 3 about here  
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## DISCUSSION

Our focus has been on the antecedents, actions, and outcomes related managerial performance. The findings of this research effort suggest that work discretion and rewards/reinforcement lead to higher perceived job satisfaction and that this heightened satisfaction results in increased entrepreneurial actions. Specifically, there is an increase in the number of new ideas suggested, the number of new ideas implemented and the number of unofficial improvements made. These findings and the resulting model advance the research in the area of organizational antecedents and the viability of the CE process. The results indicate that greater emphasis on these antecedents can lead to more internal entrepreneurial behavior thus adding to the validity of such CE antecedents suggested by Hornsby et al. (2002) and others.

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Figure 1  
Hypothesized Model

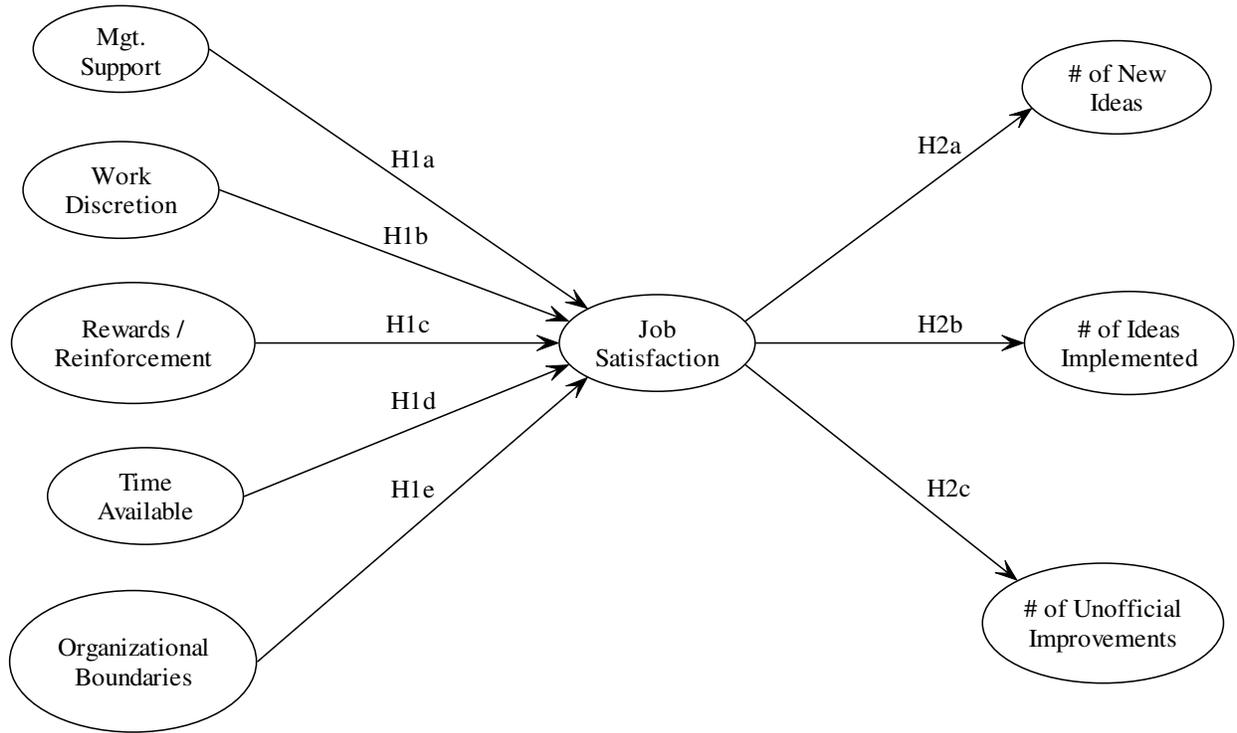


Figure 2  
Hypothesized Model Showing Manifest Indicators

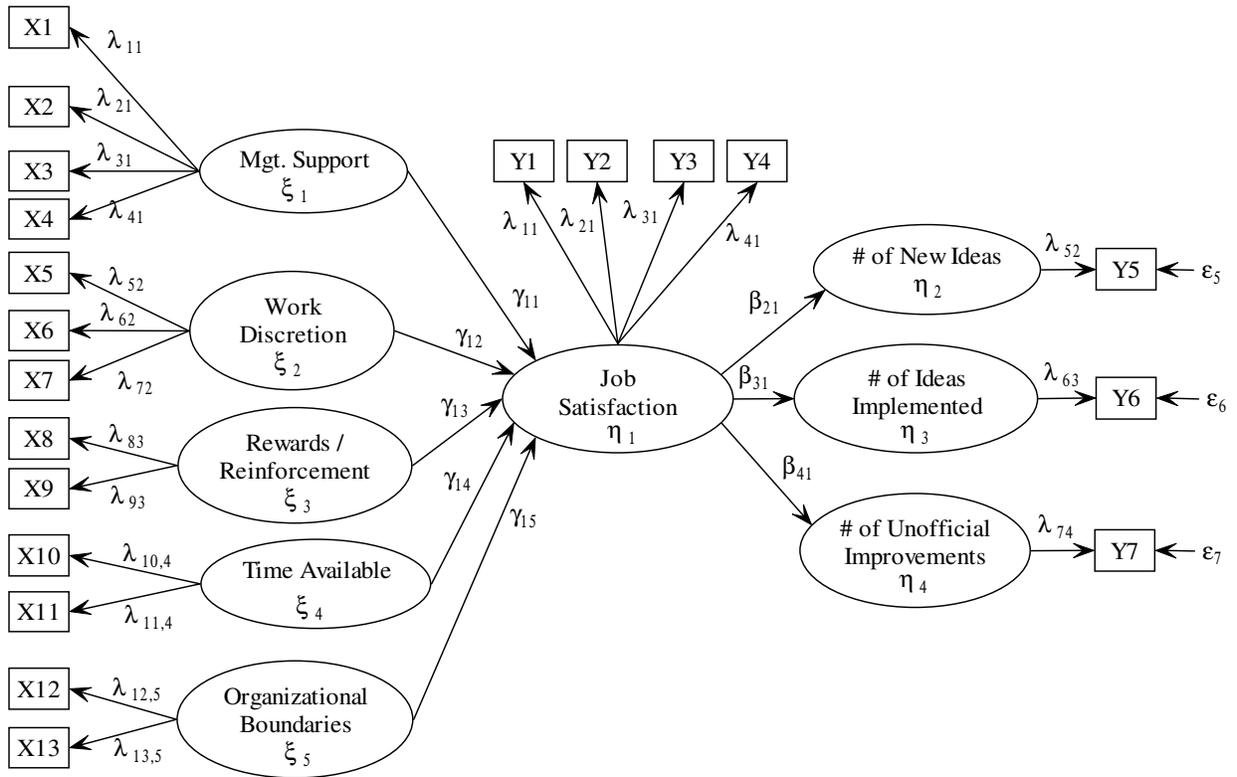
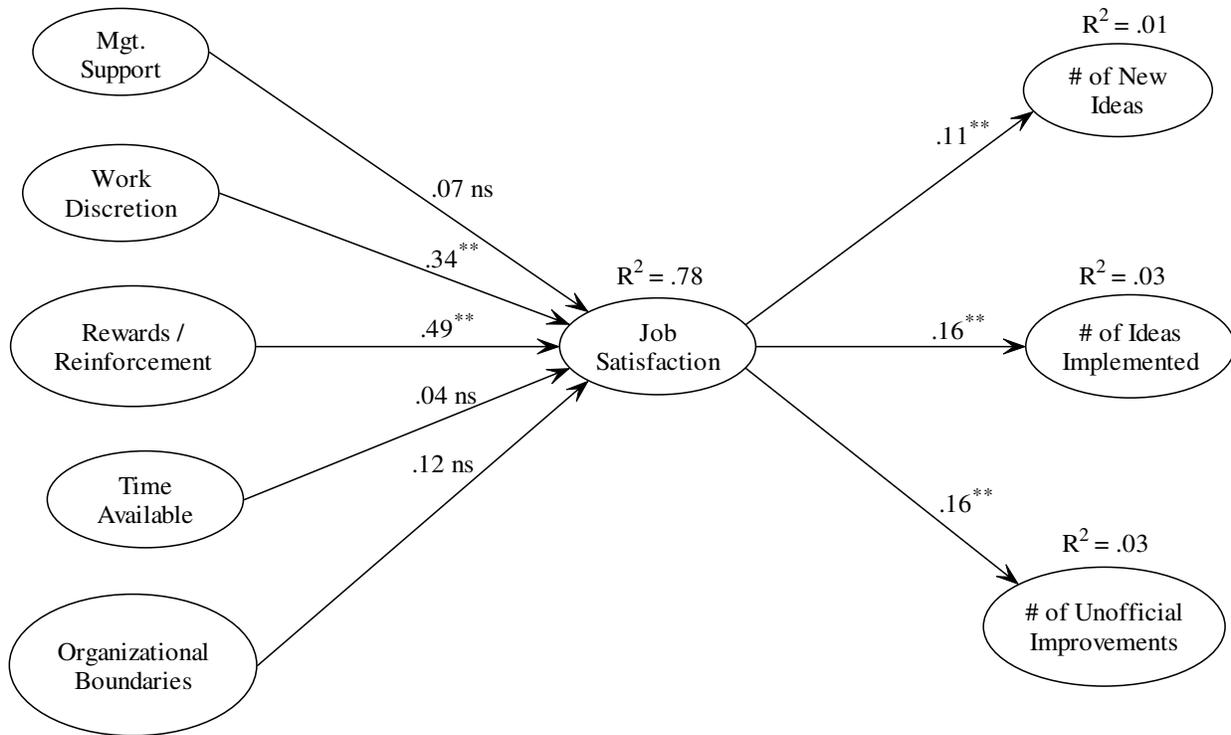


Figure 3  
Structural Path Estimates of the Hypothesized Model



ENTREPRENEURIAL SUPPORT FOR RURAL SMALL, MEDIUM AND MICRO  
ENTERPRISES (SMMES) IN SOUTH AFRICA

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## ABSTRACT

*A research project on small, medium and micro enterprises (SMMEs) support was initiated that recognised the alarming failure rate among SMMEs, especially in the rural areas. The aim of this project was to raise awareness of support for activities by rural SMMEs. Cognisance was given to the fact that some SMMEs had succeeded under the prevailing conditions. The first phase of this project sought to solicit the stories and experiences behind such successful entrepreneurs in the rural areas. The second phase, presented by this article, embraced a survey of 600 SMMEs from all six Limpopo provincial municipal districts. The purpose of the survey was, amongst others, to determine the profile of rural small businesses, assess required and availed support systems, and make recommendations for SMMEs stakeholder support. A response rate of 89% was attained. The findings revealed the following major trends: the general profile reflects 84% of sampled SMMEs to be owner-managed; 70% have 1 to 3 staff members and the majority of the businesses (71%) have been in existence for at least six years. The support available to the SMMEs sector is perceived to be generally weak with the exception of staff development training seen to be accessible by nearly 60% of the respondents. Nearly 80% of the respondents perceive finance to be inaccessible. The study recommended, inter alia, the strengthening of business chambers among rural businesses and the targeting of support systems mainly to the micro and very small businesses, which are in the majority in rural communities.*

## INTRODUCTION

Levitsky (1996:1) indicated that virtually all countries, at whatever stage of economic development, recognise the importance of small, medium and micro enterprises (SMMEs) and the need to support their development. SMMEs contribute more than 90% of employment opportunities in many countries, are responsible for revenue creation and poverty alleviation, and are a source for creativity and innovation (UNCTAD, 2003:3). The SMMEs sector, when adequately supported, could see many developing countries realise their dreams of improving their economies.

The main challenges facing many developing economies are unemployment and poverty. A Norwegian survey in March 2002 reported South Africa's unemployment rate to have risen from 6,7% in 1960 to 10,6% in 1983, to 33,7% in 1995, and to 45% in 2001 (Mahadea, 2003:3). Although SMMEs in South Africa account for 97% of all businesses, they contribute 25% of the gross domestic product (GDP), absorb 38% of the labour force and are responsible for 75% of new jobs (Netswera, 2001:32). Our country is characterised by high rural-urban influxes by young people and professional practitioners seeking survival and livelihood in cities (Kroon, 1998:36). The objectives of government and non-governmental organisations, including the World Bank, have been to reverse rural-urban migration and sustain rural development (I-Net Bridge, 2002). Rural entrepreneurs are trying hard to succeed against the odds. Many of these rural areas are characterised by population sparsity, remoteness, poor infrastructure, little or no access to vibrant markets, and many similar negative factors that impede rural economic development.

## PROBLEM STATEMENT

Some of the most significant problems currently facing South Africa are unemployment (45%) and rural poverty (71%), which have direct effects on other social ills such as crime and AIDS (Aliber, 2002:2). In tackling some of these problems, some rural dwellers start their own small business enterprises in an attempt to earn a living. A number of these SMMEs, however, end up failing (SBDC, 1996; Jackson & Alberts, 1998; AMC, 2004). Reasons that lead to failure include, amongst others, limited resources, inexperience in running and managing own enterprises, poor cash management and weak marketing efforts (Badenhorst, Cronje, du Toit, Gerber, Krüger, Marais, Strydom, van der Walt & Reenen, 1997:90; Barrie, 2003; Bizhelp24, 2004; AMC, 2004). It is argued that a lack of appropriate support is the main reason for the high failure rate of SMMEs in South Africa (Levy, 1996:11; Netswera, 2001:31).

The following are some important questions worth asking about SMMEs support in the rural areas:

- Are there support services for small businesses in the rural areas?
- Do rural entrepreneurs require support in running their businesses?
- Are small businesses aware of available support services?
- Do rural entrepreneurs make use of these SMMEs support services?
- What do small businesses think of their SMMEs support services?

The Limpopo province has been chosen as the study area for this research. The rationale behind selecting this province is that it has the highest rural population (89%) and an unemployment rate of 46% (Stats SA, 2000).

### **MAIN AIM AND OBJECTIVES OF THE RESEARCH**

The main aim of the study is to raise awareness of what SMMEs do in the rural areas of South Africa, and to solicit support to strengthen SMMEs activities.

Objectives of the research are as follows:

- To profile rural small businesses
- To assess the requirement for and availability of small business support
- To make recommendations to SMMEs stakeholders to support rural small businesses

### **GENERAL PERSPECTIVES ON RURAL SMME SUPPORT**

Rural areas are an increasingly important component of the national economy and are characterised by the importance of very small-scale enterprises, with over 90% of all rural firms defined as micro-businesses (COPIU, 2000). These small businesses are an integral part of the rural economy, and ensuring their continuing success is essential to developing and sustaining thriving rural communities (Warren-Smith & Dakin, 2002:1).

Many people choose entrepreneurship as a career for a variety of reasons. Scarborough and Zimmerer (2003:4) refer to the Dun and Bradstreet 19<sup>th</sup> Annual Small Business Survey conducted in 2000 that revealed some of the reasons that entrepreneurs go into business. Entrepreneurs who joined family business were the highest (41%); 36% wanted more control over their future; 27% were tired of working for someone else; 25% wanted to fulfil their lifelong goal; and only 5% had been downsized or laid off. Of the 25,5 million businesses in the United States, 90% are family-owned and -managed. The small business forms the biggest chunk of this sector (98,5%). Although some entrepreneurs start their enterprises when they are under 25 years of age, and others when they are over 44 years of age, the majority of entrepreneurs start their enterprises when they are between the ages of 25 and 34 (33%), and 35 and 44 (32%). The Small Business Administration (SBA) indicated that 20% of the businesses in the United States (US) are in retail, 40% in service, and 12% in construction industries. Those that are in wholesale are 8%, finance 8% and manufacturing 6%, i.e. all less than 10% (Scarborough & Zimmerer, 2003:12, 18, 20-22).

There are, however, constraints that hinder rural SMMEs from growing and developing in many countries. One of the many factors that has been identified as constraining rural business development is access to business support and advice (DETR, 2000; Hodge, 1999; Keeble, Tyler, Broome & Lewis, 1992). Lack of awareness (Rae, Ratcheva & Vyakarnam, 2000; Curran, 2000) of the value of business support amongst entrepreneurs, or problems arising from the accessibility of providers, with many located in urban areas (DTZ Pineda Consulting, 1999), may be attributed to lower SMMEs support in rural areas.

SMMEs support encompasses a wide range of support including business advice and information; training; financial assistance (Bridge, O'Neill & Cromie, 1998); and business networks and mentoring schemes (COPIU, 2000). Business advice and information incorporates generic business start-up advice and support, business planning advice, development support, and consultancy and advice on business plans and business promotion (Bennett, Robson & Bratton, 2001; Lowe & Talbot, 2000b; NRETS, 1996; Smallbone, Baldock & Burgess, 2000). Training ranges from generic skills training to business planning courses and management training (NRETS, 1996; Revolution, 2000), whereas financial assistance can consist of advice on raising finance, provision of grants and funding, financial planning and management (Curran, 2000; Revolution, 2000; Smallbone et al., 2000).

Training provides the opportunity for owner-managers to develop their management skills. However DTZ PIEDA Consulting (1999) reported that only just over a third of rural businesses use external training. Errington, Harrison-Mayfield and Bennett (1994) state that with training facilities predominantly located in urban areas, many rural businesses are significantly disadvantaged in terms of access, and many have little opportunity or funds to utilise formal training (Shropshire Partnership, 1999). Barclays bank (1998) reported that while 73% of small business owners believe training to be important to their business success, less than a third undergo training prior to starting their business, and only 30% have used training over the last three years.

Levitsky (1996:19) indicated that the reservoir of knowledge and experience in technology, management and marketing skills that could be of help to SMMEs is to be found in various elements of the business community and beyond. Private consultants in the country are one major group that can provide such support. Most private consultants, however, target larger enterprises or public bodies as their potential clients and provide less help to small business because of the high consultancy costs that SMMEs cannot afford. Levitsky further states that the independent group of local private consultants in most developing countries is relatively undeveloped, in many cases somewhat unreliable, and their services are not always of the quality standard to inspire confidence in potential clients. In some cases, the local consultant groups develop as branches or affiliates of international consulting organisations and the local operations are strengthened by more qualified and experienced expatriates. Professional staff from government offices, banks, large enterprises, universities, technical colleges, management and small enterprise development agencies usually all try their hand as consultants (full-time or part-time) in an effort to enhance their income, status and independence.

### **SMMEs SUPPORT IN SOUTH AFRICA**

Regarding constraints upon small business development, the South African government, in redressing the legacy of the past, initiated a wide-ranging consultation and research process. This process culminated in the production, in October 1994, of the Discussion Paper on *Strategies for the Development of an Integrated Policy and Support Programme for Small, Medium and Micro Enterprises in South Africa*. This document gave birth, in March 1995, to the White Paper on the *National Strategy for the Development and Promotion of Small Business in South Africa*. In 1996, the *National Small Business Enabling Act* was passed in parliament. Many other Acts that support the development and promotion of small businesses were also passed in parliament. Examples of such Acts are the *Skills Development Act 97 of 1998*, the *Preferential Procurement*

*Policy Framework Act 5 of 2000* and the *Mineral and Petroleum Resources Development Act 28 of 2002*. These pieces of legislation, amongst other things, support SMMEs in addressing the low skills levels, lack of markets, procurement, and unfavourable legal environment in the mining sector.

The White Paper (1995:12) acknowledges that small business, compared to big business worldwide, faces a wide range of constraints and problems, even in effectively functioning market economies. These constraints relate mainly to the legal and regulatory environment, access to markets, finance and affordable rental for business premises, the acquisition of skills and managerial expertise, access to appropriate technology, quality of the business infrastructure in poverty-stricken areas and, in some cases, the tax burden. South Africa's historical past, however, has exacerbated the situation, particularly for entrepreneurs in rural areas, and for women.

In addressing these constraints, the government created an enabling environment by putting the right policies in place whereby small businesses could thrive. The government acknowledged that the real engine of sustainable and equitable growth is in the private sector. The SMME support structures that started after 1994 were mainly the provincial SMMEs desks, the Ntsika Promotion Agency, and Khula Enterprise Finance Limited. The purpose of the provincial SMMEs desks were to provide SMMEs support in all the provinces. The Ntsika Enterprise Promotion Agency provides a wide range of non-financial services to local service delivery groups on a 'wholesale' basis, i.e. the delivery of resources to local providers that work directly with SMMEs. These services are offered by accredited local service providers and include institution-building of these organisations, training programmes for entrepreneurs, mentoring of individual firms, marketing, procurement advice, and technology assistance (Carana Report, 1999:25). Khula Enterprise Finance Limited provides 'wholesale' finance to the non-governmental organisations (NGOs) that offer micro loans to starter entrepreneurs. This is done through the development of Retail Financial Intermediaries (RFIs) that are financially sound, with the commitment and the capacity to serve the SMME sector, with special emphasis on its previously disadvantaged population (Carana Report, 1999:42; Ladzani, 2001:235).

The current government initiatives do not imply that there were no SMMEs support structures in place during the minority rule government. There were a number of programmes and small business-support policies during that time. Semi-government institutions such as the Development Bank of Southern Africa (DBSA), the Small Business Development Corporation (SBDC), and the Industrial Development Corporation (IDC) developed as financiers and SMMEs-support agencies. Many of these institutions that developed over the years were, unfortunately, mostly racially and gender-biased. Regional development corporations, whose focus was largely to develop black entrepreneurs, made a limited impact. Little co-operation was extended directly to the black business sector from central government level. An example is the public tendering system that favoured established and larger businesses (largely white businesses). It was very difficult for newly established businesses to enter the public tendering system. University-based small business units, and the private and non-governmental organisation (NGO) sectors were also involved in small business development but were not effective in their overall impact, were often in competition with each other, and were frequently uncoordinated. It is against this background that the call for co-ordination, co-operation and a

clear national strategy framework increased over the past few years. Lack of legitimacy made it impossible for the previous government to fulfil such a role (White Paper, 1995:13-14).

## **METHODOLOGIES AND SAMPLE REALISATION**

A stratified sampling method was used for the research. The strata were the six municipal districts of the Limpopo province. From these municipal districts, a sample of 600 respondents was selected and a total of 100 questionnaires administered in each stratum. Participating SMMEs in each stratum were purposefully selected. The selection criterion was aimed at selecting only businesses that were deemed established, that had experiences and exposure worth learning from, and that had been in existence for at least three years.

In total, 534 questionnaires were successfully administered from the 600 questionnaires intended, giving a response rate of 89%. Because the total SMMEs population in the Limpopo province is unknown, an infinite population size was used to calculate the margin of error ( $ME = \sqrt{P*Q/n*SD}$ )<sup>i</sup>. Taking refusals and spoiled questionnaires into account, a maximum margin of error of 1.36 (p=0.5) at a standard deviation of 1.96% was realised. The realised sample size reflected the following percentile responses from each stratum, i.e. Capricon 13% (70); Mopani 18,8% (100); Waterberg 12,4% (66); Vhembe 18,8% (100); Sekhukhune 18% (96); and Botlabela 19% (102).

## **RESEARCH FINDINGS**

### **The Profile of Sampled SMMEs**

The age profile of the SMMEs operators or managers interviewed ranged from less than 25 years (3%), 26-30 years (10%), 31-35 years (15%), 36-40 years (16%), 41-45 years (15%), to 46 years and above (41%). The gender composition was 79% males and 21% females, and the academic qualifications were standard 5 (16,9%), standards 6-8 (29%), matriculation certificates (25,4%), post-matriculation certificates (10,2%), diplomas (11,1%), degrees (3,4%) and postgraduate degrees (3%). The racial composition was 1% whites, 2% Indians and 97% blacks. The ethnic composition of the black-owned SMMEs included Pedi (46%), Tsonga (30%) and Venda (18%), which are the main ethnic groups in the Limpopo province [N=531].

The findings of this research indicate that 84% of the surveyed SMMEs are owner-managed, 8% are run by appointed managers, and the rest by family members. Ownership of these businesses is primarily sole proprietorship (70%), followed by family businesses (16%), partnerships (13%) and close corporations (1%). More than half of the interviewed businesses are in the retail sector (51%), followed by manufacturing (12%), agriculture (9%), entertainment (3%), transport (3%), arts and crafts (1,5%) and property (0,2%) [N=410].

Registered (and therefore tax-paying) SMMEs amounted to 71% and the rest were unregistered businesses. The existence ages of these SMMEs were 3 years (12,3%), 4-5 years (16,9%), 6-10 years (30,5%), 11-20 years (27,3%) and over 21 years (13,1%) [N=528]. The staff compositions at the start were as follows: less than 5 staff members (84,4%), 6-10 (8,9%), and 11-50 (4,4%). Current staff membership, however, stands at 1-3 staff (70,4%), 4-6 (22,1%) and 7-9 (7,5%)

[N=443]. Whereas 4,4% started with employees between 11 and 50, there were, however, no SMMEs with these numbers during interviews.

Motives for starting businesses ranged from, among others, unemployment (30,8%), a need to support communities (22,7%), and a dire need to eradicate poverty (28,6%), to interest in owning a business (17,9%). Although unemployment seems to be the main incentive for starting a business, 53,5% of sampled SMMEs started their businesses while employed and 46,5% while unemployment [N=525]. Of all the businesses that responded, 84% did not receive funding for start-up purposes, 9% received loans and 4% were funded by family members and relatives [N=522]. Of the SMMEs that received funding, 48% received this from the Land Bank followed by development corporations (11%), the Independent Development Corporation (IDC) (5%), and commercial banks (3%). At start, 49,9% of the businesses had business plans – currently only 51,4% have business plans [N=515]. Of those businesses that have business plans, 92% were compiled by owner-managers and only 8% made use of consultants. Only 68,7% of the owner-managers have knowledge of how to compile a budget. Of the businesses that compile budgets, 84,8% do so monthly, 7,7% quarterly, 2,5% twice-yearly and 5% yearly [386].

Assets of the businesses interviewed range from less than R50 000 (39,2%), R50 001 - R500 000 (41,9%), R500 001 - R1mil (9,1%), R1mil - R5mil (9,5%), to more than R5 million (0,5%) [N=528]. Monthly business turnover ranges from less than R10 000 (60,5%), R10 000 - R20 000 (18,4%), R20 001 - R30 000 (8,6%), R30 001 - R40 000 (2,3%), R40 001 - R50 000 (1,1%), R50 001 - R60 000 (0,6%), R60 001 - R70 000 (0,4%), R80 001 - R90 000 (0,4%), R90 001 - R100 000 (0,8%), to more than R100 000 (7%) [N=526].

Infrastructure includes availability of telephones (79%), electricity (84,6%), fax machines (4,7%), personal computers (4,7%), email (1,5%); Internet addresses (1,3%); printers (3,7%); running water (42,7%) and flushing toilets (12,7%) [N=452]. Businesses that serve the local markets are 83%, provincial markets 8,4%, both local and provincial markets 1,7%, international markets 0,4%, and both national and international markets (6,5%) [N=523].

### **Availability and Accessibility of SMMEs Support Systems**

Business support received after start includes finance (72,7%), training (17,8%), tendering and procurement (6%), marketing information (3,2%) and business counselling (0,3%) [N=348]. Utilised support from consultants is mainly in financial management (12,6%), marketing management (14,7%), operations management (15,2%), administrative management (14%), purchasing management (14,4%), human resources management (13,8%), and public relations (14,8%).

SMMEs that have experienced financial problems in the past made up 62,4% [N=534]. Reasons for the SMMEs' bad financial state and experiences included, among others, default payments by debtors (31,6%) and theft of organisational resources and products (14,9%).

Owner-managers that have undergone training on general management are 13,1%, and on financial management 86,9% [N=518]. The type of training undergone by employees includes customer relations (4,8%) and merchandising (95,2%) [N=482], while on-the-job employee training is a preferred mode of training (58,8%) (N=475).

Product advertising is perceived to be a costly method of attracting customers by 75,9% of the interviewed businesses – only 13,5% disagreed [N=518]. Respondents were asked about the kinds of support that their SMMEs perceive to be available or accessible, and their impressions are indicated in Table 1.

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Table 1 about here

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Of the support reflected in Table 1, finance and training for skills development were ranked the two most important support system requirements by 75,9% and 73,1% of respondents respectively.

### **DISCUSSION OF FINDINGS**

The South African government commends the SMMEs sector for contributing 25% to the national GDP, 38% to employment and for being responsible for 75% of new jobs (Katz, 1997). The SMMEs could contribute more to the national GDP and employment considering that SMMEs in countries less developed than South Africa contribute much higher proportions to GDP and employment (APEC, 1994; Katz, 1997; OECD, 1997; UNCTD, 2003). The government therefore started creating an enabling environment by putting the right policies and support institutions in place, among them Ntsika Enterprise Promotion Agency (NEPA) and Khula Enterprise Finance Limited, to enable SMMEs to thrive (White Paper, 1995:12). Khula's long-term job creation objectives were to provide broader access to finance for small businesses, as opposed to the micro-survivalist category (Carana Report, 1999:42). Although the Carana Report revealed that Khula's activities were disproportionately concentrated in the micro-survivalist sector through its Retail Financial Intermediaries, its findings are that this sub-sector in the rural areas received very little funding support.

Because access to finance is perceived to be critical to success, the private banking sector has received continued criticism for its inflexibility in helping the development of the SMMEs (Levy, 1996). Government-sponsored financial institutions such as the DBSA, although helpful, have also failed to support the entire SMMEs industry and its diverse needs (Macleod, 1995). It is important to note that 58,9% of respondents from this survey believed that the banking sector is still unwilling to provide financial support even though finance is the biggest problem facing more than 87% of the respondents. For lack of financial support, many SMMEs owners started their businesses without any external funding (84%) and only a few (9%) received loans. Only 3% of the 9% funding is from commercial banks. Findings from Netswera (2001:6) reveal availed support systems to be more effectively accessible if complemented by a publicity strategy. Lack of knowledge of the available support systems can possibly be a factor hindering accessibility in terms of, among others, language and proximity of support institutions, especially for the rural entrepreneurs where most institutions are remotely situated. The little or no support received thus far has been attributed to the lack of access to information about such support systems.

The findings revealed that only 3% receive marketing support, 6% tendering and procurement support, and 18% training support. Although many small business owners believe that training is important, few undertake training prior to starting their businesses. This is supported by Barclays (1998) who reported 73% of small business owners to believe that training is important to their business success, although less than a third undertake training prior to starting their business, while 30% had been trained over the last three years.

Poor support can be attributed to the type of ownership and size of business. Most of the businesses interviewed are owner-managed (84%) and have a staff complement of 1-3 (70,40%). This scenario hinders most owner-managers from leaving their enterprises to seek training, advice, marketing, and tendering and procurement information. Most owner-managers are only free from their business duties outside of working hours, by which time SMMEs support service providers of training and financial institutions specifically, are closed. 90% of businesses in the United States are family-owned and -managed (Scarborough & Zimmerer, 2003:18). In this study, 16% of the interviewed businesses are family-owned and -managed. Family support in running successful enterprises has numerous spin-offs such as shared values, power and the enforcing of family ties. Providing family members with the necessary skills is therefore central to the success of a business venture.

The total assets of the interviewed SMMEs are mainly R1 million and below (90,1%) and the remainder (9,9%) are above R1 million. Only 0,4% have assets worth more than R5 million. Taking into consideration that the staff complement of all interviewed businesses falls below 10 employees [1 – 3 staff (70,4%), 4 – 6 staff (22,1%), 7 – 9 staff (0,5%)], all SMMEs interviewed are therefore categorised under micro- and very small businesses. This implies that most SMMEs in the rural areas are micro- and very small businesses. The inability of the micro- and very small businesses to develop into small businesses is a cause for concern considering that 70,9% of the respondents have been running their businesses for more than six years. Taking cognisance of the fact that the micro- and very small businesses do not pay tax, it also implies a loss of revenue to the government and non-accounting of their contribution to the national GDP.

## **CONCLUSIONS AND RECOMMENDATIONS**

It can be concluded that in the midst of a third of the country's unemployment, the SMMEs industry is the main option for the survival of many rural communities. An SMME profile suggests competition in this industry to have gained huge momentum. It is becoming more difficult to vie for support resources and growth from the micro- to small business level. Since the majority of SMMEs are sole proprietors (70%), the attaining of support systems is weakened considering the tendering and subcontracting requirements for diversity in terms of ownership, gender, race and age groups, among others. It is important that SMMEs owners receive information and training on the importance of diversity of ownership – a task that can easily be fulfilled by the business chamber where available.

No affiliation to a business chamber amongst the SMMEs is an impediment to development and co-ordinated support lobbying. Also worrisome for this sample is that only 6,7% belong to a business chamber. It is important, especially for the development of the rural micro-enterprises that SMMEs jointly organise, lobby for support and implement joint projects, where necessary.

Although numerous SMMEs support institutions are in place, including the various support mechanisms and programmes, such information is relatively unknown to the emerging rural entrepreneurs. It is thus important for government and other support agencies such as Khula, Ntsika and the DBSA, among others, to move from an institutional set-up philosophy towards capacitation, support campaigns and reach-out programmes. Even more important, the evaluation and publicity of the inroads made thus far by the SMMEs support institutions would be motivational in giving an impression of the existing support possibilities and their successes.

Since the country's main problems of unemployment and poverty are essentially rural problems, and considering that the majority of the SMMEs in the rural areas are micro- and very small businesses, support systems should be designed and targeted at these sub-sectors. However, since some micro- and very small businesses are not registered, efforts should be aimed at formalising the sector and leveraging both training and financial support systems.

Despite the legislated SMMEs definitions, and scanty success factors, there seems to be a gap for continuous surveys and audits of the SMMEs industry. The lack of information in the sector impedes, among others, planning the industry's national support systems, and giving a continuous account of the contributions that the industry makes towards employment and GDP. Because of a lack of this information, it is often difficult to know the SMMEs' numbers, their successes and failures on an annual account, as well as the successes and failures of available support systems.

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**Table 1: Perception of the Different SMMEs Support Systems**

| <b>Small business support requirements/systems</b>  | <b>Agree<br/>N (%)</b> | <b>Disagree<br/>N (%)</b> |
|---|------------------------|---------------------------|
| <b>Training for skills development</b>  |                        |                           |
| On the job training is an effective form of training for my type of business                                  | (374) 69.5             | (71) 13.5                 |
| I would be able to manage my business better with some training   | (435) 83.8             | (39) 7.5                  |
| Hands-on training is readily available for staff development  | (160) 31.3             | (205) 40.2                |
| Training for staff development is easily accessible   | (115) 22.3             | (299) 57.9                |
| There are known organisations where training for my business is provided                                      | (155) 29.6             | (175) 33.5                |
| Managerial training is easily accessible  | (99) 19.1              | (319) 61.7                |
| <b>Financial assistance</b>   |                        |                           |
| Financial providers insist on greater control of the business activities                                      | (232) 44.1             | (154) 29.3                |
| There are not many financial support options available to small businesses                                    | (410) 77.9             | (61) 11.6                 |
| Banking sector is unwilling to give loans to small businesses   | (310) 58.9             | (72) 13.7                 |
| Finance is the biggest problem facing small businesses  | (456) 87.2             | (39) 7.5                  |
| Private institutions such as building societies are prepared to assist small businesses financially           | (109) 20.9             | (184) 35.2                |
| I would sacrifice my independence to obtain financial assistance  | (210) 40.8             | (248) 48.2                |
| Government is not doing enough to help small businesses financially   | (394) 75.7             | (64) 12.1                 |
| <b>Government support</b>   |                        |                           |
| Government policies are favourable to small business development  | (98) 18.9              | (292) 56.3                |
| Government sponsored organisations such as DBSA and Business Partners are prepared to assist small businesses | (139) 26.5             | (126) 24                  |
| <b>Partnerships and subcontracts</b>  |                        |                           |
| Big businesses are always ready to share valuable information with SMMEs                                      | (160) 30.6             | (240) 45.9                |
| Big business is prepared to start partnerships with SMMEs   | (152) 29.1             | (218) 41.7                |
| Subcontracting of SMMEs by big business improves skills of SMMEs employees                                    | (319) 60.9             | (74) 14.1                 |
| Forming partnerships with big businesses improves business relations  | (412) 78.2             | (41) 7.8                  |
| <b>Other forms of support</b>   |                        |                           |
| Business counselling can be attained at low cost  | (70) 13.5              | (321) 61.5                |
| Business advice is easily available   | (114) 21.9             | (301) 57.8                |
| Product advertising is a costly method of attracting customers  | (393) 75.9             | (70) 13.5                 |

## Endnote

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<sup>1</sup> ME=margin of error; P=population size; Q=1-p; n=sample size and SD=standard deviation

**TOWARDS A CONCEPTUAL PARADIGM FOR HATCHING  
BUSINESSES IN INCUBATORS:  
THE APPLICABILITY OF AGENCY AND STEWARDSHIP THEORIES**

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## ABSTRACT

This paper extends prior work on using agency and stewardship theories as complementary models of man, hence organizational behavior. We apply these theories in a new context, the business incubator—entrepreneur tenant, in order to enhance our understanding of this complex relationship. Entrepreneurs rely on incubators to provide them with access to critical resources, while incubators rely on entrepreneurs to build and maintain its reputation as a vital community economic engine. Our model of the incubator—tenant relationship takes into account the role that both asymmetrical and symmetrical goals play in turning inputs into outputs, thus start-ups into successful graduate companies. We posit that while on their own neither theory adequately describes the incubator—entrepreneur phenomenon, together agency and stewardship theories provide a great deal of insight in describing this phenomenon.

## INTRODUCTION

Since the first building, turned business incubator, opened its doors in 1959, incubators have provided a haven for entrepreneurs looking to lower the cost of hatching and growing their enterprises. Many business incubators have become an integral part of their local communities, stimulating employment opportunities and economic growth. Despite this tremendous growth in the popularity of business incubators no research could be found that examines the complex incubator—entrepreneur relationship which goes beyond that of landlord and tenant arrangement. We posit that this interdependence introduces the potential for maximizing behavior by at least one of the parties, following the precepts of agency relationship even when the incubator is a public, not-for-profit or a government sponsored one. Jensen and Meckling (1976) argue that “agency costs arise in any situation involving cooperative effort” (p. 6).

However, the agency model cannot account for all the nuances and variations-on-the-theme that exist in the incubator—entrepreneur relationships. Incubator managers often act as guardians or stewards by assisting and protecting these entrepreneurial and fragile startups. The incubator manager’s motives are often aligned with the entrepreneur’s objectives, as incubator managers are judged by, among other things, the success of their tenants. Agency theory provides little explanation when interests by the parties are aligned, therefore it cannot be exclusively relied upon to explain the complex nature of inter-organizational relationships (Davis, Schoorman, & Donaldson, 1997a). Hence, agency theory cannot provide a complete explanation for the incubator—tenant relationship. Therefore, we need another model that can fill in this gap. Stewardship theory provides an additional insight into the incubator—tenant relationship as it has been introduced to explain situations where parties are not motivated by individual goals (Davis, Schoorman, & Donaldson, 1997a).

We use both agency and stewardship theories to answer our research question “How do agency and stewardship theories enlighten this complex relationship?” Both agency and stewardship theory deal with aligning interests in the manager—principal relationship. However, each approaches human behavior and motivation differently. The agency model views man as being extrinsically motivated through tangible rewards such as salary, bonuses, and other commodities that have a market value (Davis, Schoorman, & Donaldson, 1997a), while according to stewardship theory, stewards maximize their utility by acting the organization’s best interest,

thus, they are more intrinsically motivated through rewards such as growth and achievement (Tosi, Brownlee, Silva, & Katz, 2003).

## **LITERATURE OVERVIEW**

According to the Small Business Administration (SBA, n.d.) small businesses employ over 50% of the U.S. workforce and account for roughly 23 million companies in 2002. Entrepreneurial ventures are even more of an economic engine in the high-technology sectors, as they directly account for 39 percent of the jobs (SBA, n.d.), and also provide Fortune 500 companies with access to many leading edge products through strategic alliances and other inter-organizational partnerships that large firms would not otherwise benefit from. One problem that young ventures face is high failures rates due largely to under-capitalization and a lack of management expertise. These problems are amplified in the high-technology sectors, as these firms are extremely expensive to start-up and many are run by the research scientists that often have limited business experience.

Business incubators have evolved as a solution designed to stem the flood of failures by small business and enhance survival rates of start-up businesses are doing just that. Most incubators assist entrepreneurs move along the road to self-sufficiency by dispensing advice to young firms, providing access to free or low cost consulting, access to venture capital and angel financing, and a network of other business people. These services are generally provided at or below market rates for a fee that generally includes monthly rent and sometimes a small equity stake in the budding venture. Thus, the relationship between the incubator and entrepreneur is quite important and complex.

Incubator managers serve the greater community and their institution's board, owners and other financial backers. For example, the incubator desires maintain a high occupancy level. One manager described a conflict between maintaining a high occupancy rate of high potential ventures, while improving the center's number of successful graduates. Thus, a tension between the two party's goals may arise. These conflicting roles can place a strain on incubator—tenant relationships. The tension is not just from the incubator side. We found that in some cases the incubator manager felt that entrepreneurs kept them at arm's length, as they were in the dark regarding the entrepreneurial firm's progress. When business incubators are profit making entities, owned by business concerns – developers or corporations, agency theory becomes even more relevant, as the incubator becomes more concern with earning a profit on its investment. However, while incubator managers may look out for their own self-interest, on some level they recognize that the survival of the incubator depends on the survival of the other stakeholders especially their tenants (Fama 1980).

### **The Agency Perspective**

Agency theory (e.g., Jensen & Meckling 1976, 1994) holds that people are rational and seek to maximize their individual position, thus utility. According to this theory contracts are used by principals when employing an agent to perform tasks on their behalf. A popularized illustration of the principal—agent relationship has been the stockholder as the principal and CEO as the agent. However, this relationship comes at a cost to the principal, as it is possible that the agent will not always have the principal's best interest in mind due to maximizing behavior. The

principal can provide incentives and monitor the agent's behavior; however, this increases the cost of conducting business. In the case of CEO's, often their salaries are linked to long-term company performance. Unfortunately, this has led to a number of recent financial scandals in some of the nation's largest companies, and brought a new debate about management theories to the fore. (Ghoshal 2005). In addition, it is generally impossible to ensure that the principal will always agree that even the best intended agent decisions will be optimal for zero cost (Jensen and Meckling 1976a).

While agency theory has been applied to entrepreneurial and other organizations (e.g., Jones & Butler 1992; Falbe & Larwood 1995; Norton 1995; and Arthurs & Busenitz 2003), it has yet to be applied to the relationship between business incubators and entrepreneurial start-ups. Complicating a simple application of agency theory to the business incubator context is the myriad of stakeholders and, at times, the conflicting interests of such stakeholders and the roles they play. An incubator's management faces a daunting task having to maneuver among the numerous stakeholders including tenant-entrepreneurs (present and potential), incubator employees, mentors, volunteers, the incubator's board of directors and the community-at-large. Incubator managers are saddled with the often difficult task of differentiating between entrepreneurial start-ups that are likely to succeed, hence attractive, from those that will never grow beyond the incubator's setting. Potential tenant-entrepreneurs are likely to provide the tenant screening committee or the incubator's management with a rosier picture of what their chances of success will be. Therefore, due diligence work that is required to screen tenant applications involves explicit research costs in order to decrease future agency costs and current information asymmetry (Norton 1995, p. 20). In addition, some entrepreneurs look at their partnership with the incubator more through the lens of agency theory. They are wary of providing the staff with too much information and are very careful when participating in incubator sponsored activities and services. The stewardship model offers a different explanation for motivations, "which may include the interests of all relevant stakeholders" (Preston 1998, p. 9).

### **Stewardship Perspective**

Stewardship theory (e.g., Davis, Schoorman, & Donaldson 1991, 1997a) adds another dimension to studying the inter-relationships between incubators and entrepreneurs. According to this theory, individuals are motivated to behave in a manner that is in the best interest of their organization (Donaldson and Davis 1991). They attempt to align their goals with the goals of their organization. Performance variations, according to the theory, often have to do with the structural situation in which the actor works within, thus there must be sufficient resources and means to facilitate good action (Donaldson & Davis 1991). Incubator directors, especially those of the not-for-profit and public incubators often consider themselves as stewards of their fledging tenants. In addition, the best interest of the incubator and the community immediately surrounding it is linked with the overall success of the tenant-entrepreneurs. Therefore, both incubator and tenant would like to see the startup grow and prosper.

One important measure of an incubator's success is the number of its tenants-graduates and their respective success rates. Graduates' success also contributes to the local economy and job creation in the surrounding community. The incubator can therefore be credited for that positive

economic impact and value to the local geographic area. Thus, goal alignment seems to be critical in order for all stakeholders to obtain their goal. In dealing with multiple stakeholder groups with competing objectives, stewards are motivated to make decisions they perceive in the best general interest of the group in order to provide the most overall benefit (Davis, Schoorman, & Donaldson 1997a). Thus, according to stewardship theory, the manager of the incubator and the entrepreneur benefit most when self-serving behaviors are put aside (Davis, Schoorman, & Donaldson 1997a) and the two parties collaborate.

## **Outside Funding and Revenue Sources**

Business incubators get their operating funds from a variety of sources, which are often a function of the incubator's ownership and mission. In the case of publicly owned incubators funding comes from local and state tax revenues, private donations and contributions of in-kind services, grants from foundations, state and local economic development bodies and federal grants programs.

University owned and operated incubators get funds from all the above sources – albeit at different proportions, as well as university sources both actual funding and in-kind contributions such as space, computer facilities and services, research grants, graduate assistants etc.

Private incubators get most of their funding from private funding sources which may include corporations, individual or groups of angels, venture capitalists and developers. They may also get some public funding or assistance from State and local organizations. To the extent that the missions of the different types of incubators reflect the interests of the funding sources there will be the issue of the congruency of the goals between these funding sources, represented by the incubator board and managers and the tenant entrepreneurs. We posit that an incubator's mission has an effect on whether it tends to be more agency- or steward-like in its relationships.

*Proposition 1: The business incubator's mission affects the degree that incubator managers take more of an agency or stewardship perspective in relation to their tenants.*

*Proposition 2: The type of perspective view (agency or stewardship) that the incubator management takes in relation to their tenants affects the incubator's mission or purpose.*

*Proposition 3: The amount of outside support and revenue the business incubator receives from non-tenant sources (e.g. affiliate companies and anchor tenants) play a role in determining whether incubator managers take more of an agency or stewardship perspective in relation to their tenants.*

*Proposition 4: The type of outside funding sources that the business incubator seeks depends on whether incubator managers take more of an agency or stewardship perspective in relation to their tenants.*

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Figure 1 about here

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## CONCLUDING REMARKS

Our central purpose has been to extend previous work that has used agency and stewardship theories as complementary approaches, rather than arguing that one is better or more relevant than the other. In fact, in her “excellent review” (Albanese, Dacin, & Harris 1997, p. 611) of agency theory, Eisenhardt (1989) recommends that it be used with complementary theories, as the theory presents view of organizational life that is valid, but incomplete (p.71). In addition, we sought to extend these theories to the context of the business incubator—entrepreneur relationship.

Our observation regarding the shifting roles that these theories play in the incubator-tenant relationship is not far flung. The move from an agency relationship to stewardship and back, reflects both the changes of interests over time and the dynamic nature of interactions between organizations (Davis, Schoorman, & Donaldson 1997b). This dynamic relationship demands that theory focuses more upon the task being performed rather the initial relationship and that agency relationships must be viewed through a lens that can accommodate the shifting of interest alignment (Albanese, Dacin, & Harris 1997). As Albanese and colleagues (1997) put it, “[T]oday’s “agent” may be tomorrow’s “steward,” or vice versa” (p. 611). In addition, Leblebici & Fiegenbaum (1986) point out that, managers must deal with multiple constituencies some of which they are members, thus, “To define the manager as an agent who owes reasonable effort and unswerving loyalty to a specific class of principals becomes logically impossible” (p. 496).

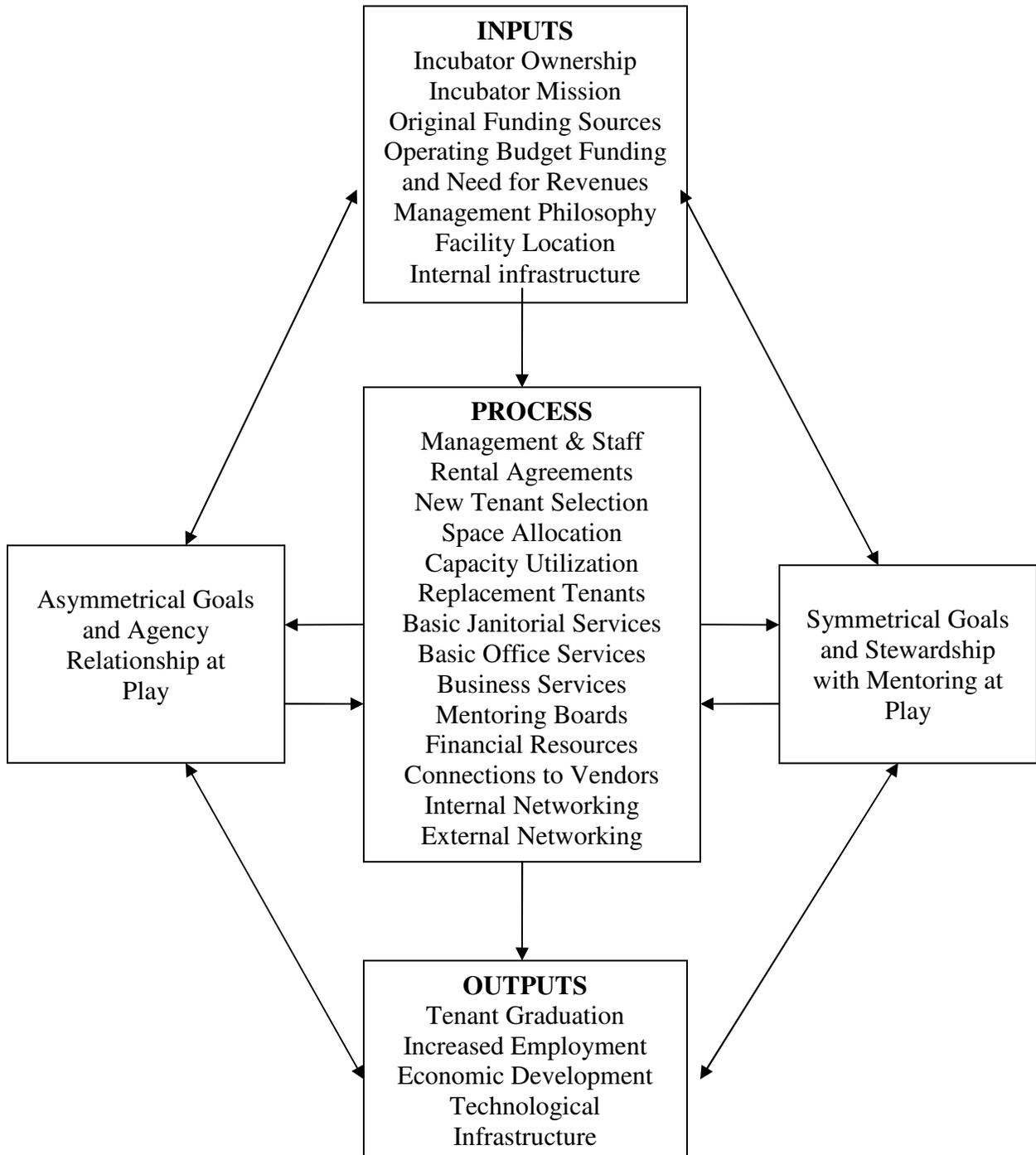
We call for research that studies the dynamic relationship between business incubators and their entrepreneurial tenants. Such research should study the phenomena over a period of time, rather at one particular point. We also recommend that researchers carefully consider the incubator’s mission and the type of firms that the incubator attracts. We posit there may be differences between low technological and high technological start-ups in terms of the applicability of these theories to the relationship.

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**Figure 1: Model of Incubator--Tenant Relationship**



## STRATEGIC SPIN-OFFS IN SMALL AND MEDIUM SIZE ENTREPRISES

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Our research aim at exploring the strategic implications of spin-off processes for small and medium size enterprises (SMEs). Building on three in-depth case analysis, our research shows how owner-managers of SMEs have been able to turn what was initially a disruptive and threatening event into a value creating process, enhancing the competitive advantage and performance potential of their company.

For instance, the first case shows how a spin-off enabled an owner-manager to seize new opportunities in an emerging market by leveraging his relation with creative employees preparing their departure from the firm. The second case depicts how it helped secure the outsourcing of peripheral but critical activities of another SMEs. The third case illustrates how a spin-off simultaneously favoured employee's mobility and helped secure access to critical human resources. On the whole, our research tend to confirm that, in the context of SME, spin-offs can constitute powerful strategic tools.

However, for this to happen, the owner-managers have to display certain attitudes and competencies such as – a) encouraging and integrating individual initiatives, b) strong personal involvement in the spin-off process and c) in depth knowledge of the entrepreneur and the entrepreneurial process. These behaviors are enabled by SME's organizational characteristics such as, simple structure and processes, actors' proximity and centralized leadership.

### INTRODUCTION

Spin-offs – the process by which employees of an established organization leave this organization in order to create a new one – are a common phenomenon. In certain industries, such as management consulting, they even constitute the prevailing mode of entry (Garvin, 1983). Spin-offs are an inevitable by-product of Corporate Entrepreneurship programs and as such rather frequent in hi tech companies where employees are strongly encouraged to develop new activities. In 1998, corporate spin-offs represented almost 13% of all new firms created in Europe (European Commission, 1999).

Yet the strategic implications of spin-offs are understudied. We don't know how spin-offs affect the competitive position and performance potential of "mother" companies. This key question has not been thoroughly addressed in the literature which focuses either on macro aspects, such as the

impact of spin-offs on national competitiveness and employment or on micro aspects, such as their financial and human resources implications, neglecting overall firm implications. Among practitioners, spin-offs are generally associated to the loss of valuable employees and the emergence of new competitors and therefore seldom seen in a good light. In Europe, spin-offs are also connected with downsizing measures and are viewed by most managers essentially as outplacement tools.

Spin-offs, however, can be effective strategic tools. Examples stemming from the Japanese industry (Ito, 1995) but also from French Small and Medium Size Enterprises (SMEs) – the subject of our ongoing study – provide solid evidence in support of this statement.

Through the presentation of three selected cases studies, we will show how, in a variety of situations, owner-managers of SMEs have been able to turn what was initially a disruptive or even a threatening event into a value creating process, enhancing the competitive advantage and performance potential of their company.

### **SPIN-OFFS IN THEORY AND PRACTICE**

Spin-offs are an understudied phenomenon. A review of the literature produced on both sides of the atlantic reveals that A journal articles on spin-offs are less than a dozen and that the bulk of spin-off literature is constituted by colloquium presentations, working papers and official reports (Pirnay, 1998).

Though most spin-off definitions share common basic features – spin-offs “take place in an established organization and involve one or few of its members who leave the organization to create a new organization” (Pirnay, 1998) – they also diverge widely according to cultural factors (Pirnay, 1998). American literature, for example, apprehends the spin-off as a spontaneous phenomenon and focuses on the individuals that engage in it. For Garvin (1983), spin-offs are “new firms created by individuals breaking off from existing ones to create companies on their own.” On the contrary, European and French literatures in particular, tend to view spin-offs as the result of a deliberate corporate practice and focus on the “mother” organization. Bruyat (1989) defines spin-off (“*essaimage*”) as “a voluntary practice by which a company encourages and helps employees creating their own business.”

The questions investigated are also very different. An important stream of the American literature centers on the impact of “spontaneous” spin-offs on shareholder’s value (Schipper and Smith 1983; Aron, 1991; Woo, Willard and Daellenbach, 1992). In Europe, research has attempted to measure the impact of “induced” spin offs on headcount reduction and company performance (Laurent and Helderle, 1998; Rocchi, 1998) as well as national competitiveness and employment (European Commission, 1999). However, both sides have equally and largely overlooked the strategic implications of spin-offs.

From practitioners’ point of view, spin-offs obviously constitute major threats when they result in the departure of valuable employees and the emergence of direct competitors,. In the consulting industry, for instance, spin-offs are a common and much feared occurrence that established firms try to contain. In Europe, furthermore, spin-offs are closely associated to downsizing measures and managers of large established firms tend to view them as a “humane” outplacement tool,

which hopefully will not concern them in the near future. In synthesis, we can say that most practitioners view spin-offs as a phenomenon they have no reason to encourage unless their goal is to reduce headcount...

The position that researchers and practitioners have adopted up to now, seems to us somewhat restricted. We know for example that spin-offs can bring into being valuable suppliers, clients or partners (Johnsson and Hägg, 1987; Johannisson et al., 1994). Ito (1995) has shown that Japanese corporations used spin-offs strategically i.e., “as flexible alternative for survival in a highly competitive environment” which allow them to “satisfy corporate stakeholders.” He argues that the “mother” company and its spin-off, tied by financial participation and strong personal relations constitute a loose, adaptive organizational form, and a favorable compromise between hierarchy and markets (Ito, 1995).

To the extent they allow managers to redefine their company’s domain, boundaries and network of alliances in response to emergent threats and opportunities, spin-offs can enhance organizational flexibility and resilience and constitute valuable strategic tools. Our ongoing study on Spin-offs in the Context of SMEs provides some interesting empirical evidence in support of this proposition.

#### **UNDERLYING ASSUMPTIONS, SCOPE AND METHODOLOGY OF THE STUDY**

Viewed as an organizational type, SMEs share the following characteristics: limited resources and small size (MacMillan, 1975 ; Robinson and Pearce, 1984); simplified and informal structures and processes (D’Amboise and Muldowney, 1988) and clear leadership embodied in a centrally positioned owner-manager (Deeks, 1976 ; Charan et al., 1980 ; Welsh and White, 1981). Taken together, these characteristics should enhance the capacity of SMESs to set up innovative and flexible arrangements that would be out of the scope of larger, more bureaucratic firms.

Strategic spin-offs, which fall in this category of arrangement, are also the outcome of an entrepreneurial process, harbored and sometimes deliberately supported by the “mother” company. Strategic spin-offs can in fact be viewed as a special case of Corporate entrepreneurship, “the process whereby an individual or a group of individuals, in association with an existing organization, create a new organization or instigate innovation or renewal within the existing one” (Sharma and Chrisman, 1999). It is an emergent process in which individuals, as well as chance and improvisation (Burgelman, 1983; Kanter, 1985; Stevenson and Gumpert, 1985) play a critical role. Dealing with such processes is generally out of the scope of large, bureaucratized firms, which are unable or unwilling, for their most part, to provide timely and individualized support to what they generally consider marginal initiatives.

Thanks to their organizational characteristics, SMEs should be better at supporting and exploiting these processes. Their limited resources push them to look for external resource providers and to create and maintain privileged links with them, even if this leads to blurred organizational boundaries. The flexible and informal structure of SMEs provides a more supportive milieu for the largely ad-hoc structures and processes that characterize entrepreneurial ventures. The proximity of organizational actors, as well as the significant impact of any employee’s action or

project on the whole organization, favor an early and thorough assessment of the project's pros and cons by top management. Finally, the presence of a centrally positioned owner-manager simplifies and accelerates the decision to support or not the venturing project. For the aforementioned reasons, we hypothesized that SMEs constituted a favorable context for the study of “strategic spin-offs”.

More precisely, our goal was 1) to observe how SMEs dealt with spin-offs, adopting a top management perspective, 2) to identify the processes involved and 3) to assess their impact on performance. We adopted a retrospective and in-depth approach, which necessarily reduced our sample to a small number of firms. In the absence of database on spin-offs in the SME context, we proactively solicited an extensive panel of private and public business actors belonging to chambers of commerce, local incubators and entrepreneurs associations. They were asked to name SMEs and individuals involved in spin-off processes. Within three months, we were able to identify twenty-five SMEs apparently involved in spin-offs. We contacted the owners and the entrepreneurs in order to establish whether this involvement was recent and whether the key actors were accessible and willing to be interviewed. This was the case for fifteen SMEs. These fifteen SMEs, all of them French, represented a wide panel of industries. Data was gathered mainly through semi-structured interviews with the two main groups of actors – the owner-managers of “mother” SMEs and the entrepreneurs at the origin of spin-offs. When necessary, complementary interviews were conducted. In total, forty interviews were performed.

### **PRESENTATION AND ANALYSIS OF THREE REPRESENTATIVE CASE STUDIES**

The three case studies we now are going to present and analyze, illustrate each one of the three basic motives of “strategic spin-offs” in the context of SMEs.

- *The Teemo → Optix Case: Rejuvenating aging core competencies*

Teemo is a family business, which has been producing and selling mechanical fluid pumps for industrial use, mainly in France, for more than fifty years. In the late nineties, the owner-manager of Teemo was facing a slow but constant erosion of his main business due to the increased maturity of both technology and market. As margins started to decline, he decided to look for substitute products and technologies. To do so, the owner-manager of Teemo strongly involved all the managers of the company. After a long debate, the majority agreed that the technology of the “immersed rotor pump”, which guaranteed water tightness, was the most interesting and suitable one in terms of functionality, market and profit potential.

Teemo, however, possessed only part of the required knowledge and skills and was therefore not capable of internally developing and mastering this complex technology. All the managers of the company, and in particular its technology manager who was known for his resourcefulness and creativity, were asked to “deploy their antennas” in order to spot any opportunity to access the missing competencies. A few months later, the technology manager met by chance a technician specialized in the repair of immersed rotor pumps, who manifested a strong desire to set up a workshop and start producing rotor pumps. The two men had very similar views on the evolution of the technology and market and their affinities persuaded them to become partners. They rapidly went to present their project to Teemo’s owner-manager. Somewhat surprised by this turn of event, the owner-manager proposed them a number of arrangements in which Teemo would

continue to play a leading role, till he finally realized he had to accept their conditions. As he puts it: “I wanted more than 15 % of the company but I did not want to risk being excluded from the project (...)” Apart from this small financial participation, the two companies were tied by a strong commercial and technical assistance partnership since Teemo distributed and serviced the products of “Optix”, which also took advantage of the well-known Teemo brand.

In spite of his initial fears, the owner-manager of Teemo now judges very positively the whole process. In less than five years, the two entrepreneurs were capable of appropriating a complex technology, mastered by only three companies in the world. Optix is now the French leader on this growing and attractive niche. Such a fast development would not have been possible had the entrepreneurs been regular employees. The owner-manager claims that they would have been less motivated and daring in a company that, over the years, has become a little sleepy. The spin-off process has been a means to overcome the rigidity and prudence that characterizes Teemo’s culture and limits its innovation potential. This view is shared by the entrepreneurs who assert that they would never have gone as far had they been employees: “ (...) every time the technology was not working well, we spent long hours trying to find a solution instead of giving up (...) It is hard to imagine the same dedication from a regular employee (...)”.

Though it led to the loss of a valuable manager, the Optix spin-off enabled Teemo to access – at a relatively low cost and in little time – a technology well beyond its reach but critical for the balance of its business portfolio and long term survival. It has contributed to improve both its sales and margins.

- *The Mecanix → Beka Case: Creating a top level supplier/partner*

Mecanix is a small firm, which develops, produces and sells, mainly in France, complex mechanical parts. A few years ago, the owner-manager of Mecanix decided to outsource the machining shop of his production plant. He hoped with this move to improve productivity, gain space and facilitate the substitution of steel components with plastic ones. He proceeded with a call for tender. He soon discovered, however, that the available suppliers were not able to provide the level of quality achieved in-house. He also came to realize that his machining shop detained unique and valuable competencies and that it would be hard for his employees to find satisfactory outplacement solutions. Firing could not be avoided, along with its high human and financial costs.

The outsourcing project was therefore abandoned, till the shop supervisor came up with a take-over proposition. Skeptical at first, the owner-manager accepted to start the search process over again, inserting the shop supervisor in his short list of potential sub-contractors. Confronted with competitors, the shop supervisor deployed unexpected talents, showing both commitment and resourcefulness. Within three months, he performed a thorough market analysis proving the viability of his project, explained in details how he planned to improve productivity and promised to recruit all displaced employees. He managed to convince Mecanix’s owner-manager and “Beka” was created.

The take-over went on smoothly causing minimal disruption to Mecanix’s operations. The partnership is now giving fruit and the initial objectives of the owner-manager are about to be reached. Mecanix activities have remained stable, no firing has taken place and Beka is highly

productive. The purchasing manager of Mecanix emphasizes the value of their special relationship: "They know our products and our way of doing things very well. They often send us back our orders to tell us that some components can be simplified (...) you could not expect such advice from a regular supplier."

- *The Rally → Eva Case: Securing a key human resource in a tight labor market*

Rally is a medium-size company, which develops and publishes video games. Its activity requires a mix of artistic and technical competencies deployed in workgroups, which for the sake of creativity are granted a great deal of freedom. In 1998, Rally's owner-manager had to face the shocking news that a group of top employees was about to leave. They explained him that they needed even more autonomy and wanted to become entrepreneurs. These employees had developed the most successful video game in the company's history and were highly appreciated. Moreover, this event was taking place at a time when the labor market was very tight and competitors were out to recruit the best talents. Overcoming his dismay, Rally's owner-manager accepted to support the new venture with a small financial participation and a first game development contract. Shortly after "Eva" was created.

Right from the start, the new company experienced a steady growth of its personnel, turnover and margins. The various clients of Eva (and competitors of Rally) pushed the company to continuously improve the quality of its games, as well as the cost and speed of their development. Impressed by its performance, Rally's owner-manager expressed a desire to increase his financial participation in the spin-off. Later on, following the burst of the new economy bubble, Eva's director, with whom Rally's owner had maintained strong personal ties, accepted to return with Rally, on condition that he could preserve his autonomy. Since 2002, Eva has become a subsidiary of Rally but continues to function as an independent SME. Meanwhile, Rally's owner-manager has shut down his own game development department whose performance could not compare with that of Eva.

## **DISCUSSION**

Apart from the three basic strategic motives which each of them illustrate, the selected case studies also exemplify different top management postures vis-à-vis the spin-off.

The Teemo → Optix case, which shows how a spin-off can help rejuvenate the core competence of a company competing in a mature industry, is also a good example of a spin-off process in which the owner-manager plays a very active role right from the start. In fact we can say that he almost induces the process by focusing the attention of managers on the missing competencies and explicitly asking them to explore the full range of potential solutions. The spin-off constitutes an adequate, albeit surprising, solution to the problem he stated. When confronted with the unexpected part of the solution (the departure of his technology manager), the owner-manager vigorously attempts to take regain control but then realizes he has to proceed differently. He comes up with a win-win solution in which his strategic goals as well as the wishes of the entrepreneur are taken into account. Overall, the owner-manager takes a *proactive* posture with just the right dose of adaptiveness.

The Mecanix → Beka case, which shows how a spin-off can help resolve a make or buy dilemma by allowing the emergence of a supplier/partner, exemplifies a part induced, part emergent spin-off process. Confronted with a totally unexpected event – the shop supervisor take-over proposition –, which can nonetheless constitute a potential solution to his problem, the owner-manager of Mecanix quickly regains control over the process and decides to test the resources and determination of his employee and future supplier. He then fully supports the spin-off thus reinforcing his privileged relations with the entrepreneur. The owner-manager of Mecanix takes successively an adaptive and a proactive posture.

The Rally → Eva case, which portrays a spin-off process used to secure key human resources, also exemplifies a completely emergent spin-off process, which initially constitutes both a major disruption and threat to the mother company. In the face of this potential catastrophe, the owner-manager of Rally chooses to support the choice of his most valued employees. He manages, in this way, to maintain excellent relations with them, a move that later will prove wise and rewarding. He adopts a purely adaptive posture: his approach is one of yielding to contrary forces while keeping all options open.

Turning now to the empirical evidence we have gathered, we have identified three managerial attitudes or competencies, which are at the root of SME owner-managers' ability to use spin-offs as strategic tools.

- *Encouraging and considering employees' strategic initiatives*

In all three cases, owner-managers demonstrate a distinct ability to encourage and integrate employees' contribution to the definition of the firm's strategic agenda. Their attitude clearly stimulates employees' creativity, who then come up with innovative ideas and propositions. Such an attitude is encouraged by the proximity and simplicity that characterize relations in small-size organizations. It is clear that the close and informal environment of SMEs does favor a high level of interaction and communication among managers, thereby enabling strategic initiatives to flourish and compete (Amabile, 1996; Woodman et al., 1993). On the contrary, in large *centralized* organizations, hierarchical distance and structural inertia tend to limit strategic initiatives to the very top level while in large, *polycentric* organizations, the multiple and contradictory messages sent by top managers tend to disorient employees and bridle initiative.

However, encouraging creative ideas and debate is not sufficient: top management must be able to transform valuable employee's initiatives into effective strategies. For this to happen, a high level of involvement is required.

- *High level of involvement in the venturing process*

In all the cases presented, the owner-manager is personally and deeply involved in the venturing process. The three owner managers provide tangible support to entrepreneurs in the form of commercial and financial aids. They follow closely the entrepreneurs, testing them; encouraging them to go further and helping them refine their projects, in some case setting regular review meetings. Such a personalized support not only accelerates project development but also helps strategize the spin-off process by allowing the owner manager to 1) influence the final result, 2)

strengthen his ties with the entrepreneur and 3) legitimize the spin-off to the eyes of the rest of the company.

Such a close interaction between top and field managers can hardly be found in large firms for the reasons discussed previously whereas in SMEs, small size and proximity bring the strategic and operational levels together. In this context, top management's direct involvement becomes natural and easy. The owner-manager's central position shortens communication lines and considerably reduces lead times. Top management support helps put the project on the fast track and on the top of the company's strategic agenda. Implementation is made easier by the simple structure and informal procedures prevailing in SMEs. However, in order to ensure a quick launch another ingredient is required: an in-depth knowledge of the entrepreneur and the entrepreneurial process.

- *In-depth knowledge of the entrepreneur and the entrepreneurial process*

In the cases presented, all the owner-managers were very knowledgeable about their employees and about the entrepreneurial process, having founded or significantly developed a business themselves. Knowing well the would-be entrepreneurs enables the owner-managers to better assess their chances of success but also their capacity to work together later on. Being entrepreneurs themselves, the owner managers are in a better position when it comes to advise and support their employees concerning critical aspects of the entrepreneurial process.

Similarly to our previous arguments, this competence is less likely to be found in large firms than in SMEs where proximity and informality facilitate exchange and familiarity. Moreover, we could expect members of a SME to have greater "exposure" to entrepreneurial contexts, thereby to be more competent in the appreciation of entrepreneurial projects.

The attitudes and competencies we have just reviewed are required in order to "strategize spin-offs" i.e., to ensure that spin-offs *significantly contribute to the competitive advantage and performance potential of the mother company via the redefinition of its domain, boundaries and network of alliances*. These attitudes and competencies belong to individuals but the simple processes and structures, the actors' proximity and the clear leadership of SMEs definitely facilitate to their unfolding and affirmation.

In synthesis, we found that:

- In the context of SMEs, spin-offs generally contribute positively to the "mother" company's competitive advantage and performance potential: they constitute strategic tools;
- In their attempt to diversify their portfolio, find a reliable supplier or secure a key human resource, owner-managers of SMEs are able to turn an initially disrupting or threatening event – an impending spin-off – into an opportunity, and this by displaying a range of postures;
- This strategic ability relies on three key managerial attitudes and competencies: encouraging and integrating individual initiatives; strong personal involvement in the spin-off process and in depth knowledge of the entrepreneur and the entrepreneurial process;

- A strong link between these managerial attitudes and competencies and the SME context, characterized by organizational flexibility, actors' proximity and centrality of the owner-manager can be established.

## CONCLUSION

Up to now, spin-offs have never been studied in the context of SMEs (Carrier, 1996). Our study has established that spin-offs could be effective answers to some of the strategic issues facing SMEs such as diversifying, outsourcing and retaining key human resources. However, our study has not enabled us to ascertain if these benefits were long lasting. It would be important to establish whether this is the case and what parameters most influence the longevity of the "mother" company/spin-off relations: to answer these questions, a longitudinal study of these relations would be required.

Our study also reveals that SMEs are particularly good at making the most out of spin-offs. However, the determinants of this capacity need to be further explored and understood in order to determine whether large firms can built up such capability and how. If, as we suggested, this capability depends on attitudes and competencies which themselves depend on organizational characteristics such as flexibility, simplicity, proximity and centralized decision-making, quantitative research could aim at establishing beyond doubt their influence.

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# WHY DOES AN ENTREPRENEURIAL MANUFACTURER SPIN OFF AND LOCATE IN A CLUSTER?

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## ABSTRACT

This paper investigates a useful way to answer three fundamental questions about a cluster: (1) Under what conditions will a potential entrepreneur spin off from an incumbent firm? (2) Under what conditions could a cluster be created by entrepreneurial firms? (3) Are those conditions different depending on the types of industries/clusters? In order to address these issues, a three stage game between an incumbent firm and an entrepreneurial firm was constructed and analyzed. Basically, a potential entrepreneur will spin off from the incumbent firm if market size ( $M$ ) is large enough and entry cost ( $F$ ) is low enough. In the case of an industry producing complements with Firm I's products, Firm E will always spin off from it under those conditions. However, Firm I will always try to deter Firm E's entry by buying out Firm E when they are producing perfect substitutes. If an entrepreneurial firm has decided to spin off from an incumbent firm, its choosing to locate near a cluster would maximize its profit under certain conditions based on the comparison between the increase of congestion cost and the decrease of marginal production cost. The spin-off of the entrepreneur to start a new firm is efficient in the case of an industry producing differentiated products (imperfect complements and substitutes), but inefficient in the case of an industry producing perfect substitutes.

## I. INTRODUCTION

When you think of the Silicon Valley in California or Route 128 in Massachusetts, what is the most noticeable characteristic of those areas? It would be the clustering of firms. Although a lot of firms have already existed there for a long time – especially firms in the same industry, recently the tendency has been for them to concentrate in those areas even more quickly. Why have a lot of business firms been motivated to continue clustering in those areas? The answer to that question is very simple: because business firms in a cluster get spillover benefits from clusters and, thereby, maximize profits.

This paper investigates a purely “theoretical framework” in order to answer the next three fundamental questions about a cluster based on the assumption of profit maximization: (1) Under what conditions will a potential entrepreneur spin off from an incumbent firm? (2) Under what conditions could a cluster be created by entrepreneurial firms? (3) Are those conditions different depending on the types of industries/clusters? These three fundamental questions have not been answered in a theoretical framework, especially by using Game Theory. Thus, this paper could

be a useful way to address those issues, and help to fill the knowledge gap in the entrepreneurship literature. In section II of this study, three models of clusters to be analyzed in this paper will be described in detail. Then, in section III, solutions to and implications from our three models, including the conditions of an entrepreneurial firm's spin-off and location choice, will be discussed and suggested. In the conclusion, some of the limitations of this paper and possible research topics in the future will be discussed.

## II. THE MODELS

Our models in this paper can be thought of as a three stage game between an incumbent firm and an entrepreneurial firm, both of which try to maximize their profits through the location choice. In the first stage, a potential entrepreneur decides whether to spin off from the incumbent firm and enter the market with his own entrepreneurial firm. In the second stage, the entrepreneurial firm selects a location in which to operate, given that the incumbent firm's location is fixed. Then in the third stage, each firm names a quantity for its product simultaneously.

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Insert Figure 1 about here  
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In order to incorporate different context of different industries, three models of industries/clusters will be categorized. The first case of clusters is the one created by regional specialties, the typical example of which is the Third Italy in Italy focusing on textile/clothing/leather industries. With "coopitition" of firms, the synthesis of cooperation and competition, both tradition and skill by regional specialties could have been maintained well in that cluster. Therefore, firms in the Third Italy have been said to produce almost homogeneous products which are perfect substitutes for each other and compete in a same market. On the other hand, the second case of clusters is the one by large company, for example Toyota City in Japan, which is famous for automobile industry. If a potential entrepreneur spins off from the incumbent automobile-making company, he/she doesn't produce a vehicle and compete in a same market with the incumbent. Rather, he/she usually produces a particular part of a car, which is a complement to the incumbent's vehicle. Therefore, one large company constitutes a hub of networks with its car-parts suppliers in that cluster, just like the case of Toyota City in Japan. The last case of clusters is the one created by university and research institutes. Bio-clusters in San Diego or Silicon Valley of IT industry might be good examples of this kind of cluster, in which the role of R&D development and technological innovations of firms have been most important in this cluster. Firms with science-based technology in high technology industries produce a lot of differentiated products which are imperfect substitutes with each other and compete in a same market.

Basically we will assume that there are two firms – Firm I (an incumbent firm) and Firm E (an entrepreneurial firm) – who are supposed to be located on a linear space of length  $l$ . If a potential entrepreneur decides to stay in the incumbent firm, then he can get a remuneration of  $B$  from the incumbent firm as compensation, which will be determined endogenously in our models.

Firm I is located at  $a = l / 2$  (which is fixed, because it already exists in that market) from the left extreme point of the linear space, and produces  $q_I$  of its product at  $c(q_I)$  and sells them at  $p_I$  per unit. Because we have only two firms in our model, we will assume that a cluster is composed of one incumbent firm for simplicity. If it is then shown that an entrepreneurial firm has a tendency to locate as close as possible to that incumbent firm, the implication will be that the cluster will expand progressively in the future. Firm E is located at  $b$  from the right extreme point of the linear space, and produces  $q_E$  of its product at  $c(q_E)$  and sells them at  $p_E$  per unit.

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 Insert Figure 2 about here  
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In the case of Model I: the Third Italy, market size is assumed to be  $M$ , which does not depend on a geographic market space. Each firm is supposed to face with the same demand function  $P = M - Q$ , in which  $P = p_I = p_E$  and  $Q = q_I + q_E$ . Therefore, we are considering Cournot competition in this market, because if the price of one firm is lower than that of the other, then one firm will disappear in our model and it will be unnecessary for us to talk about the clustering of firms. We assume that there are spillover benefits from the clustering of two firms, which decrease the production cost of each firm. There are two kinds of production costs, entry cost in this market ( $F$ ) and marginal cost of production ( $c$ ). We assume that Firm I will have zero entry cost, because it has already been sunk in the past, and zero marginal cost of production for simplicity. Therefore, Firm E's cost function can be expressed as  $C(q_E) = F + \frac{cq_E}{(\frac{l}{2} + b)}$ , in which

spillover benefits decrease the total variable production cost of Firm E as the sum of distances  $a (= l / 2)$  and  $b$  from the extreme points of a linear space increases, because it implies that the two firms have come closer to each other. On the other hand, we assume that there is a per unit / per distance congestion cost from clustering ( $G$ ), which increases the production cost of each firm. Therefore, total congestion cost of each firm,  $G(q_I) = q_I G(\frac{l}{2} + b)$  and  $G(q_E) = q_E G(\frac{l}{2} + b)$ , will subtract its profit.

In the case of Model II: Toyota City in Japan, Firm E is supposed to produce a particular part of Firm I's vehicle, which is a complement with the incumbent's product. Therefore, each firm is supposed to be faced with the demand function of differentiated product,  $q_I = M - 2p_I - p_E$  and  $q_E = M - 2p_E - p_I$ , respectively. Other assumptions on spillover benefits and congestion costs from clustering will be exactly same with those in Model I: the Third Italy.

In the case of Model III: Bio-clusters in San Diego, Firm E is supposed to produce a lot of differentiated products, which are imperfect substitutes for each other, based on the science-based technology. Therefore, each firm is supposed to be faced with the demand function of differentiated product,  $q_I = M - 2p_I + p_E$  and  $q_E = M - 2p_E + p_I$ , respectively. Since R&D investment and spillover play an important role in this cluster, we assume that the R&D investment by both firms ( $R > 1$ ) will decrease the total variable production cost of Firm E further than in the case of Model II: Toyota City in Japan. Therefore, Firm E's cost function can be expressed as  $C(q_E) = F + \frac{cq_E}{R(\frac{l}{2} + b)}$ . Other assumptions on congestion costs from clustering are exactly same as before.

### III. RESULTS AND DISCUSSION

We can find the equilibrium in this three stage game by applying a backward induction method. The main results from our 3 models used in this analysis and certain conditions under which a potential entrepreneur spins off from and locates close to the incumbent firm are summarized in < Table 1 >.

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 Insert Table 1 about here  
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We can get some interesting implications on an entrepreneurial firm's spin-off and location choice in a cluster, depending on the different types of industries considered in this analysis. First, a potential entrepreneur in the Third Italy, in which perfect substitutes are produced based on homogeneous products, will always stay in Firm I if congestion cost is low enough. We can anticipate that the only case of Firm E's entry in this market will be when entry cost ( $F$ ) is large enough and subsidized by others, for example, a local government or manufacturers association in that area.

Secondly, in the case of Toyota City in Japan, where complements are produced by both Firm I and Firm E, a potential entrepreneur will always spin off from and locate close to Firm I if the market size is large enough and entry cost and congestion cost are low enough. In other words, Firm I would not try to buy out Firm E's entry in this market, because Firm E's spin-off producing complements is advantageous to Firm I's profit.

Third, a potential entrepreneur in Bio-clusters in San Diego, in which imperfect substitutes are produced with differentiated science-based technology, will spin off from and locate close to Firm I if market size is large enough and entry cost and congestion cost are low enough.

Fourth, regarding the location choice of Firm E, it will compare the increase of congestion cost with the decrease of marginal production cost when it chooses its location. We should note that

$$G = \frac{\partial G(q_E)}{\partial q_E \partial b}$$

is the increase of congestion cost per quantity per unit distance, and

$$\frac{c}{(\frac{1}{2} + b)^2} = - \frac{\partial C(q_E)}{\partial q_E \partial b}$$

is the decrease of marginal production cost per quantity per unit

distance. We can see from < Table 1 > that a different type of industry has a different condition of Firm E's location choice close to the incumbent firm. In the case of industry producing complements, Firm E's location choice close to Firm I will be much easier than in other cases. Whereas Firm E's location choice close to Firm I will be much harder than in other cases in the case of industry producing perfect substitutes, because of increased competition and eventually increased congestion cost.

Fifth, regarding the spin-off choice of Firm E producing complements with Firm I's products, it will always spin off from Firm I if market size is large enough and entry cost is low enough as we have seen before. In the case of industry producing perfect substitutes, Firm I will always try to deter Firm E's entry by paying  $B$  to and buying out Firm E. In other cases, Firm E will spin

off from Firm I if market size is large enough and entry cost is low enough. That will be intensified in the case of industry producing imperfect substitutes with large level of R&D spillover.

Last, we can think about the next question; in each case, is the spin-off of the entrepreneur to start a new firm efficient or not? We can compare the monopoly profit by only the Firm I with the sum of duopoly profits by Firm I and Firm E in this market. Industry profits in each case are summarized in < Tabel 2 >.

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Insert Table 2 about here  
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As we can see in < Table 2 >, the detailed result will be sensitive to the specification of parameters in our models. Therefore, we can use a numerical example with specified parameters, which satisfies every condition derived in our models, to get a tentative answer to the question above. With the numerical example of  $l = 10$ ,  $a = l / 2 = 5$ ,  $b = 4$ ,  $M = 100$ ,  $F = 600$ ,  $c = 10$ ,  $G = 0.05$ , and  $R = 2$ , we can get solutions to each stage in each model, which are summarized in < Table 3 >. Therefore, we can see that monopoly will realize larger industry profit than duopoly in the case of industry producing perfect substitutes because duopolists are supposed to compete fiercely in quantity in the same market, whereas duopoly will realize larger industry profit than monopoly in the case of industry producing differentiated products (complements and imperfect substitutes) because duopolists can make best use of differentiation of consumers in those differentiated markets.

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Insert Table 3 about here  
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#### IV. CONCLUSION

A three stage game between an incumbent firm and an entrepreneurial firm was constructed and analyzed in order to answer three fundamental questions about a cluster: (1) Under what conditions will a potential entrepreneur spin off from an incumbent firm? (2) Under what conditions could a cluster be created by entrepreneurial firms? (3) Are those conditions different depending on the types of industries/clusters? Basically, a potential entrepreneur will spin off from the incumbent firm if market size ( $M$ ) is large enough and entry cost ( $F$ ) is low enough. In the case of industry producing complements with Firm I's products, Firm E will always spin off from it under those conditions. However, Firm I will always try to deter Firm E's entry by buying out Firm E when they are producing perfect substitutes. Regarding the location choice of Firm E, if an entrepreneurial firm has decided to spin off from an incumbent firm, its choosing to locate near a cluster would maximize its profit under certain conditions based on the comparison between the increase of congestion cost and the decrease of marginal production cost, which are different depending on the type of industry. The spin-off of the entrepreneur to start a new firm is efficient in the case of industry producing differentiated products (complements and imperfect substitutes), but inefficient in the case of industry producing perfect substitutes.

This paper has limitations that can be the basis for some useful future research. First, since our models in this paper are purely “theoretical” and “algebraic” frameworks for an entrepreneurial firm’s spin-off and location choice analyzed by Game Theory, the main results suggested have not yet been tested with real data. Moreover, there was no discussion about what would be the most appropriate variables to measure the parameters of our models. Empirical research could be designed in that direction in order to test the validity of the main results suggested in this paper. Second, our model implicitly assumes that there is only one period of time in which each firm can realize a profit. Although this assumption is made mainly for the sake of simplicity of analysis, we can think about the possibility of using the N-period finite model or the infinite model in the real business world. Therefore, there could be future research that would incorporate a long time horizon and a discounting factor of time preference into our models. Third, our models in this paper assume that there are only two players in this game, Firm I and Firm E. However, we can expect that there might be somewhat different results in the case of many incumbents, many entrants, or both of them. Three additional cases can be considered in the future; < Case 1 > Many incumbent firms & One potential entrepreneur, < Case 2 > One incumbent firm & Many potential entrepreneurs, and < Case 3 > Many incumbent firms & Many potential entrepreneurs. Lastly, our analysis in this paper was confined to the case of complete information. However, we can think about the case of incomplete information, in which information about some of parameters in our models is not known to both an incumbent firm and an entrepreneurial firm. We can assume that an entrepreneurial firm has complete information of its own production cost, but an incumbent firm has to predict what type of production cost an entrepreneurial firm has on the basis of its subjective probability and the distribution of an entrepreneurial firm’s production cost. These limitations of this paper will be our next destination in future research.

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< Table 1: The Main Results from 3 Models >

|           | The 3 <sup>rd</sup> stage<br>: Cournot Quantity Choice   | The 2 <sup>nd</sup> stage<br>: Location Choice   | The 1 <sup>st</sup> stage<br>: Exit Choice   |
|-----------|--|--|--|
| Model I   | $q_E^* = \frac{1}{3} \left\{ M - G\left(\frac{l}{2} + b\right) - \frac{2c}{\left(\frac{l}{2} + b\right)} \right\}$ $\Pi_E^* = \frac{1}{9} \left\{ M - G\left(\frac{l}{2} + b\right) - \frac{2c}{\left(\frac{l}{2} + b\right)} \right\}^2 - F$ <p>→ <math>F &lt; \frac{1}{9} \left\{ M - G\left(\frac{l}{2} + b\right) - \frac{2c}{\left(\frac{l}{2} + b\right)} \right\}^2</math></p>                      | $\frac{\partial \Pi_E^*}{\partial b} > 0 \text{ if}$ $G < \frac{2c}{\left(\frac{l}{2} + b\right)^2}$   | $B = \frac{1}{36} \left\{ 5M - 5G\left(\frac{l}{2} + b\right) + \frac{2c}{\left(\frac{l}{2} + b\right)} \right\} \left\{ M - G\left(\frac{l}{2} + b\right) - \frac{2c}{\left(\frac{l}{2} + b\right)} \right\}$ <p>→ <math>B &gt; 0</math> if <math>M &gt; G\left(\frac{l}{2} + b\right) - \frac{2c}{5\left(\frac{l}{2} + b\right)}</math></p> $\Pi_E^* - B = \frac{1}{9} \left\{ M - G\left(\frac{l}{2} + b\right) - \frac{2c}{\left(\frac{l}{2} + b\right)} \right\} \left\{ -\frac{M}{4} + \frac{1}{4} G\left(\frac{l}{2} + b\right) - \frac{5c}{2\left(\frac{l}{2} + b\right)} \right\} - F$ <p>→ Always negative under <math>G &lt; \frac{2c}{\left(\frac{l}{2} + b\right)^2}</math> !</p>   |
| Model II  | $q_E^* = \left\{ \frac{M}{3} - G\left(\frac{l}{2} + b\right) - \frac{4c}{5\left(\frac{l}{2} + b\right)} \right\}$ $\Pi_E^* = \frac{2}{3} \left\{ \frac{M}{3} - G\left(\frac{l}{2} + b\right) - \frac{4c}{5\left(\frac{l}{2} + b\right)} \right\}^2 - F$ <p>→ <math>F &lt; \frac{2}{3} \left\{ \frac{M}{3} - G\left(\frac{l}{2} + b\right) - \frac{4c}{5\left(\frac{l}{2} + b\right)} \right\}^2</math></p> | $\frac{\partial \Pi_E^*}{\partial b} > 0 \text{ if}$ $G < \frac{4c}{5\left(\frac{l}{2} + b\right)^2}$  | $B = -\frac{1}{24} \left\{ \frac{7}{3} M - 7G\left(\frac{l}{2} + b\right) - \frac{4c}{5\left(\frac{l}{2} + b\right)} \right\} \left\{ \frac{M}{3} - G\left(\frac{l}{2} + b\right) - \frac{4c}{5\left(\frac{l}{2} + b\right)} \right\}$ <p>→ <math>B &lt; 0</math> if <math>M &gt; 3G\left(\frac{l}{2} + b\right) + \frac{12c}{35\left(\frac{l}{2} + b\right)}</math></p> $\Pi_E^* - B = \left\{ \frac{M}{3} - G\left(\frac{l}{2} + b\right) - \frac{4c}{5\left(\frac{l}{2} + b\right)} \right\} \left\{ \frac{23}{72} M - \frac{23}{24} G\left(\frac{l}{2} + b\right) - \frac{17c}{30\left(\frac{l}{2} + b\right)} \right\} - F$ <p>→ Might be positive if <math>M &gt; 3G\left(\frac{l}{2} + b\right) + \frac{204c}{115\left(\frac{l}{2} + b\right)}</math> and the entry cost (F) is low enough.</p> |
| Model III | $q_E^* = \frac{3}{5} \left\{ M - G\left(\frac{l}{2} + b\right) - \frac{4c}{3R\left(\frac{l}{2} + b\right)} \right\}$ $\Pi_E^* = \frac{6}{25} \left\{ M - G\left(\frac{l}{2} + b\right) - \frac{4c}{3R\left(\frac{l}{2} + b\right)} \right\}^2 - F$ <p>→ <math>F &lt; \frac{6}{25} \left\{ M - G\left(\frac{l}{2} + b\right) - \frac{4c}{3R\left(\frac{l}{2} + b\right)} \right\}^2</math></p>              | $\frac{\partial \Pi_E^*}{\partial b} > 0 \text{ if}$ $G < \frac{4c}{3R\left(\frac{l}{2} + b\right)^2}$ | $B = \frac{3}{200} \left\{ 9M - 9G\left(\frac{l}{2} + b\right) + \frac{4c}{3R\left(\frac{l}{2} + b\right)} \right\} \left\{ M - G\left(\frac{l}{2} + b\right) - \frac{4c}{3R\left(\frac{l}{2} + b\right)} \right\}$ <p>→ <math>B &gt; 0</math> if <math>M &gt; G\left(\frac{l}{2} + b\right) - \frac{4c}{27R\left(\frac{l}{2} + b\right)}</math></p> $\Pi_E^* - B = \frac{3}{25} \left\{ M - G\left(\frac{l}{2} + b\right) - \frac{4c}{3R\left(\frac{l}{2} + b\right)} \right\} \left\{ \frac{7}{8} M - \frac{7}{8} G\left(\frac{l}{2} + b\right) - \frac{17c}{6R\left(\frac{l}{2} + b\right)} \right\} - F$ <p>→ Might be positive if <math>M &gt; G\left(\frac{l}{2} + b\right) + \frac{68c}{21R\left(\frac{l}{2} + b\right)}</math> and the entry cost (F) is low enough.</p>                       |

< Table 2: Industry Profits >

|           | $\Pi_I(\text{Monopoly})$                            | $\Pi_I(\text{Duopoly}) + \Pi_E(\text{Duopoly})$   |
|-----------|---|---|
| Model I   | $\frac{1}{4}\{M - G(\frac{1}{2} + b)\}^2$           | $\frac{1}{9}\{M - G(\frac{1}{2} + b) + \frac{c}{(\frac{1}{2} + b)}\}^2$<br>$+ \frac{1}{9}\{M - G(\frac{1}{2} + b) - \frac{2c}{(\frac{1}{2} + b)}\}^2 - F$                       |
| Model II  | $\frac{3}{8}\{\frac{M}{3} - G(\frac{1}{2} + b)\}^2$ | $\frac{2}{3}\{\frac{M}{3} - G(\frac{1}{2} + b) - \frac{c}{5(\frac{1}{2} + b)}\}^2$<br>$+ \frac{2}{3}\{\frac{M}{3} - G(\frac{1}{2} + b) - \frac{4c}{5(\frac{1}{2} + b)}\}^2 - F$ |
| Model III | $\frac{3}{8}\{M - G(\frac{1}{2} + b)\}^2$           | $\frac{6}{25}\{M - G(\frac{1}{2} + b) + \frac{c}{3R(\frac{1}{2} + b)}\}^2$<br>$+ \frac{6}{25}\{M - G(\frac{1}{2} + b) - \frac{4c}{3R(\frac{1}{2} + b)}\}^2 - F$                 |

< Table 3: A Numerical Example >

|       | Cournot Competition  | Location Choice   | Spin-off Choice   | Industry Profits                             |
|-------|--|---|---|--|
| M I   | $q_I = 33.55$<br>$q_E = 32.44$<br>$P = 34.01$<br>$\Pi_I = 1,125.85$<br>$\Pi_E = 452.52$                      | $\frac{\partial \Pi_E}{\partial b} = 4.26 > 0$<br>$G(=0.05) < 0.25$ | $B = 1,351.70$<br>$M(=100) > 0.006$<br>$\Pi_E - B = -899.18$                    | $\Pi_I(M) = 2,477.55$<br>$\Pi(D) = 1,578.37$ |
| M II  | $q_I = 32.66$<br>$q_E = 31.99$<br>$p_I = 22.22$<br>$p_E = 22.89$<br>$\Pi_I = 711.17$<br>$\Pi_E = 82.43$      | $\frac{\partial \Pi_E}{\partial b} = 2.08 > 0$<br>$G(=0.05) < 0.10$ | $B = -305.67$<br>$M(=100) > 1.73$<br>$\Pi_E - B = 388.10$<br>$M(=100) > 3.32$   | $\Pi_I(M) = 405.49$<br>$\Pi(D) = 793.60$     |
| M III | $q_I = 59.84$<br>$q_E = 59.28$<br>$p_I = 40.35$<br>$p_E = 40.53$<br>$\Pi_I = 2,387.30$<br>$\Pi_E = 1,743.18$ | $\frac{\partial \Pi_E}{\partial b} = 1.53 > 0$<br>$G(=0.05) < 0.08$ | $B = 1,329.02$<br>$M(=100) > 0.368$<br>$\Pi_E - B = 414.16$<br>$M(=100) > 2.25$ | $\Pi_I(M) = 3,716.33$<br>$\Pi(D) = 4,130.50$ |

## **Heterogeneities In Women Entrepreneurship – Is There A Common Ground Between Theories, Policies, And Realities?**

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### **Abstract**

To search for a common ground, may or may not exist, between entrepreneurship theories, policies, and realities, an on-going national survey was designed and implemented to explore perceptions of male and female entrepreneurs in new venture formation. Sample information showed discrepancies between male and female entrepreneurs in their expectations and learning experiences associated with personal goals, financial achievement, and family life. Heterogeneities also exist among women entrepreneurs in manufacturing industry and retail/service industry corresponding to their expectations and learning experiences of new venture formation. Current policies may serve some needs for women entrepreneurs. More segregated and targeted services and assistance could be provided to women who would be interested in starting new businesses, or who failed in the new venture formation process.

### **Introduction**

Among the fascinating movements in the formation of the new businesses, there seems to be a more rapid growth trend for women to embark on entrepreneurial activities than male entrepreneurs according to a recent report by the National Women's Business Council (NWBC, 2005). Statistics showed that the number of women- and equally-owned firms grew by 17 percent, compared to 9 percent among all privately-held firms between 1997 and 2004 (NWBC, 2005). The number of majority-owned, privately-held women-owned businesses grew by 23 percent during the same period (NWBC, 2005). The growth rates in employment among women-owned firms with 100 or more employees increased by 44 percent between 1997 and 2000, and the number of women-owned firms with \$1 million or more in revenue grew by 32 percent in the same period – both nearly twice the rate of all comparably sized firms (WNBC, 2005).

The new estimates showed an average of 424 new women-owned firms were started every day, equivalent to 775,000 start-ups per year and accounting for fully 55 percent of new firm start-ups (WNBC, 2005). While there is an increasing amount of research on entrepreneurs and/or the entrepreneurial environment, there has been limited information that differentiates decisions or behaviors between female entrepreneurs and their male counterparts. Does this new generation of women business owners have the traits or psychological characteristics described in previous theories? Do women entrepreneurs develop their ideas into businesses following the same patterns as described by entrepreneurship theories? Do women entrepreneurs present similar expectations in business decisions, personal satisfaction, and family benefits compared to their male counterparts?

It is important to distinguish the studies of entrepreneurship from other economic theories given different characteristics and cultural background of men and women, due to the complexity of understanding interactions between gender issues and entrepreneurship. Some researchers have started to realize that differentiating factors may separate female entrepreneurs from male entrepreneurs such as accessing educational opportunities, accessing resources to create and develop ideas, identifying sustainable ideas, finding supportive networks, and being recognized as equally competitive in the markets. More policies have also tended to facilitate capital access, technical assistance, mentoring assistance and equalities in bidding on government contracts.

This paper presents the results of an on-going study to explore three research questions: (1) Are there any differences between female and male entrepreneurs in their characteristics, personal traits, business decisions, and personal assessment of impacts of new venture creation on quality of life, given a set of hypotheses described in previous literature? (2) Are there any differences among women entrepreneurs in different type of industries in their characteristics, personal traits, business decisions, and personal assessment of impact of new venture creation on quality of life, given a set of hypotheses described in previous literature? (3) Do current policies designed to support entrepreneurial activities among women make any differences for women entrepreneurs?

The findings of our study will benefit other professionals and practitioners who work closely with entrepreneurs and their families to understand the common ground, if any, between entrepreneurship theories, policies, and realities. Several assumptions need to be introduced in this study: (1) the businesses in this study are “new ventures” that have high potential for job creation and wealth accumulation from the societal perspective, not “micro-businesses” that are generally defined as small scale operations. (2) Wealth creation, sustainable profitability, personal satisfaction, and family welfare are simultaneously valued by entrepreneurs, not necessarily in any particular rank or with equal importance. (3) Both “entrepreneurial individuals” and the “environment in which entrepreneurs have been found” contribute to the success or failure of the new venture creation.

Since this is an exploratory study, it is not the authors’ intention to generalize the results of this study. The results presented in this article examine a set of the variables that might lead to some new discovery in entrepreneurship field. Through exploration of the variables that might influence entrepreneurs’ perceptions of business decisions and family relationships, this article hopes to present some outcomes that would be of interest to other researchers and to further develop entrepreneurship theories and testable hypotheses corresponding to the theories. This approach was inspired by the Grounded Theory to develop any theory inductively from a corpus of data using well-structured constraints and frameworks to ensure the robust ability of the theory when tested by new data (Galser & Strauss, 1967).

### **Overview of Research and Theory**

Two approaches have emerged in recent years that examine entrepreneurial phenomenon, which also represent the division among scholars in entrepreneurship study. One group of researchers had sought to explain or identify those members in our society who could be considered “entrepreneurial individuals”. These researchers have discussed entrepreneurship as a locus of human attributes, characteristics, traits, or psychology that differentiated entrepreneurs from the rest of the society (Shane,

2003; Carland & Carland, 2000; Liang & Dunn, 2002). Another group of researchers sought to explain entrepreneurship by examining the environment where entrepreneurs have been found (Shane, 2003). This school of thought attempted to identify situations in which entrepreneurial activities were more likely to occur. These activities usually relate to new firm formation or new expansions/renovations of existing firms. Some key variables examined in previous literature included variations in industry dynamics, organizations, technology, market structure, and other exogenous economic factors (Shane, 2003).

Differences between female and male entrepreneurs do exist in business and industry choices, financing strategies, growth patterns, and governance structures of ventures (Green, Hart, Gatewood, Brush & Carter, 2003). Scholars continue to challenge Gertrude Stein's comment, "An entrepreneur is an entrepreneur," by looking into more details of the separation between female and male entrepreneurs. While exploratory studies have identified similarities between female and male entrepreneurs, there is limited information to understand the differences. There seems to be a growing interest in examining if female and male entrepreneurs differ in terms of objectives, motivations, preparation, organization, strategic orientation, and access to resources (Greene, Hart, Gatewood, Brush, & Carter, 2003). A paper containing a comprehensive literature review (Greene, Hart, Gatewood, Brush, & Carter, 2003) of women entrepreneurship indicated that a small, yet increasing, proportion of published journal articles discussed women entrepreneurs. In earlier studies such as in the 1980s, smaller sample and interview information focused more on "women entrepreneurs". Some popular questions for investigators included what women entrepreneurs were like (traits, demographics, personal characteristics), why women entrepreneurs started businesses (motivations), and how women managed to start businesses (psychological measures). Some scholars tried to define "average women entrepreneurs" by comparing with their male counterparts. Earlier studies discovered that women were more inclined to start new businesses in traditionally female industries (retail, hospitality, service). Some researchers discovered challenges, barriers, and constraints for women to start businesses in access to financial support, generating capital, and general negative beliefs about women succeeding in business world.

These earlier studies drew attention to the fact that there was a significant population of women entrepreneurs were starting a wide variety of new ventures, and women entrepreneurs somewhat differed from male entrepreneurs in personalities and decision-making strategies. Several government initiatives were since established to support women entrepreneurs, such as Community Reinvestment Act (CRA) and Small Business Investment Companies (Greene, Hart, Gatewood, Brush, & Carter, 2003).

Research themes emerging since the 1990s became broader than earlier trait theory or psychological theories. Newer studies on women entrepreneurs included growth and performance of new ventures, strategic choices, determinants of opportunities, financing, business outcomes, social network, international trade issues, education and skills, and movements of female's role in our society. New policies were also developed and implemented to assist women entrepreneurs from a broader perspective (Greene, Hart, Gatewood, Brush, & Carter, 2003). Babson College and London Business School initiated the Global Entrepreneurship Monitor (GEM) in 1999 to measure differences in the level of entrepreneurial activity between countries, probe for a systematic relationship between entrepreneurship and national economic growth, uncover factors that lead to higher level of entrepreneurship, and suggest policies that may enhance the national level of entrepreneurial activity. The GEM data has shown that the participation of women in entrepreneurship is significant in spite of national variations (Minniti & Arenius, 2003). Evidence has shown that adult women represented a readily available pool of potential

entrepreneurs that countries may leverage to improve their economies. Moreover, this potential existed among nations in various stages of development and with different demographic patterns and labor force conditions (Minniti & Arenius, 2003).

National Women's Business Council released 2004 annual report recently and summarized research results among women entrepreneurs across industries and ethnicity (NWBC, 2004). There is an on-going effort to promote, support, and educate women entrepreneurs by various private and government agencies. Several studies and outreach programs in the United States and around the globe have been supported by the NWBC such as the global Entrepreneurship Monitor (GEM) research program, State Economic Networks for Women Business Owners, The Legacy and the Future of Women Entrepreneurs, Trend in Women-Owned Employer Establishments, Best Practices in Supporting Women's Entrepreneurship in the United States, Policy and Progress in Supporting the Growth of Women's Business Enterprise, Analyzing the Economics Impact of the Women's Business Center, Mentoring Web Cast Discussion Event, Accessing Government Markets and Women's Business Connection Conference Calls. Based on the research conducted in 2004 by the NWBC, several policy recommendations were proposed to the President, the U.S. Congress, and the U.S. Small Business Administration regarding challenges and barriers that women business owners still encounter such as access to capital, access to federal procurement markets, access to training and technical assistance, fact-based policy-making, and ongoing advocacy (NWBC, 2004).

To conclude, previous literature provided a broad discussion about women business owners from "entrepreneurial individualism" to "entrepreneurial environmentalism". There seems to be a gap between anecdotal information, theoretical framework, and policy implications. Do women entrepreneurs possess different expectations and learning experiences compared with male business owners given the variations in industries and personalities? Do women entrepreneurs in different businesses have the same expectations and learning experiences? Do current policies serve women entrepreneurs effectively? This study attempts to examine the above questions that have not been fully discussed in other literature.

### **Data**

A sequential probability sample of 1009 manufacturing and 1036 retail and service firms with fewer than 50 employees that had been in the database less than five years was drawn from the American Business Disc, Second Edition, 1999. This database has often been used by the Small Business Development Center to conduct impact studies. A questionnaire was developed, pre tested, and revised to collect the information needed for the study. The survey was designed for entrepreneurs only, and one business owner in each business or each household answered the questions. The answers reflected the owner's personal view regarding his/her personal perspectives for themselves, their spouse and children. None of the spouses or children was expected to answer the questions because (1) spouses and children might not live in the business address, and (2) there were technical difficulties and concerns to access spouses and children to collect their responses. Of the 1009 questionnaires mailed to manufacturer entrepreneurs, 258 were returned as not deliverable and of the 1036 questionnaires mailed to retail/service firm entrepreneurs, 158 were returned as undeliverable. One hundred thirty five retail questionnaires and 137 manufacture questionnaires were returned for a 15 percent retail and a 14 percent manufacture response rate.

Questions were separated into several sections. The first section related to personal and business demographics –

- When and how business was started.
- Business location (rural or urban areas).
- Entrepreneur's age, marital status, and education.
- Whether spouses and children worked in the business.
- Number of full-time and part-time employees.
- Annual sales of the business.
- Major sources of funds.

The second section of the questions involved “expectations of the new venture” –

- If sales were higher than expected.
- If profits were higher than expected.
- If starting the new venture was harder than expected.
- If starting the new venture took longer than expected.
- If entrepreneur's expectation was too optimistic.
- If spouses and children were enthusiastic before starting the new venture.
- If entrepreneur expected to be happier and financially better off before starting the new venture.
- If entrepreneur expected the new venture would improve family happiness and financial situation.

The third section of the questions provided an opportunity for entrepreneurs to express the learning experiences after starting and running the new ventures –

- Entrepreneurs were happier and better off financially.
- Family members were happier and financially better off.
- Entrepreneurs and family members had challenges in time management.
- Entrepreneurs revealed various effects of new venture creation on their marriages.
- If the entrepreneurs and family members would start another new venture again.

The last section of the questions was only responded by manufacturing business owners. This section asked the manufacturing entrepreneurs, both men and women, what they would do differently if they were to start another new venture. Options provided for entrepreneurs to choose from included –

- Change business location.
- Use more advertising.
- Define target market better.
- Get more cash before starting the new venture.
- Do more research before starting the new venture.
- Prepare a better business plan.
- Get more business training before starting.
- Not involve family members in the start-up process.

Since responses to the questions were collected by level choices or preferences, categorical data analysis is more appropriate. Two instruments were applied to test the differences in two categories (entrepreneur versus spouse): *Chi-square* test and *Gamma* test. *P*-values were calculated for both of the tests in all categories.

## Discussions of the Results

Results of the analysis were presented in three sections based on the questions. We separated the results into two categories – all entrepreneurs including men and women, and women entrepreneurs in manufacturing businesses and retail/service businesses. We would like to discover the differences, if any, between male and female entrepreneurs, and women entrepreneurs in two industries in their demographics, expectations, and learning experiences.

### Personal and Business Demographics

Among all entrepreneurs, 49 percent of 78 women and 36 percent of 172 men started the businesses less than five years ago. Only 5 percent of 78 women started businesses more than 11 years ago, which was lower than their male counterparts (15 percent of 172 men). The years of starting up were statistically significantly different between women and men at 10 percent significance level. Fifty-four percent of 79 women businesses were in rural areas, while 38 percent of 177 male-owned businesses were located in rural areas. The responses of business location were also statistically significantly different at 10 percent between women and men. Fifty-nine percent of 80 women business owners were married with children, and 79 percent of 179 male business owners were married with children. A slightly higher percent of women business owners (18 percent) were single parents than their male counterparts (8 percent). Marital situation also showed 10 percent statistical significance between men and women. Sixty percent of both female and male entrepreneurs had spouses working in the businesses either full time or part time. More women entrepreneurs (37 percent of 57) had children working part time in the business compared to the male business owners (24 percent of 152). Most of the entrepreneurs, both men and women, did not involve children in the business (60 percent). Interestingly a significantly majority of women business owners (91 percent of 68) had less than 5 full time employees, and this proportion was almost twice as high as their male counterparts (48 percent of 172). The age distribution of women business owners were about the same as men with 96 percent to 99 percent of them older than 30 years of age. Thirty-nine percent of the 80 women entrepreneurs used personal savings, while 48 percent of 177 male entrepreneurs used personal savings to start the new venture. A slightly higher proportion of women entrepreneurs used family savings (18 percent of 80) and loan (36 percent of 80) to start the new venture, compared to male entrepreneurs using family savings (7 percent of 177) and loan (34 percent of 177). Another noticeable result (statistically significant at 1 percent level) was revealed in the annual sales. Eighty percent of 80 women business owners had annual sales less than \$500,000 compared to 52 percent of 180 male entrepreneurs.

When comparing women business owners in two industries, 52 percent of 25 manufacturing women entrepreneurs and 47 percent of 53 retail/service women entrepreneurs started businesses less than five years ago. The majority of the women, 40 percent of 25 in manufacturing and 50 percent of 53 in retail/service started businesses between 6 to 15 years. Fifty-two percent of 27 manufacturing women entrepreneurs were located in rural areas, versus 56 percent of retail/service women entrepreneurs. The majority women business owners were married with children in both industries (67 percent of 27 in manufacturing and 56 percent of 53 in retail/service). Spouses did not work for 52 percent of 21 manufacturing women entrepreneurs, while 67 percent of 39 retail/service women entrepreneurs had their spouses working either part time or full time in the business. The majority of women did not have their children working in the business (63 percent to 53 percent). A very high percentage of retail/service women business owners had less than five full time employees (96 percent of 49), compared with

manufacturing women business owners (79 percent of 19). This was the only variable indicated 10 percent statistical significance. More manufacturing women entrepreneurs used personal savings to start the new venture (44 percent of 27), while more retail/service women entrepreneurs used loan to start the new venture (43 percent of 53). Most of the women entrepreneurs, in both manufacturing (81 percent of 27) and retail/service (83 percent of 53) businesses, reported less than \$500,000 in annual sales.

### **Expectations of New Venture Creation**

A significant proportion of all entrepreneurs, men or women, went into businesses because they would like to be in control (over 50 percent for both men and women). A significant proportion of women entrepreneurs (81 percent of 63 women), compared to 71 percent of 157 men, believed that their spouses were enthusiastic before starting the new venture. Seventy-three percent of 52 women and 67 percent of 140 men believed their children were enthusiastic before creating the new venture. Approximately 70 percent of all entrepreneurs expected the family (including themselves and family members) to be happier before starting the new venture. A slightly higher proportion of women entrepreneurs (81 percent of 75 women) versus men (76 percent of 177 men) expected the new venture to improve their financial situations. Seventy percent of all entrepreneurs, men and women, expected the new venture to improve family financial situation.

Expectations among women entrepreneurs were not uniformly distributed in different industries. A higher percentage of women entrepreneurs in retail/service businesses expected their spouses to be enthusiastic (87 percent of 39 women) compared to 71 percent of 24 women in manufacturing businesses. Statistically significant at 1 percent level, more women business owners in retail/service industry (89 percent of 28 women) believed that their children were enthusiastic about the new venture before starting, compared to 54 percent of 24 women manufacturers in our sample. A slightly higher percentage of women in retail/service businesses (71 percent of 51 women) expected to be happier before the new venture formation, compared with 65 percent of 23 women manufacturers. However a higher proportion of women manufacturers (71 percent of 21 women) expected their family member to be happier before the new venture formation, compared to 63 percent of 46 women in retail/service businesses. Personal financial achievement seemed to a major objective for 88 percent of 25 women manufacturers and 78 percent of 50 women entrepreneurs in retail/service businesses. Sixty-seven percent of 24 women manufacturers and 71 percent of 44 women business owners in retail/service businesses expected their family members to be happier as a result of the new venture.

### **Perceptions of Reality**

A significant proportion of all entrepreneurs (82 percent of 79 women and 81 percent of 176 men) in our sample revealed that their income was good before starting the new venture. Approximately sixty percent of all entrepreneurs, men or women, in our sample agreed that starting the new venture took longer than expected and that the process was harder than expected. Only thirty-nine percent of the 80 women entrepreneurs and 42 percent of 178 male entrepreneurs agreed that sales were higher than expected. Even fewer women entrepreneurs (22 percent of 78) and male entrepreneurs (28 percent of 178) indicated that profits were higher than expected. Interestingly, a significant proportion of men believed that their business was up and running well (89 percent of 180) compare to women (83 percent of 78). Fifty-three percent of 77 women and 44 percent of 178 men agreed that their expectations of the

new venture were too optimistic. A statistically significantly (at 1 percent level) smaller proportion of women entrepreneurs (60 percent of 79 women) reported that they were actually happier after starting the new venture, compared to 85 percent of 178 male entrepreneurs in our sample. Another statistical significant difference showed in the evaluation of family happiness after starting the new venture (at 1 percent significant level). Only forty-one percent of the 64 women entrepreneurs agreed that their family members were happier after starting the business, versus 69 percent of 162 male entrepreneurs. Women and men seemed to have quite different assessments of the financial improvement in new venture formation (statistically significantly different at 1 percent). Only 35 percent of 74 women believed that their own financial situation was improved due to the new venture, while 65 percent of 176 men believed that their own financial situation was improved. Forty percent of 61 women entrepreneurs indicated that the family financial situation was improved after starting the new venture, and 59 percent of 158 men indicated the new venture actually improved their family financial situation.

Women in different industries definitely revealed diverse perceptions of reality after new venture creation. Almost twice as many as women manufacturers (89 percent of 27 women) believed that sales were lower than expected, compare to 47 percent of 53 women in retail/service businesses. Only eight percent of 25 women manufacturers agreed that the profits were higher than expected, compared to 28 percent of 53 women businesses owners in retail/service industry. There were statistically significant differences in women entrepreneurs' perceptions of sales (significant at 1 percent) and profits (significant at 5 percent) in different industries. More women in retail/service businesses believed that their businesses were up and running well (85 percent of 53 women) compared to 67 percent of 27 women entrepreneurs, and this result was significant at 10 percent level. A majority women entrepreneurs (52 percent of 27 women manufacturers, and 70 percent of 53 women retail/service owners) revealed that starting the new venture was harder than they expected. Almost 63 percent of women entrepreneurs, either in manufacturing or retail/service businesses, believed that starting the new venture took longer than they expected. Half of the women entrepreneurs in our sample, either in manufacturing or retail/service businesses, believed that their expectations on the new venture were too optimistic. An interesting phenomenon existed in women's perceptions on financial improvements. Eighty to eighty-three percent of women entrepreneurs in both manufacturing and retail/service businesses revealed that their income was good before the new venture formation. Only 29 percent of 24 women manufacturers and 38 percent of 74 women in retail/service businesses admitted that their personal financial situation was improved after starting the new venture. Almost two-thirds of women entrepreneurs in both manufacturing and retail/service businesses agreed that the new venture actually improved their family financial situations.

### **Impacts of New Venture Creation on Quality of Life**

Statistically significant at 1 percent level, more male entrepreneurs (85 percent of 178 men) agreed that they were actually happier after forming the new venture. Only 60 percent of the 79 women shared the same feeling, though. Also a significant (at 1 percent significance level) proportion of men (69 percent of 162 men) agreed that their family members were actually happier after starting the new venture, compared to 41 percent of 64 women. Sixty-eight percent of 78 women entrepreneurs and 65 percent of 173 male entrepreneurs agreed that they did not have enough time for themselves after starting the new venture. More women entrepreneurs (55 percent of 62 women) revealed that they had not been able to spend as much time with their spouses, compared to 48 percent of 161 male entrepreneurs. Similarly, more women entrepreneurs (58 percent of 55 women) responded that they were not able to

spend enough time with their children, compared to 46 percent of 166 male entrepreneurs. Statistically significant at 10 percent level, more male entrepreneurs (56 percent of 163) believed that new venture creation had no effect on their marriage, compared to 42 percent of 64 women entrepreneurs. Some negative consequences of the new venture formation influencing marriage according to our male sample were estranged (4 percent), separated (2 percent), and divorced (5 percent). Some negative impacts of new venture formation according to female entrepreneurs included estranged (2 percent), separated (3 percent), and divorced (3 percent). Interestingly, 14 percent of the male entrepreneurs and 11 percent of the female entrepreneurs agreed that the new venture creation actually improved their marriage relationships. Significantly a higher proportion of male entrepreneurs (91 percent of 170) agreed that they would start another new venture again, and their family members would support them. Women entrepreneurs, however, were not as inclined to start another new venture again. Only 75 percent of 72 women entrepreneurs in our sample would be willing to start another new venture again, and their family members would support them again.

There were discrepancies in the perceptions of “quality of life” among women entrepreneurs in different industries after starting the new venture. A significantly higher proportion (at 5 percent level) of women businesses owners in retail/service industries (76 percent of 53) revealed that they had no time for themselves after starting the new venture, compared to 53 percent of 25 women manufacturers. Also a higher percentage of women in retail/service businesses (62 percent of 39) admitted that they did not spend enough time with their spouses, compared to 44 percent of 23 women manufacturers. Almost 60 percent of all women entrepreneurs, either in manufacturing or retail/service industry, admitted that they did not spend enough time with their children due to new venture creation. More women business owners in retail/service industry (63 percent of 41) agreed that new venture creation had some impacts on their marriages, compared to 48 percent of 23 women manufacturers. Although most of the impacts of new venture creation on their marriages were negative (estranged, separated, or divorced), 17 percent of 24 women manufacturers and 8 percent of women in retail/service businesses believed that their marriage relationship was actually improved due to the new venture. A significantly higher proportion of women manufacturers (91 percent of 23) would be willing to start another new venture again, compared to 68 percent of 53 women in retail/service businesses. Interestingly, 76 percent of all women entrepreneurs (in either manufacturing or retail/service) believed that their family members would be supportive if they would start another new venture.

### **Changes of Strategies Corresponding to Learning**

Several questions were presented to manufacturing entrepreneurs only – what would you do differently if you were to start another new venture? Women and men seemed to have different perceptions. Among women entrepreneurs, 33 percent would like to have more cash and to define their market better; 30 percent would like to write a better business plan and to have more business training; and 26 percent would like to change their business locations and conduct more research. Forty percent of the male entrepreneurs would like to have more cash, 31 percent would like to prepare for a better business plan, and 27 percent of the men would not change anything compared to what they did before.

### **Conclusions and Policy Implications**

Some common themes of the study of entrepreneurship have involved understanding individual entrepreneurs or environment where entrepreneurs exist (Shane, 2002; Mitchell, Busenitz, Lant,

McDougall, Morse, & Smith, 2002). The individualization approach discussed entrepreneurial personalities, traits, cognitions, and how the entrepreneurial decisions related to individual psychology in new venture formation (Mitchell, Busenitz, Lant, McDougall, Morse, & Smith, 2002). To extend the understanding of how environment or exogenous economic factors influencing new venture formation, researchers studied the organizational transformations, industrial fluctuations, economic cycles, managerial transactions, and orientations of public policies that might or would open the window of opportunities for entrepreneurs (Carland & Carland, 2000). Most of this research developed conceptual frameworks based on some necessary, yet may not be sufficient, conditions to define entrepreneurship due to the diverse nature of the research topic (Shane, 2003). Various fragmentary outcomes of recent entrepreneurship studies have been generated by case studies, surveys, or collections of anecdotal sources such as Internet or observations. Are we trying too hard to find a robust one-size-fits-all model to explain entrepreneurship corresponding to the fluctuations in modern economy?

A mail survey was conducted with business owners in the United States. Sample entrepreneurs (both female and male in retail, service, and manufacturing industries) responded to a set of questions regarding their demographics, business profiles, expectations of business development and quality of life, realities of business development and quality of life, and learning experiences associated with business decisions and policies. The results of this exploratory study revealed some significant differences between female and male entrepreneurs in their characteristics, personal traits, and business decision process. Female and male entrepreneurs also have different perceptions of the impacts of new venture creation on their business performance, personal life, and family life. More interestingly, heterogeneities exist among female entrepreneurs in different industries regarding entrepreneurial decisions and personal and family welfare.

To summarize the results –

- Women entrepreneurs seemed to have less full time employees and less annual sales compared to male entrepreneurs. Other business profile and personal demographics were similar between male and female entrepreneurs in our sample.
- More male entrepreneurs were more optimistic about the new venture formation compared to female entrepreneurs, which related to their expectations in sales, profits, personal happiness, and family welfare.
- More male entrepreneurs had positive experiences in the new venture formation compared to female entrepreneurs, which reflected in their learning experiences associated with the reality.
- Women in different industries seemed to have similar personal and business profiles. The structures of the businesses and the nature of the businesses seemed to influence women's perceptions on expectations and learning experiences. Women in manufacturing businesses seemed to be more optimistic than women business owners in retail/service businesses. Yet women manufacturers also seemed to have a more conservative assessment of the new venture on their personal and family lives in their expectations. In reality, women manufacturers seemed to encounter less negativities and challenges in personal and family relationship, compared to women business owners in retail/service businesses.
- While current policies provide some support and assistance to women entrepreneurs, women business owners in our sample have mixed feelings and identified other areas that might need further research. The needs revealed by women entrepreneurs seemed to deviate from male entrepreneurs.

Another interesting observation derived from our study is the differences between current policies and what entrepreneurs really need. The National Women's Business Council (WNBC, 2004) had made some policy recommendations such as access to capital, access to federal procurement markets, access to training/technical assistance, fact-based policy-making, and ongoing advocacy. Women in our sample, however, proposed other things that they would like to pursue if they would start a new venture again. These women, operating in a much smaller scale compare to their male counterparts or other enterprises, revealed the needs of more cash (access to capital), the needs to prepare for a better business plan (access to training and education), and the needs to have more business training. They also indicated that they needed to learn how to conduct initial research that would assist them to identify a feasible location and an effective market segment.

Some policy implications from our exploratory study include –

- (1) The changes that entrepreneurs would make suggest that emphasis could be placed on making entrepreneurial education programs available for pre-venture entrepreneurs. These programs could include classes, mentoring, or advising services for entrepreneurs. Perhaps government lending programs could “strongly” suggest to potential borrowers that participation in such programs would be advisable, if not required, before loans are made or guaranteed. Such a policy could improve entrepreneurial performance and reduce the number entrepreneurs who have difficulties.
- (2) Technical assistance and training offered by Small Business Development Center and other agencies should go beyond “preparing for a loan package”. Research process and contents should be included in workshops, classes, or symposium to guide entrepreneurs how to conduct effective research on their market, location, trade partners, and economic variations. Updated research lists should be provided to entrepreneurs directly in these training events. Some entrepreneurs may not even know the existence of the webpage for various agencies unless someone tells them so.
- (3) There is a need to compile a comprehensive dataset to record entrepreneurs who succeed versus who fail in the new venture creation process. All studies, including ours, use a data set that include entrepreneurs in some kind of database or listings collected by private or public agencies. It will be ideal for training organizations or service providers to keep a record of those who participate in the training or information sessions, who continue to pursue the new venture opportunities, who actually create businesses, and who disappeared from the market after a certain period of time.
- (4) We need to access those women who never ask for assistance, assuming women have not been taught to be aggressive in seeking assistance.
- (5) There may be a need to train male counselors to work with women. Women have different learning style than men. Women also bear different societal responsibilities and roles compared to men, given cultural and conventional perspectives in our community. Male trainers and counselors need to understand women entrepreneurs' perceptions better, so that the programs or information will be delivered efficiently.
- (6) To serve women entrepreneurs better, there is a need to train more female trainers and counselors in the field. This could be accomplished using current mentoring system to recruit more female professionals to provide services to other women. While mentoring system connects women together, women also need to be trained and educated in a more aggressive manner before delivering programs to others.

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**Entrepreneurs and Family Relations in Recently Started Small Businesses**

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**Section 1. General Information about you, your family, and your business**

- A. Are you  Female  Male
- B. When did you start/buy this business? (what year) \_\_\_\_\_
- C. What type business do you have? (Example: Plastic extrusion) \_\_\_\_\_
- D. What is the legal form of the business?  Sole Proprietorship  Partnership  Corporation  
 LLC  Other please specify (\_\_\_\_\_)
- E. Business Location: Town/City \_\_\_\_\_ State \_\_\_\_\_
- F. Is the business located in a  Rural area or an  Urban (50,000 people or more in the city and county of location) area?
- G. Marital Situation:  single  married with children  married without children  others
- H. If married, does your “spouse” or “significant other” work in the business (choose one)  
 Full-time  
 Part-time  
 Spouse or Significant Other does not work in the business
- I. If with children, do your children work in the business (choose one)  
 Full-time  
 Part-time  
 Children do not work in the business
- J. Number of employees:  Full Time  Part Time
- K. Your age:  less than 30  between 30 and 50  older than 50  
Spouse or Significant Other’s age:  less than 30  between 30 and 50  older than 50
- L. Please indicate the major financial sources you used to start the business (only choose one):  
 personal savings  family savings  loan  gift  
 others (please specify \_\_\_\_\_)
- M. Compared to what I expected before I start/buy this business, sales are  
 Higher than expected  About as expected  Lower than expected
- N. Compared to what I expected before I start/buy this business, profits are  
 Higher than expected  About as expected  Lower than expected
- O. In planning for the business development, my spouse or “significant other” was  
 Very involved  Somewhat involved  A little involved  Not involved

**Section 2. Please indicate whether you 1, strongly agree; 2, agree; 3, disagree, or 4, strongly disagree with each of the following assertions. If you have not or are not married, do not answer the questions related to marriage. If you do not have children, do not answer the questions related to children.**

|   | SA | A | D | SD |
|---|----|---|---|----|
| A. My business is up and has been running well.   | 1  | 2 | 3 | 4  |
| B. Starting a business has been harder than I expected.   | 1  | 2 | 3 | 4  |
| C. Starting a business has taken longer than I expected.  | 1  | 2 | 3 | 4  |
| D. My expectations regarding the business were too optimistic.  | 1  | 2 | 3 | 4  |
| E. Before starting the business, my family income was good.   | 1  | 2 | 3 | 4  |
| F. Before starting the business, I was very enthusiastic about this business.   | 1  | 2 | 3 | 4  |
| G. Before starting the business, my family was very enthusiastic about this business.                                   | 1  | 2 | 3 | 4  |
| H. Before I started the business, I expected my family to be happier.   | 1  | 2 | 3 | 4  |
| I. Before starting the business, I expected that I would be happier.  | 1  | 2 | 3 | 4  |
| J. Before starting the business, I expected that my family would be happier.  | 1  | 2 | 3 | 4  |
| K. Before starting the business, I thought I would be better off financially.   | 1  | 2 | 3 | 4  |
| L. Before starting the business, my family thought<br>we would be better off financially.                               | 1  | 2 | 3 | 4  |
| M. As a result of starting the business, I am really happier.   | 1  | 2 | 3 | 4  |
| N. As a result of starting the business, my family is really happier.   | 1  | 2 | 3 | 4  |
| O. As a result of starting the business, I am actually better off financially.  | 1  | 2 | 3 | 4  |
| P. As a result of starting the business, my family thinks our family is<br>better off financially.                      | 1  | 2 | 3 | 4  |
| Q. As a result of starting the business, I do <b>not</b> have time for myself<br>as before.                             | 1  | 2 | 3 | 4  |
| R. As a result of starting the business, I have <b>not</b> been able to spend as<br>much time with my family as before. | 1  | 2 | 3 | 4  |
| S. My relationship with my spouse or “significant other” has been strained<br>After I start this business               | 1  | 2 | 3 | 4  |
| T. Starting and managing a business has had no effect on my marriage.   | 1  | 2 | 3 | 4  |
| U. Starting and managing a business has had no effect on my family relationship.  | 1  | 2 | 3 | 4  |
| V. Given what I know now, I would start up a business again.  | 1  | 2 | 3 | 4  |
| W. Given what they know now, I think my family would support me<br>starting a business again.                           | 1  | 2 | 3 | 4  |
| X. As a result of starting my business, I have (choose one)   |    |   |   |    |
| Had some problems in my marriage  |    |   |   |    |
| Become estranged from my spouse or “significant other”  |    |   |   |    |
| Been separated from my spouse or “significant other”  |    |   |   |    |
| Been divorced from my spouse or “significant other”   |    |   |   |    |
| Had no particular problems in my marriage   |    |   |   |    |
| Improved my marriage  |    |   |   |    |

Y. If you could start this business again, what would you do differently?

- Change business location.
- Use more advertising.
- Define target market better.
- Need more cash before starting the new venture.
- Need to conduct more research before starting the new venture.
- Prepare for a better business plan.
- Need more business training before starting.
- Do not involve family members in the start-up process.

Z. Are there other things that have happened as a result of starting your business that you can share with this research team? Your inputs will help others to better understand the process of starting the business.

# VALUES AND ENTREPRENEURIAL ATTITUDE AS PREDICTORS OF NASCENT ENTREPRENEUR INTENTIONS

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## ABSTRACT

This exploratory research examines the relationship between values, the entrepreneurial attitude of nascent entrepreneurs (individuals intending to establish new businesses), and their entrepreneurial intentions. This involved administering a questionnaire to 166 participants who were unemployed and who identified themselves as nascent entrepreneurs after a thorough screening process to ensure they intended starting businesses. Prior research has identified values/beliefs as influencing attitudes, attitudes as influencing intentions, and intentions ultimately influencing behavior. Surprisingly, in this research, only a weak relationship existed between the three List of Values dimensions (empathy, achievement, and hedonism) and entrepreneurial attitudes. Significant relationships, however, were identified between the dimensions underpinning entrepreneurial attitude orientation (EAO) and entrepreneurial intention. In addition, although a relationship existed between two of the values dimensions, empathy and hedonism, there was no significant relationship between the achievement values dimension and entrepreneurial intention. This was perplexing since it could be expected that there would be an achievement-entrepreneurial intention relationship for nascent entrepreneurs. Since attitudes are changeable and values are more likely to be stable over time, values may enhance the information provided by nascent entrepreneur EAO.

## INTRODUCTION

This exploratory research examines the relationship between values, the entrepreneurial attitude of nascent entrepreneurs, and their intentions. An attitude is the predisposition to respond in a generally favorable or unfavorable manner with respect to the object of the attitude (Ajzen 1982; Rosenberg and Hovland 1960; Shaver 1987). Models based upon the theories of reasoned action (Fishbein and Ajzen 1975) and planned behavior (Ajzen 1985) use attitude as indirect behavior prerequisites, via intentions, to perform particular behaviors. Performance of a behavior is determined by the strength of the person's intention to perform that behavior. Intention is viewed as a function of the person's attitude toward performing the behavior (Ajzen 1985).

Whereas attitudes are open to change - across time and situations, values are thought to be relatively stable (Rokeach, 1973; Schwartz, 1992); however, they can and do change (Kahle, 1983; Kahle, Poulos, and Sukdial, 1988; Rokeach and Ball-Rokeach, 1989). Values are enduring beliefs that a specific mode of conduct or end state of existence is personally or socially preferable to an opposite or converse mode of conduct or end state of existence. Values guide attitudes, intentions, and behaviors (Rokeach, 1973). As such, in order to appreciate entrepreneurial attitude, it is important to appreciate an entrepreneur's value system.

In examining entrepreneurial attitude, a validated measurement scale has been developed (e.g., Robinson, Stimpson, Heufner, and, Hunt, 1991) though it does not incorporate values. This

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research, therefore, makes a contribution by building upon prior entrepreneur attitude research to (1) extend it to nascent entrepreneurs and, as part of this, linking it to entrepreneurial intentions and (2) incorporate values as a means of better understanding entrepreneurial attitude, intentions, and behavior. Since attitudes are not enduring and values are, values may provide a more stable understanding of entrepreneurial intentions and entrepreneurial behavior.

## MODEL DEVELOPMENT

Figure 1 provides an overview of the values-entrepreneurial attitude-intentions model. This demonstrates hypothesized relationships between the three constructs.

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Insert Figure 1 about here  
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### Values

Values are “enduring beliefs that a specific mode of conduct or end state of existence is personally or socially preferable to an opposite or converse mode of conduct or end state of existence” (Rokeach, 1973, p.5). Values are considered to be shaped largely by pre-adult socialisation and have been viewed as situationally invariant (Schwartz, 1992); however, values can and do change with time and events (Kahle, 1983; Kahle, Poulos, and Sukdial, 1988; Rokeach and Ball-Rokeach, 1989).

Various studies support the hierarchical primacy of values over attitudes and behaviors whereby values can influence attitudes and behaviors (e.g., Homer and Kahle, 1988). As such, values provide a stable and inner-oriented understanding of individuals – more so than attitudes. The relative importance of different values to an individual has frequently been measured using the method developed by Rokeach (1973). A simplified alternative to Rokeach’s (1973) method is the List of Values or “LOV” (Kahle, 1996; Kahle, Beatty, and Homer, 1986). LOV is used in this research. It consists of nine values: a sense of belonging, excitement, fun and enjoyment in life, warm relationships with others, self-fulfilment, being well-respected, a sense of accomplishment, security, and self-respect.

Various studies have demonstrated that, through factor analysis, these nine values (usually) can be reduced to three dimensions (e.g., Homer and Kahle, 1988). Various names have been attributed to these three dimensions including empathy, achievement, and hedonism (Kamakura and Novak, 1992). In this research, the following hypotheses are generated ...

H1: Nascent entrepreneurs will exhibit moderate levels of Empathy.

H2: Nascent entrepreneurs will exhibit high levels of Achievement.

H3: Nascent entrepreneurs will demonstrate moderate levels of Hedonism.

### Entrepreneurial Attitude Orientation (EAO)

EAO is based upon both attitude theory and entrepreneurship theory. Robinson, Stimpson, Huefner, and Hunt (1991) use a tripartite model to measure attitude in terms of affect, behavior, and cognition (Rosenberg and Hovland, 1960; Shaver, 1987). In measuring entrepreneurial attitude, four additional entrepreneurship subscales are adopted. These are achievement, innovation, perceived personal control, and perceived self esteem. These

dimensions combine to provide a scale that has been used to correctly classify entrepreneurs from non-entrepreneurs (Robinson, Stimpson, Huefner, and Hunt, 1991). This research extends the use of this scale to nascent entrepreneurs.

H4: Nascent entrepreneurs will demonstrate high levels of EAO.

### **Entrepreneurial Intentions**

In this research, we define entrepreneurial intention as the commitment to starting a new business (Kruger, 1993). Individuals are predisposed toward entrepreneurial intentions based on a combination of personal and contextual factors. Individuals develop attitudes toward undertaking specific behaviors based on their values/beliefs. Intentions result from attitudes and become the immediate determinant of behavior (Fishbein and Ajzen, 1975). In other words, values drive attitudes which, in turn, drive intentions which ultimately drive behaviors.

H5: There will be a relationship between values and entrepreneurial attitudes.

H6: There will be a relationship between values (empathy, achievement, and hedonism) and intentions.

H7: There will be a relationship between entrepreneurial attitudes and intentions.

## **RESEARCH DESIGN**

### **Participants**

There were 166 participants in this study. These participants were unemployed but identified themselves as intending to start businesses. Newspaper advertisements were placed in leading newspapers asking for unemployed individuals wanting to start a business to apply. The advertisements also promoted a one year entrepreneurship training and mentor program. Participants were to be paid a small allowance by the government if accepted onto the program. Over 2,000 responses were received. Approximately 400 participants were identified as “budding” potential entrepreneurs. Of these, a random sample of 166 participants was selected for participation in this research. Table 1 provides participant demographics.

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Insert Table 1 about here  
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### **Measures**

Entrepreneurial Attitude Orientation (EAO): Robinson, Stimpson, Huefner, and Hunt’s (1991) instrument was used to measure EAO. The instrument uses a total of 75 questions using a 10 point Likert scale (1 = Strongly Disagree and 10 = Strongly Agree) to collect information about the 12 underlying EAO dimensions.

Entrepreneurial Intentions: Participants were asked whether they intended to start a business and, using a 7-point Likert scale (1 = Unsuccessful and 7 = Successful), their intentions to achieve success across a range of areas including financial, personal achievement, family security, and community related.

Values: The LOV instrument developed by Kahle (1983) was used to measure personal values. This comprises nine questions and uses a Likert scale (1 = Important to Me and 9 = Extremely Important to Me).

## Results

Table 2 provides the descriptive statistics, reliabilities, and correlations.

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Insert Table 2 about here  
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There were seven hypotheses. H1 to H3 focused on personal value levels. These three hypotheses appear to be confirmed though statistical analysis was not possible. Since the research is exploratory, means and standard deviations were used. On the nine point value scale with 1 = Important to Me and 9 = Extremely Important to Me, the means (standard deviations) of the three value dimensions empathy, achievement, and hedonism were 5.8 (2.1), 7.8 (1.5), and 5.7 (2.2) respectively. Thus, in this sample, nascent entrepreneurs exhibited moderate levels of Empathy (H1 – confirmed), high levels of achievement (H2 – confirmed), and moderate levels of hedonism (H3 – confirmed).

H4 hypothesizes that nascent entrepreneurs will demonstrate high levels of EAO. Similarly, statistical analysis was not possible and means (standard deviations) were used instead. Questions used a 10 point Likert scale (1 = Strongly Disagree and 10 = Strongly Agree). H4 was only partially confirmed with only 10 of the 12 means tending toward the upper levels of the scale (with innovation-behavior (mean = 5.9 (s.d. = 1.2)) and self-esteem-affect (mean = 4.7 (s.d. = 1.8)).

H5 hypothesizes that there will be a relationship between values and entrepreneurial attitudes. This hypothesis was only partially confirmed with nine out of the possible 36 values-EAO relationships demonstrating significance.

H6 hypothesizes that there will be a relationship between values and entrepreneurial intentions. This was only partially confirmed. There were significant relationships for empathy and hedonism but not achievement.

H7 hypothesizes that there will be a relationship between entrepreneurial attitudes and intentions. This was partially confirmed with no significant relationship between self esteem-behavior and entrepreneurial intentions.

## DISCUSSION

Values/beliefs influence attitudes. Yet, in this research there was only a very weak relationship identified between values and EAO. Examining the EAO results independently of the values results suggests that nascent entrepreneurs tend to demonstrate an entrepreneurial attitude toward the start-up intention and decision – at least at the time when the data was collected. However, in terms of the three values dimensions (empathy, achievement, and hedonism); the dimension most expected to be associated with entrepreneurial intention – achievement – was not significantly related to intention (though relatively high levels of achievement were identified in participants). This is perplexing since one would expect entrepreneurs (whether existing or intending) to demonstrate a significant achievement-entrepreneurial intention relationship.

One interpretation of this result is that values tend to be enduring and do not easily change over time. They are instilled in us from an early age. Attitudes, on the other hand, are susceptible to change – over time and situations. They are dependent upon time and situational context. In

other words, measured at different points in time or in different given situations, they may vary. In this research, the entrepreneurial attitude of participants was measured. At that point in time, participants demonstrated high levels of EAO and a significant relationship between EAO and entrepreneurial intention. Yet, there was no significant relationship between personal achievement and intention. Despite that participants stated that they intended to start businesses and their attitudes supported this, the lack of a relationship between achievement and intention suggests that these participants may not carry out their intentions. A longitudinal study is necessary to support this explanation and this is currently being undertaken. To date, one year after the data in this research was collected, a significant number of the participants in the research have failed to develop business plans and assistance has been necessary to help participants identify business opportunities. The study is ongoing.

In the past, EAO has been used successfully to discriminate between existing entrepreneurs and non-entrepreneurs (Robinson, Stimpson, Huefner, and Hunt, 1991). EAO has previously not been used with nascent entrepreneurs. It would seem that using the EAO instrument, by itself, for attempting to identify nascent entrepreneur long term intentions (and behavior) may be insufficient. Although measuring entrepreneurial attitudes are useful, values are more stable and therefore may provide a deeper understanding of nascent entrepreneur long term intentions and behavior. As such, EAO may be enhanced – at least when investigating nascent entrepreneurs - by incorporating values as an integral part of the EAO model.

### **Research Contributions**

This research is exploratory and raises a number of questions. However, from a theoretical perspective, the research extends the current body of knowledge to include nascent entrepreneurs with the aim of creating a more holistic EAO theory. From an applied perspective, the research provides insights into the selection of individuals who identify themselves as nascent entrepreneurs. Although stated intentions to start a business and having an entrepreneurial attitude may be useful in evaluating the potential for nascent entrepreneur to actually start a business, personal values may enhance the evaluation process.

### **Research Limitations and Future Research Directions**

The research has a number of limitations. First, the sample was not selected randomly. Participants were pre-qualified as being potential nascent entrepreneurs. As such, extrapolation of the results to nascent entrepreneurs generally should be done with caution. Second, the research did not examine non-entrepreneurs. As such, comparisons of statistical significance could not be undertaken between nascent and non-entrepreneurs. Third, participants were unemployed. Further research needs to examine nascent entrepreneurs who are not unemployed.

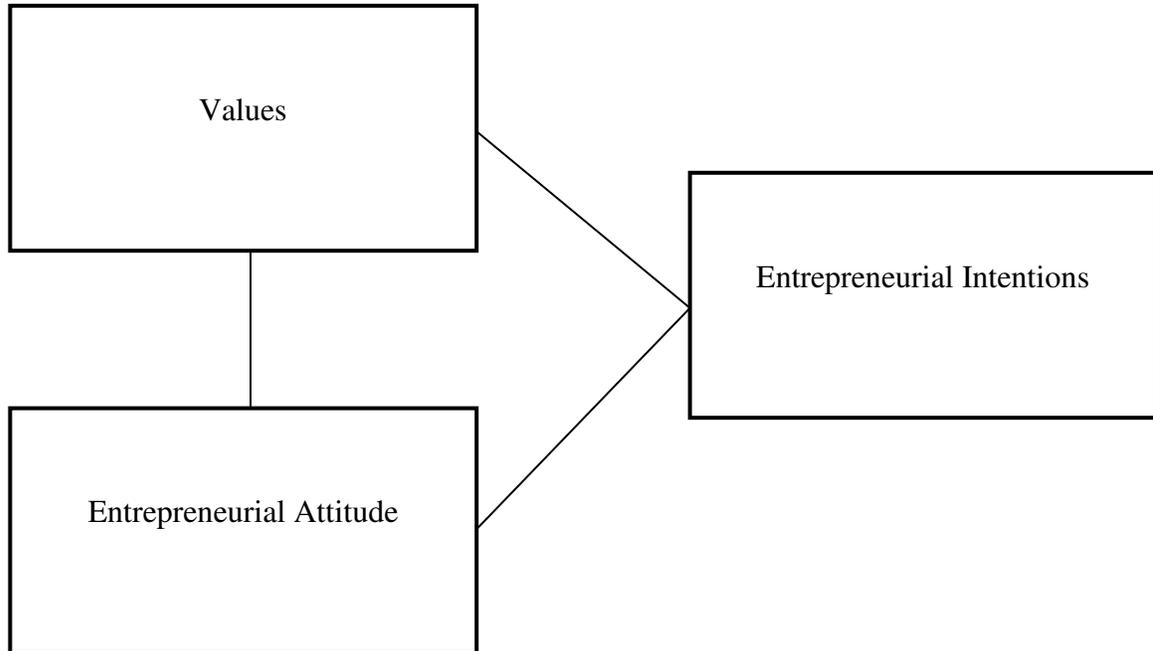
## **SUMMARY**

The purpose of this exploratory research was to contribute toward the development of an holistic theory of entrepreneurial attitude orientation that incorporates both existing and nascent entrepreneur perspectives. EAO has been successfully used to discriminate between existing entrepreneurs and non-entrepreneurs. This research attempted to extend its use to nascent entrepreneurs. In dealing with nascent entrepreneurs, it may be advantageous to also incorporate personal values into the model.

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**Figure 1**  
**Model Overview**



**Table 1**  
**Respondent Demographics**

| Details   | Frequency   | %   |  |
|---|---|---|--|
| Gender  | Male<br>Female  | 67<br>99                                    | 40%<br>60%                                       |
| Age   | 20 years or less<br>21 years to 25 years<br>26 years to 30 years<br>31 years to 40 years  | 5<br>80<br>60<br>21                         | 4%<br>47%<br>36%<br>13%                          |
| Highest Education Achieved?                                   | Primary School<br>Secondary School<br>Technical<br>Qualification<br>Cert. after High School<br>Dip. after High School<br>Undergraduate Degree<br>Postgraduate Degree<br>Other Qualification | 3<br>16<br>11<br>36<br>60<br>18<br>11<br>11 | 2%<br>10%<br>7%<br>22%<br>36%<br>11%<br>7%<br>7% |
| In what area(s) do you have most work or business experience? | Food<br>Hospitality<br>Tourism<br>Automotive<br>Other   | 36<br>6<br>3<br>8<br>113                    | 22%<br>4%<br>2%<br>5%<br>68%                     |
| How long have you been unemployed?                            | Less than 1 month<br>1 – 11 months<br>1 – 5 years<br>6 – 10 years<br>More than 10 years   | 19<br>23<br>105<br>18<br>1                  | 11%<br>14%<br>64%<br>10%<br>1%                   |
| Have you ever started your own business previously?           | Yes<br>No   | 52<br>114                                   | 31%<br>69%                                       |

**Table 2**  
**Descriptive Statistics, Reliabilities, and Correlations**

| Measure                         | Means (s.d.) | 1          | 2          | 3          | 4          | 5          | 6          | 7          | 8          | 9          | 10         | 11         | 12         | 13         | 14         | 15         | 16         |
|---------------------------------|--------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| 1. Values - Achievement         | 7.8 (1.5)    | <i>.74</i> |            |            |            |            |            |            |            |            |            |            |            |            |            |            |            |
| 2. Values - Empathy             | 5.8 (2.1)    | .359**     | <i>.72</i> |            |            |            |            |            |            |            |            |            |            |            |            |            |            |
| 3. Values - Hedonism            | 5.7 (2.2)    | .499**     | .686**     | <i>.73</i> |            |            |            |            |            |            |            |            |            |            |            |            |            |
| 4. Achievement-Affect           | 8.2 (1.2)    | .079       | -.029      | .096       | <i>.71</i> |            |            |            |            |            |            |            |            |            |            |            |            |
| 5. Achievement-Behavior         | 7.9 (1.2)    | .104       | -.008      | .032       | .677**     | <i>.71</i> |            |            |            |            |            |            |            |            |            |            |            |
| 6. Achievement-Cognition        | 8.3 (1.3)    | .075       | -.007      | .079       | .612**     | .554**     | <i>.76</i> |            |            |            |            |            |            |            |            |            |            |
| 7. Innovation-Affect            | 7.8 (1.1)    | .107       | .071       | .163*      | .721**     | .690**     | .616**     | <i>.71</i> |            |            |            |            |            |            |            |            |            |
| 8. Innovation- Behavior         | 5.9 (1.2)    | .178*      | .091       | .167*      | .373**     | .440**     | .324**     | .352**     | <i>.70</i> |            |            |            |            |            |            |            |            |
| 9. Innovation- Cognition        | 7.3 (1.2)    | .139       | .159*      | .223**     | .484**     | .563**     | .456**     | .561**     | .403**     | <i>.71</i> |            |            |            |            |            |            |            |
| 10. Personal Control-Affect     | 8.2 (1.7)    | .093       | .001       | .083       | .560**     | .635**     | .496**     | .501**     | .293**     | .457**     | <i>.74</i> |            |            |            |            |            |            |
| 11. Personal Control- Behavior  | 7.1 (1.7)    | .066       | .206**     | .154*      | .404**     | .473**     | .418**     | .360**     | .405**     | .474**     | .348**     | <i>.83</i> |            |            |            |            |            |
| 12. Personal Control- Cognition | 7.6 (1.9)    | .114       | .098       | .101       | .473**     | .504**     | .495**     | .458**     | .274**     | .358**     | .495**     | .361**     | <i>.74</i> |            |            |            |            |
| 13. Self Esteem-Affect          | 4.7 (1.8)    | -.046      | -.088      | -.130      | -.125      | -.156*     | -.280**    | -.147      | -.160*     | -.073      | -.021      | -.080      | -.067      | <i>.73</i> |            |            |            |
| 14. Self Esteem- Behavior       | 6.8 (2.0)    | -.108      | -.236**    | -.222**    | .147       | .101       | .031       | .082       | .141       | -.017      | .129       | -.027      | .040       | .168*      | <i>.75</i> |            |            |
| 15. Self Esteem- Cognition      | 8.3 (1.6)    | .048       | .024       | .084       | .495**     | .644**     | .508**     | .518**     | .361**     | .485**     | .556**     | .343**     | .455**     | -.146      | .175*      | <i>.77</i> |            |
| 16. Entrepreneurial Intentions  | 5.7 (.76)    | .020       | .182*      | .190*      | .435**     | .494**     | .342**     | .419**     | .272**     | .429**     | .326**     | .361**     | .317**     | -.166*     | .011       | .403**     | <i>.89</i> |

Reliability coefficients (Cronbach alphas) are on the diagonal in italics

\*  $p < 0.05$ ; \*\*  $p < 0.01$

# **VENTURE CAPITALIST OPPORTUNITY RECOGNITION DIFFERENCES: EAST VERSUS WEST**

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## **ABSTRACT**

A range of studies have focused on examining how entrepreneurs evaluate opportunities and to a lesser extent how they recognize them. This study builds upon prior entrepreneurship research into opportunity recognition (OR) behaviors and processes and extends this to venture capitalists (VCs) from two countries: Japan (the East) and Australia (the West). Much of the VC research has a western orientation and although venture capital is a global phenomenon, nation cultures may influence how VCs recognize opportunities. This research examines eastern and western VC OR similarities and differences and the OR - VC firm performance relationship. Although there were similarities between Japanese and Australian VC OR behavior and process types, there were significant weighting differences between the two groups on all but one OR behavior – opportunity causes. In addition, Japanese VCs differed from Australian VCs in terms of the relationship between OR behaviors and processes and VC firm performance.

## **INTRODUCTION**

This exploratory research investigates opportunity recognition (OR) similarities and differences and the OR-firm performance relationship of Japanese (Eastern) versus Australian (Western) venture capitalists (VCs). VC performance is dependent, in part, on recognizing opportunities (Timmons and Spinelli, 2004). Opportunities are characterized by general attributes such as the existence of a customer need, large and/or growing markets, forgiving financial returns, and having a sustainable competitive advantage (Timmons and Spinelli, 2004).

Opportunity evaluation has been the focus of substantial research. OR has been investigated less so (Hills, 1995) until only more recently (Venkataraman, 1997). As a result, how entrepreneurs recognize opportunities is still developing (Hills, Shrader, Baltrusaityte, and Izberk-Bilgin, 2002) and the literature that exists is fragmented and often appears contradictory (Lumpkin, Hills, and Shrader, 2001).

Less is known about VC OR behavior and the relationship between OR and VC firm performance. This research, therefore, is motivated by a gap that exists in the literature. In addition, much of the research undertaken is western oriented. A secondary motivation for this research, therefore, is to understand how western VC OR behaviors and processes are similar to or different from eastern VC behaviors and processes.

The research makes a contribution at two levels. First, it builds upon existing OR knowledge and extends this to VCs. In doing so, it contributes toward developing a more holistic OR theory. Second, it provides practical insights for VCs.

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## MODEL DEVELOPMENT

Figure 1 provides an overview of the model that is the focus of this research.

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Insert Figure 1 about here  
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The model builds upon the findings of Hills (1995), Hills, Lumpkin, and Singh (1997), and Hills and Shrader (1988) who focused on OR for entrepreneurs. The model identifies five OR behaviors and processes: self perceived entrepreneurial alertness to opportunities; fundamental causes of entrepreneurial opportunities; importance of venture ideas, individualism, creativity, and sources; opportunity recognition processes, deliberate search, spinoffs and immersion; and evaluation of new business opportunities. A sixth element of OR (source importance for identifying major new business ideas) reflected in the research undertaken by Hills (1995), Hills, Lumpkin, and Singh (1997), and Hills and Shrader (1988) is not incorporated in this research since VCs receive a continuous flow of potential investments from entrepreneurs wishing to raise money and each potential investment is evaluated in terms of whether it fits specified VC investment criteria.

VCs are professional investors that raise money primarily from financial institutions such as pension funds and insurance companies. They pool the monies they raise to create their own VC funds. The monies in these funds are then used for investing in growth oriented entrepreneurial firms that are assessed as having the potential to provide significant returns. By raising money from others to invest in entrepreneurial opportunities, VCs can be considered to act entrepreneurially. As such, it is expected that VCs will demonstrate OR behaviors and processes similar to those identified in entrepreneurs by Hills (1995), Hills, Lumpkin, and Singh (1997), and Hills and Shrader (1988).

Since venture capital investment in entrepreneurial ventures is a global phenomenon, it can be expected that OR will be common across cultures. What is regarded as an opportunity in one culture may be considered an opportunity in another. Similarly, the behaviors and processes that underpin how opportunities are recognized can also be expected to be similar across cultures. As such, in this research ...

- H1: The types of OR behaviors and processes adopted by Australian VCs will be similar to those adopted by Japanese VCs.
- H2: There will be no differences between the weighting levels placed on OR behaviors and processes for Australian and Japanese VCs.

Picking “winners” (successful investments that will produce super normal financial returns) is what VCs aim to achieve. Thus, by identifying superior investment opportunities from the myriad of investments presented to them, VCs aim to achieve superior VC firm performance. Thus, there will be a relationship between VC OR behaviors and processes and VC firm performance ...

- H3: There will be a relationship between *self perceived alertness* and VC firm performance for both Australian and Japanese VCs.

- H4: There will be a relationship between *opportunity causes* and VC firm performance for both Australian and Japanese VCs.
- H5: There will be a relationship between *ideas and creativity* and VC firm performance for both Australian and Japanese VCs.
- H6: There will be a relationship between *deliberate search and immersion* and VC firm performance for both Australian and Japanese VCs.
- H7: There will be a relationship between *opportunity evaluation* and VC firm performance for both Australian and Japanese VCs.

## RESEARCH METHOD

### Participants

Participants were identified using VC directories in Australia and Japan as well as by accessing industry contacts to identify VC firms not in the directory. A questionnaire was sent to these participants. The Japanese response rate was 35% (n = 83); the Australian response rate was 30% (n = 42). The Japanese survey instrument was translated into Japanese and then retranslated into English to ensure that both the English and Japanese instruments were equivalent. The questionnaire included sections on demographic information, OR, and firm performance. Table 1 provides demographic information on the participants.

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Insert Table 1 about here  
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### Measures

An independent samples t-test and correlation analysis were undertaken to analyse the data. A validated scale developed by Hills and others was used to capture VC OR behavior and processes. Perceived alertness, causes, ideas and creativity, search, and evaluation were the underlying OR dimensions. For the Australian study, details are as follows: perceived alertness (mean = 2.029; s.d. = 0.782); causes (mean = 2.414; s.d. = 0.746); ideas and creativity (mean = 2.638; s.d. = 0.578); search (mean = 2.667; s.d. = 0.540); and evaluation (mean = 2.536; s.d. = 0.782). For the Japanese study, details are: perceived alertness (mean = 1.347; s.d. = 0.3850.); causes (mean = 2.190; s.d. = 0.895); ideas and creativity (mean = 1.841; s.d. = 0.354); search (mean = 1.780; s.d. = 0.333); and evaluation (mean = 1.733; s.d. = 0.391).

VC firm performance was measured using the Internal Rate of Return which is the standard VC industry performance measure (Mason & Harrison, 2002). Respondents were asked to rate the IRR of the entire portfolio of their investments in absolute terms ("1 = over 20%" to "5 = less than 5%"). This was referred to as the IRR performance scale. For the Australian study, mean = 1.952, s.d. = 0.936; for the Japanese study, mean = 3.084, s.d. = 1.232.

## RESULTS

Tables 2.1 and 2.2 provide the Australian and Japanese Correlation Coefficients and Descriptive Statistics.

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Insert Tables 2.1 and 2.2 about here

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H1 hypothesized that OR behaviors and processes adopted by Japanese VCs will be similar to those adopted by Australian VCs. This hypothesis was confirmed. Both Australian and Japanese demonstrated use of the five OR behaviors and processes.

H2 hypothesized that there will be no differences between the weighting levels placed on OR behaviors and processes for Australian and Japanese VCs. This hypothesis was disconfirmed. An independent samples t-test was conducted to compare the five OR behaviors and processes of each group. Significant OR differences on four of the five behaviors and processes were identified: perceived alertness ( $t(123) = 6.540, p = 0.000$ ); causes ( $t(123) = 1.394, p = 0.166$ ); ideas and creativity ( $t(123) = 9.530, p = 0.000$ ); search ( $t(123) = 11.325, p = 0.000$ ); and evaluation ( $t(123) = 7.664, p = 0.000$ ). There was no significant difference between the two groups with opportunity causes.

H3 hypothesized that there will be a relationship between *self perceived alertness* and VC firm performance for both Australian and Japanese VCs. This hypothesis was only partially confirmed. A relationship existed for Australian VCs but not for Japanese VCs.

H4 hypothesized that there will be a relationship between *opportunity causes* and VC firm performance for both Australian and Japanese VCs. This hypothesis was only partially confirmed. A relationship existed for Japanese VCs but not for Australian VCs.

H5 hypothesized that there will be a relationship between *ideas and creativity* and VC firm performance for both Australian and Japanese VCs. This hypothesis was disconfirmed.

H6 hypothesized that there will be a relationship between *deliberate search and immersion* and VC firm performance for both Australian and Japanese VCs. This hypothesis was disconfirmed.

H7 hypothesized that there will be a relationship between *opportunity evaluation* and VC firm performance for both Australian and Japanese VCs. This hypothesis was only partially confirmed. A relationship existed for Australian VCs but not for Japanese VCs.

## DISCUSSION

The results have implications for VC research specifically and for OR research generally. First, the results highlight the independence of the OR behaviors and processes. Though related, these can vary independently of each other. Each can independently influence performance.

Second, culture may provide a possible explanation for VC firm differences. National culture is programmed into us from the day we are born. Culture is the collective programming of the mind that distinguishes the members of one category of people from another (Hofstede, 1980). Culture can be measured in terms of (Hofstede, 1980) power distance (level of preference for equality or inequality within groups), uncertainty avoidance (preference for risk versus structure), individualism (degree of individual or group orientation), masculinity (relative degrees of relationship versus task orientation), and long term versus short term orientation (thrift and perseverance versus respect for tradition and fulfilling social obligations) (Hofstede, 1991; The Chinese Culture Connection, 1987).

Although culture does not equate with nations (nations may be multi-cultural), culture provides a partial explanation of nation differences. Hofstede (1980), for example, identified cultural profiles for a range of nations including Australia and Japan. Compared to Australia, Japan has a higher power distance, a much lower tolerance for uncertainty and risk, much less of an emphasis on the individual and more on the group, a greater masculine task orientation, and a much longer time orientation. Since significant cultural differences exist between the two countries, and culture affects beliefs, attitudes, and behavior, it is not unexpected that there will be significant OR differences between Australian and Japanese VCs. All VCs need to recognize and invest in profitable opportunities; culture, however, can be expected to influence *how* VCs recognize opportunities. As such, VC OR models and decision aids need to consider culture as an important contextual variable.

Third, it is apparent that Japanese and Australian VCs emphasize different OR behaviors and processes. OR is underpinned by a number of behaviors and processes and VC firm performance may be enhanced through using a more holistic OR approach. Thus, from a practitioner perspective, it may be beneficial for VCs to spend time in other countries (immersed in other cultures) so as to develop a more holistic appreciation of foreign approaches to OR dimensional weighting with a view to supplementing “local” with “foreign” OR dimensional emphases.

### **Managerial Implications**

VCs are professional investors; however, they do not necessarily “get it right” every time and get a 100% success rate. Since OR appears to be related to VC performance, it would appear that training VCs (particularly novice VCs) to better understand OR behaviors and processes and opportunity characteristics would be beneficial to them. In addition, by enhancing their OR behaviors and processes, they may be better positioned to mentor their investments which, in turn, may result in improved performance of those investments.

### **Research Limitations**

There are a number of limitations associated with this research that may influence the generalizability of results. First, the research did not include VCs from countries other than Australia and Japan. As such, the generalizability of the results to other eastern and western countries should be done so with caution. Second, the Australian VC industry is relatively young when compared to US and European VC industries. As such, generalizability of the Australian results to more mature country VC industries also should be done with caution. Third, only successful venture capitalists were examined (those that were still operating). There is a need in future research to examine the OR-performance relationship in less successful VC firms. Fourth, the sample size of Australian VCs used in this research appears small. However, the Australian VC population is relatively small with there being probably no more than 150 VC Australian firms (Bivell, 2005).

## **SUMMARY**

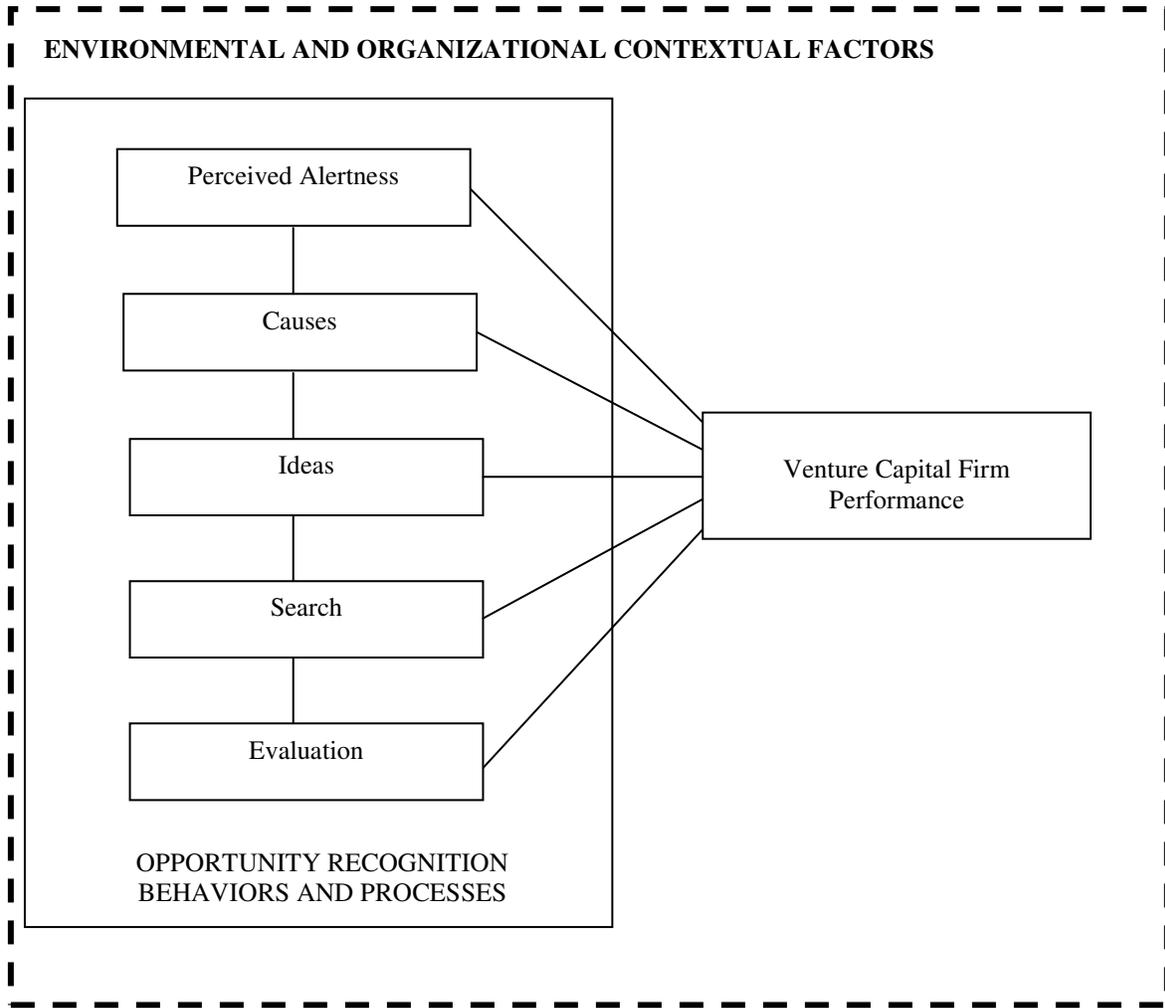
This research examined the OR behaviors and processes of Japanese and Australian VCs and the OR-VC firm performance relationship. Although both Australian and Japanese VCs used similar OR behaviors and processes, each group applied different OR behavior and process weightings resulting in different OR behavior and process firm performance relationships.

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FIGURE 1

Hypothesized Relationship of the OR Dimensions with Venture Capitalist Performance



**TABLE 1**  
**Respondent Demographics**

| <b>Details</b>                             |  | <b>Australian<br/>Frequency</b>  | <b>Australian<br/>%</b>                      | <b>Japanese<br/>Frequency</b>      | <b>Japanese<br/>%</b>                     |
|--|--|----------------------------------|--|------------------------------------|---|
| Your gender?                               | Male<br>Female   | 39<br>3                          | 93%<br>7%                                    | 76<br>7                            | 92%<br>8%                                 |
| Your age?                                  | 30 yrs or less<br>31 yrs to 40 yrs<br>41 yrs to 50 yrs<br>51 yrs to 60 yrs<br>61 yrs to 70 yrs | 5<br>23<br>4<br>10<br>0          | 12%<br>55%<br>9%<br>24%<br>0%                | 7<br>38<br>23<br>4<br>11           | 8%<br>46%<br>28%<br>5%<br>13%             |
| Highest Education Achieved?                | Secondary School<br>Technical<br>Qualification<br>UG Degree<br>PG Degree                       | 2<br>1<br>10<br>29               | 5%<br>2%<br>24%<br>69%                       | 1<br>1<br>54<br>27                 | 1%<br>1%<br>65%<br>33%                    |
| Have you ever started your own business?   | Yes<br>No  | 20<br>22                         | 48%<br>52%                                   | 10<br>73                           | 12%<br>88%                                |
| Background before venture capital?         | Accountant<br>Banker<br>Lawyer<br>Entrepreneur<br>Stockbroker<br>Other                         | 8<br>3<br>1<br>6<br>6<br>18      | 19%<br>7%<br>3%<br>14%<br>14%<br>43%         | 7<br>14<br>5<br>7<br>12<br>38      | 8%<br>17%<br>6%<br>8%<br>15%<br>46%       |
| No. years involved in venture capital?     | 5 or less yrs<br>6 to 10 yrs<br>11 yrs or more   | 24<br>9<br>9                     | 56%<br>22%<br>22%                            | 29<br>24<br>30                     | 36%<br>29%<br>35%                         |
| No. investments you have made?             | 10 or less<br>investments<br>11 or more<br>investments   | 17<br>25                         | 41%<br>59%                                   | 23<br>60                           | 29%<br>71%                                |
| Were you one of the founders of this firm? | Yes<br>No  | 21<br>21                         | 50%<br>50%                                   | 61<br>22                           | 74%<br>26%                                |
| What is your position in the firm?         | Chairperson<br>CEO/Man. Dir<br>Director<br>Manager<br>Employee<br>Shareholder/Partner<br>Other | 4<br>12<br>8<br>7<br>5<br>5<br>1 | 10%<br>28%<br>19%<br>17%<br>12%<br>12%<br>2% | 1<br>15<br>29<br>33<br>0<br>5<br>0 | 1%<br>18%<br>35%<br>40%<br>0%<br>6%<br>0% |
| Primary type of investment profile?        | Generalist Fund<br>Specialist Fund   | 42<br>0                          | 100%<br>0%                                   | 83<br>0                            | 100%<br>0%                                |

TABLE 2.1  
Australian Correlation Coefficients and Descriptive Statistics

| Measure                        | Mean (s.d.)   | 1.          | 2.          | 3.          | 4.          | 5.          | 6.           |
|--------------------------------|---------------|-------------|-------------|-------------|-------------|-------------|--------------|
| <b>1. Perceived Alertness</b>  | 2.029 (0.782) | <b>.810</b> |             |             |             |             |              |
| <b>2. Causes</b>               | 2.414 (0.746) | -.153       | <b>.798</b> |             |             |             |              |
| <b>3. Ideas and Creativity</b> | 2.638 (0.578) | .200        | -.162       | <b>.703</b> |             |             |              |
| <b>4. Search and Immersion</b> | 2.667 (0.540) | -.049       | -.262       | .328*       | <b>.704</b> |             |              |
| <b>5. Evaluation</b>           | 2.536 (0.782) | .316*       | .042        | .019        | -.090       | <b>.791</b> |              |
| <b>6. IRR</b>                  | 1.952 (0.936) | .482**      | .197        | -.068       | -.105       | .508**      | <b>1.000</b> |

*Reliability coefficients are on the diagonal*

\* $p < 0.05$ ; \*\*  $p < 0.01$

TABLE 2.2  
Japanese Correlation Coefficients and Descriptive Statistics

| Measure                        | Mean (s.d.)   | 1.          | 2.          | 3.          | 4.          | 5.          | 6.           |
|--------------------------------|---------------|-------------|-------------|-------------|-------------|-------------|--------------|
| <b>1. Perceived Alertness</b>  | 1.347 (0.385) | <b>.744</b> |             |             |             |             |              |
| <b>2. Causes</b>               | 2.190 (0.895) | .006        | <b>.923</b> |             |             |             |              |
| <b>3. Ideas and Creativity</b> | 1.841 (0.354) | -.096       | .043        | <b>.702</b> |             |             |              |
| <b>4. Search and Immersion</b> | 1.780 (0.333) | -.014       | .166        | .667**      | <b>.705</b> |             |              |
| <b>5. Evaluation</b>           | 1.733 (0.391) | -.316**     | .101        | .253*       | .252*       | <b>.705</b> |              |
| <b>6. IRR</b>                  | 3.084 (1.232) | .035        | .501**      | -.093       | -.028       | .073        | <b>1.000</b> |

*Reliability coefficients are on the diagonal*

\* $p < 0.05$ ; \*\*  $p < 0.01$

# SME FINANCIAL STRUCTURE AND THE IMPLICATIONS FOR REGIONAL ECONOMIC POLICY DEVELOPMENT IN NEW ZEALAND

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## ABSTRACT

This paper reports on an investigation into the potential to use the financial ratios of New Zealand small businesses to discriminate their location as an aid for in the accurate targeting of regional economic development programmes. To the extent that there are clearly identifiable differences in performance and financial structure for urban and non-urban firms this could be significant for small business policy development and the efficient implementation of strategies.

An expanded awareness of the role of small business in employment generation and sustainable economic growth has resulted in more government attention being directed toward the sector. The non-interventionist approaches of the 1980s and 1990s have given way to more proactive government policies to achieve economic and social growth. As government becomes more active in working for and with small business it is important that scarce resources should not be wasted but directed toward gaining the best pay-off.

The paper discusses the data sources, the statistical testing, the results, the interpretation of the findings and finally a range of policy implications. While the statistical analysis is rigorous and robust the focus is upon the results and implications and not upon the statistical analysis per se.

## INTRODUCTION

Government policy, in New Zealand, has increasingly incorporated strategies supporting economic growth, including programmes which encompass the small medium enterprise (SME) sector. The initiatives are directed toward reducing compliance cost, regional development and maximising expected value added through export encouragement. The aim of this study is to analyse subsets of SMEs distinguished by their regional base to determine whether there are detectable structural differences which may be of importance in maximising the outcomes of government programmes directed toward improved economic growth.

One target mooted at the last national election, in 2002, was to move New Zealand into the top half of the OECD rankings for income per capita. At the opening of the parliamentary session The Governor General, delivering the Speech from the Throne, observed that the new government "sees its most important task as building conditions for increasing New Zealand's long term sustainable rate of economic growth".

That broad theme enunciated in 2002 continues to be an important target. The head of Treasury, speaking at a conference in mid 2004 noted that:

*If New Zealand is to catch-up to OECD average level of per capita GDP then New Zealand will need to grow faster than average OECD growth, which means growing faster than some countries.*

*Just how challenging that will be will depend on how fast other countries above and below us perform. To catch up with the OECD median in ten years for example, New Zealand per-capita GDP has to grow approximately 2% more on average per annum than the OECD median for the next 10 years. Over a 20 year horizon the required rate is about 1% more than the OECD.*  
(Whitehead, 2004)

The SME sector is increasingly recognised as an important component of the economy. Government continues implementing a range of policy initiatives directed toward providing stable macroeconomic conditions, enhancing labour productivity, regional development and removing constraints to trade, etc. Of particular significance, to this study, are a number of policies directed toward improving productivity in the SME sector and targeting key areas with a growth innovation framework (GIF).<sup>b</sup>

The initial proposals regarding the growth innovation framework (GIF) were promulgated by Prime Minister Helen Clark (2002) as a key plank in the Government's policy framework for economic transformation. The framework, *Growing an Innovative New Zealand*, has three key elements:

- Strengthening the economic foundations
- Investment in innovation, talent and global connectedness
- Sectoral policies focussing on the bio-technology, ICT and creative sectors.

Subsequently the GIF has been extended to include regional development as a key component of current economic development efforts. Significant drivers of growth arise at regional and local levels through the opportunities and incentives provided by region-specific attributes. The government has adopted a partnership approach to regional development. This includes the Regional Partnerships Programme under which local government, Iwi<sup>1</sup> and economic development professionals work together on economic development strategies to make the most of regional strengths and local resources. Central government provides support to build the capacity of each region in establishing the foundations for sustainable economic growth (MED, 2004b).

### **SME SECTOR IN NEW ZEALAND**

The 2004 report of Small Business Advisory Group, an independent committee established by government to make recommendations relating to SMEs, made 19 recommendations. There were no links with the regional economic development policy of government.

MED (2004b, p12) addresses the size of output attributable to SMEs. Using value-added<sup>2</sup> as a measure of the contribution to total output in the economy that SMEs

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<sup>1</sup> Iwi are tribal groupings of Maori people, the indigenous people of Aotearoa/New Zealand.

<sup>2</sup> Value-added is calculated as gross output minus intermediate consumption and is provided with the following caveats:

- Value-added is calculated as gross output minus intermediate consumption. This should only be seen as a proxy. While source data used for this feed into the system for National accounts from which official GDP is calculated, these data have not been through this process and therefore only provide an indicator.
- The numbers have been deflated by a generic deflator which is not output specific and are not related to GDP published by Statistics New Zealand.
- These data are not standard output and as such are not available in any other cross-tabulations.
- Figures expressed in terms of 1997 dollars.

accounted for 38 percent of total output in 2002, with small enterprises making up over half of that portion.

Figure1 about here

The regional make-up of SMEs, as shown in Figure 1 sourced from MED 2004a, is heavily biased toward Auckland, reflecting the concentration of population in that region. Other regions while exhibiting numbers far less than Auckland, nevertheless, have a significant number of firms which may present potential for stimulating employment and product growth throughout most regions.

From Figure 2 it is apparent that the proportion of total employed varies from 36.7% in Wellington, the nation's capital with a strong public sector base, to 57.3% in Tasman, a tourist oriented horticultural and agricultural region.

Figure 2 about here

The linkage between regional policy and SME performance requires further research. Karlsson and Dahlberg (2003) discuss three factors they consider to be of particular importance regarding how the regional context relates to SME performance. First, social capital transmission is typically bounded by region differences. This view is supported by the Westlund and Bolton (2003) who describe how the social capital platform enhances SME surplus generation, noting that social capital variability is consistent with spatial differences in SME performance. Second, knowledge is suggested as being rooted in regions. The accession and participation in knowledge requires geographical proximity. SME clusters, industry training organisations and tertiary education provision tend to have a regional base. Third, the regional dimensions of geographical transaction costs, internal and external economies of scale, and self reinforcing growth are of significance in determining sustainable SME performance.

Until relatively recently there were few empirical data, for New Zealand, providing a comprehensive oversight of regional economic performance.

### **REGIONAL PERFORMANCE**

The lack of regional economic accounts poses a range of difficulties for the assessment of regional economic performance. A recent official study found:

- Economic activity and growth are unequally distributed amongst New Zealand regions.
  - The inequality between New Zealand regions is not substantial, with some notable exceptions.
  - Canterbury and Wellington are regional star performers, while Northland has under-performed.
  - A significant portion of inter-regional economic variation appears to be explained by labour market and demographic variation (although this partly relates to the method of regional GDP estimation employed).
-

- Gaps in regional data make explaining inter-regional economic variation difficult. (MED, 2004a).

The report considers a number of industrial classification groupings such as government, agriculture, etc. and compares the share of nominal national GDP with regional GDP. The proportion of national GDP is plotted on the Y axis and the proportion of regional GDP is plotted on the X axis. Figure 3, which is Figure 22 in the MED report, presents the position for the Waikato region. It is apparent that the Waikato is strongly represented by the Agricultural sector, plotting well to the right of the diagonal line. Anything plotting on the diagonal indicates the region is equal to the national average. The Waikato is under represented by business services.

Figure 3 about here

New Zealand Trade and Enterprise is the government agency charged with delivering regional development programmes. The primary thrust of their services includes:

1. Business development:
  - businesses starting up and at an early stage of development.
  - businesses seeking to grow and internationalise: including new exporters, high growth businesses and other exporters.
  - investment services, providing New Zealand business information as well as extensive networks for investors seeking existing and start-up New Zealand-based ventures with excellent future potential.
2. Business Partnerships:
  - Supporting companies working together in export networks and regional and national clusters to achieve higher growth.
3. Regional Development:
  - Working with and funding regions to grow by encouraging them to focus on their regional advantages.
4. Industrial Capability Network:
  - Providing access to government markets through a low cost, one port of call service.
  -

### **SME FINANCIAL STRUCTURE**

Financial ratios are widely used for investment analysis and other purposes relating to large and small businesses alike. It is generally accepted that certain ratios are of importance in terms of performance while others are more closely associated with liquidity and solvency. These matters are widely discussed in accounting texts and more specialist books directed toward financial statement analysis, eg White et al (2003). It is further recognised that financial ratios may vary between industries and between countries. Walsh (2004) appendix 3 provides examples of the distribution of many key financial ratios across several industry groupings and countries. In Figure 4 below an illustrative extract is presented.

Figure 4 about here

As is apparent there is variability in the ratio both between sectors and between countries. Similar findings are reported by Walsh across a broad range of ratios.

Financial ratios are widely used in lending decisions by financial institutions, credit rating, performance assessment and forecasting future performance. The movement

to use more than one financial ratio in the decision calculus, ie multivariate analysis rather than univariate analysis increasingly leads to more sophisticated statistical techniques. Altam (1968) used discriminant analysis to develop and test a bankruptcy prediction model. The study involves dividing a sample of companies into two groups, viz those that failed and non-failed. Each financial ratio is arranged as a descending array, ie from highest to lowest value. The discriminant analysis technique determines the optimal cut-off point for discriminating between the failed and non-failed groups.

Subsequent studies have tended to focus on many of the same ratios. Gentry et al (1984) reported on 14 multivariate studies noting that liquidity and solvency ratios were the most commonly used followed by profitability and activity ratios. Recent studies have considered the performance of companies and looked at the ratings awarded by rating services such as Standard and Poor.

Potentially, similar differences might be detected between SMEs based in large city, provincial city, town and rural environments. If the financial structure of small business does differ between urban, provincial and rural areas, then this may provide a clearer guidance as to where to target policies in order to affect growth increases. A sufficiently robust set of financial data is a precursor to such an empirical investigation.

#### **DATA**

Financial statements for the SME sector are not readily available in New Zealand as there is no requirement for smaller businesses to file annual reports as is the case for larger companies. Although taxation returns are compulsory these are not available in the public domain. For the purposes of this study data for a sample of small businesses are extracted from an annual survey of SMEs undertaken by the Management Research Centre of the University of Waikato for the Institute of Chartered Accountants. Changes to the annual financial statement survey, which has been conducted for 27 years, introduced in 2003 allow for the tracking of individual businesses through a confidential unique numbering system. Data on 35 financial ratios, as shown in Table 1, are available for over 3000 businesses and it is possible to match 1700 firms as present in the 2003 and 2004 surveys. The actual collection instruments are completed by chartered accountants, with the permission of their client businesses, and aggregate results are made available to members of the Institute of Chartered Accountants and extensively used for benchmarking purposes. Prior research, using the MRC data has established the robustness of the data (Locke, (2002), Locke and Scrimgeour (2003)).

Table 1 about here

#### **ANALYSIS**

The aim of the analysis is to establish whether it is possible to determine accurately whether businesses operate in major urban cities, provincial towns or rural centres based upon the value of some of their financial ratios. The analysis proceeds through a series of steps.

First, are the financial ratios for firms across regions the same? In order for the ratios to have a role in discriminating between regions there needs to be a difference in ratio values between regions. Various statistical tests are available to consider this question.

In particular they are testing a hypothesis that there is no difference in the ratio values between regions. An analysis of variance (ANOVA) test is undertaken as the simplest way to proceed. Several further statistical procedures are undertaken to ensure the robustness of the analysis. As the power of test statistics are affected by such issues as the variance of the ratios refinements are followed to limit the potential error of determining the ratios are the same between regions when they are different and vice versa<sup>3</sup>. Post hoc tests<sup>4</sup> are undertaken to minimise the likelihood of finding a specific ratio differs between regions when it does not. In addition to the ANOVA procedure pair-wise T-tests were taken for the different regional classifications for all ratios to test the hypothesis that the ratios are the same. After these processes it was found that some ratios do differ between regions.

Table 2 about here

The initial analysis indicates that there are statistically significant differences between regions for some financial ratios. The stability of the differences between years was tested by comparing 2002 and 2003. For the majority of ratios where a difference is exhibited in one year it continues to be the case for the next year.

The second question to investigate is whether knowing the ratio values will allow for accurate prediction of where the business is located. Discriminant analysis is applicable for building “a predictive model of group membership based on observed characteristics of each case. The procedure generates a discriminant function (or, for more than two groups, a set of discriminant functions) based on linear combinations of the predictor variables that provide the best discrimination between the groups.” (Field, 2003, p 342).

The results of the discriminant analysis indicate that three variables were capable of discriminating between the three regional settings urban, provincial and rural. The three financial variables are:

- Cost of Goods Sold
- Total Overheads
- Working owners (fulltime equivalents)

### **POLICY IMPLICATIONS**

The findings suggest there are financial differences in the ratios of SMEs in different geographical regions. To the extent that government policy is directed toward strengthening the SME sector further investigation of the ratio differences could prove fruitful. The times-interest-coverage ratio is both lower and has a lower variance for SMEs in non-metropolitan centres. An investigation of why may determine that given the majority of financial institutions operate nationally there may be a lower degree of business specialisation available in non-metropolitan settings and a higher degree of conservatism operates. Potentially such an inhibition in using increased gearing may lower growth opportunities. Structural differences in the ratios may assist in pointing to issues requiring regional policy refining.

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<sup>3</sup> Levene test

<sup>4</sup> The tests used are Tamhane, Dunnett T3, Games-Howell and Dunnett C.

Where government policy, as noted in the discussion above, is more directed toward SMEs with growth, and especially exports oriented growth, the financial structure in terms of growth readiness is important. However, the findings to date do not indicate there is a clear statistical selection scanning process likely to emerge.

The government initiatives, in respect of lowering compliance costs, do bear directly on the cost of operations of SMEs. The statistically significantly higher overheads faced by business in metropolitan centres, however, are more closely attributed to rent differences.

Non-urban SMEs have a higher proportion of owner participation in the staffing. This is not necessarily a function of size and growth, however, further work is needed. However, the data indicates that firms in the upper quartile of growth (ratio 26) do have a higher number of employees per owner. A tentative hypothesis, nevertheless, is that employment readiness in non-metropolitan areas may be lower. This could have implications for rural education, apprenticeship schemes and tertiary/community education.

### **FURTHER RESEARCH**

The opportunity to investigate the structural differences between firms of differing lives and differing growth rates will be pursued using the current database. Hopefully it will soon be further augmented with the calendar 2004 data becoming available.

### **CONCLUSION**

The analysis has indicated that there are discernible and consistent differences in the financial structure of SMEs operating in metropolitan, provincial and rural areas of New Zealand. Government is becoming more active in policy formulation and implementation to assist the small business sector. The general thrust of policies is twofold. First, reduce compliance cost and second to assist businesses or clusters of businesses that look likely to exhibit significant growth, especially export oriented growth.

The regional development policy does not appear to be sufficiently clear, at this juncture, to establish a clear nexus between SME financial structures and government policy. To the extent that policy is looking for stability, employment growth and non-inflationary expansion, then the encouragement of more employees and less owner concentrated participation is likely to be of significance in the non-urban centres.

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Figure 1.  
Number of geographic Units with 0-19 full time equivalent employees by regional council

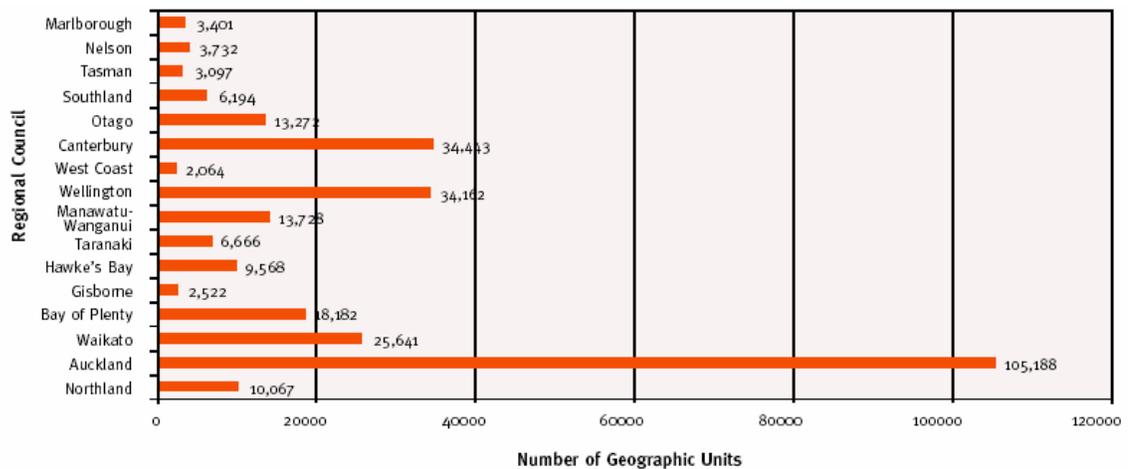


Figure 2.  
Percentage of full time employees employed by SMEs by regional council

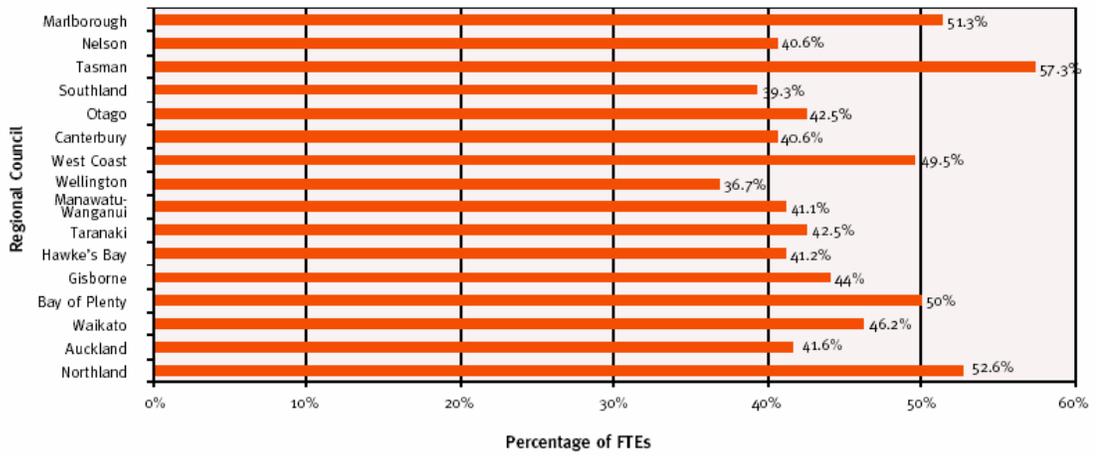


Figure 3

### Waikato's Industry Profile

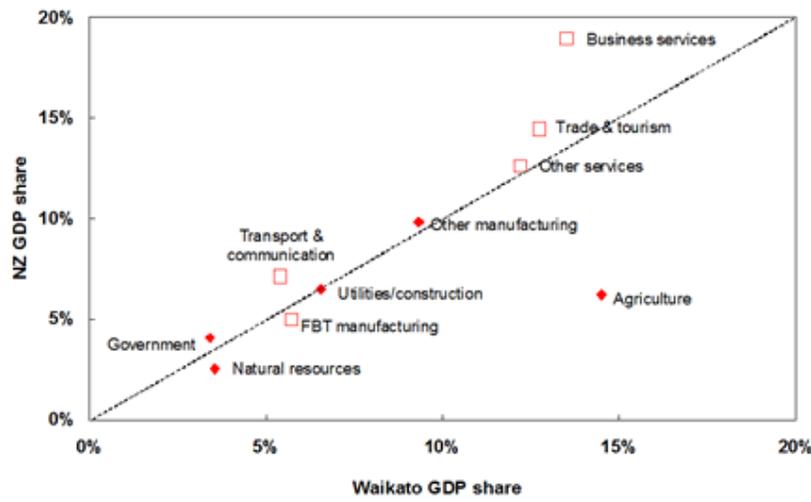


Figure 4

### Sales to Total Assets

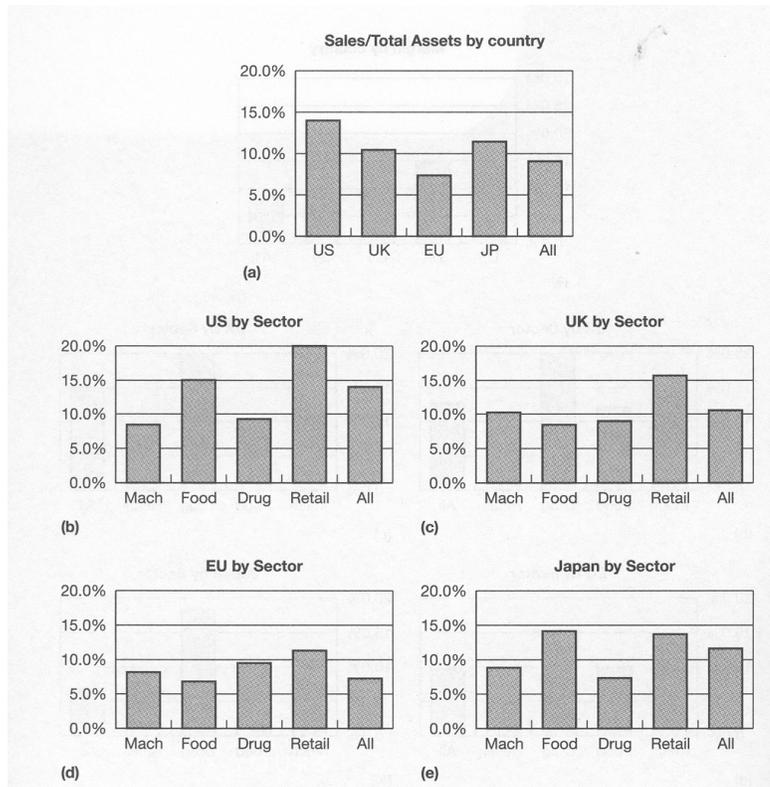


Table 1

Financial Ratio for Small Medium Enterprises

|    |   |
|----|---|
| 1  | Income – revenue and fees                 |
| 2  | Cost of Goods Sold                        |
| 3  | Gross Profit                              |
| 4  | Administration                            |
| 5  | Advertising and Promotion                 |
| 6  | Interest                                  |
| 7  | Occupancy expenses                        |
| 8  | Plant and equipment                       |
| 9  | Telephone and Fax                         |
| 10 | Vehicle expenses                          |
| 11 | Wages employees and labour only contracts |
| 12 | Other expenses                            |
| 13 | Total Overheads                           |
| 14 | Operating profit (% income)               |
| 15 | Operating profit                          |
| 16 | Net profit (% of income)                  |
| 17 | Net profit                                |
| 18 | Net profit per working owner              |
| 19 | Working owners (fulltime equivalents)     |
| 20 | Employed staff excluding owners           |
| 21 | Income revenues and fees per owners       |
| 22 | Gross profit per person                   |

|     |  |
|-----|--|
| 23  | Overheads (excluding wages) per person |
| 24  | Total Wages per number of staff        |
| 25  | Operating profit per person            |
| 26  | Growth in total income                 |
| 27  | Rent of premises                       |
| 28  | Debt to total assets                   |
| 29  | Times interest earned                  |
| 30  | Return on assets                       |
| 31  | Working capital                        |
| 32  | Quick Ratio                            |
| 33  | Debt collection period                 |
| 34  | Inventory turnover                     |
| 335 | Assets per person                      |

Table 2

Financial Ratios in Different Regions

| Test                                      | ANOVA       |             | T-test       |              |
|---|-------------|-------------|--------------|--------------|
|   | 2002        | 2003        | 2002         | 2003         |
| Year                                      | all regions | all regions | urban & rest | urban & rest |
| Ratio                                     | all regions | all regions | urban & rest | urban & rest |
| Income – revenue and fees                 | Different   | Different   | Same         | Same         |
| Cost of Goods Sold                        | Different   | Different   | Different    | Different    |
| Gross Profit                              | Different   | Different   | Different    | Different    |
| Administration                            | Different   | Different   | Different    | Different    |
| Advertising and Promotion                 | Same        | Same        | Same         | Same         |
| Interest                                  | Different   | Different   | Different    | Different    |
| Occupancy expenses                        | Different   | Different   | Different    | Different    |
| Plant and equipment                       | Same        | Same        | Same         | Same         |
| Telephone and Fax                         | Different   | Same        | Different    | Same         |
| Vehicle expenses                          | Different   | Different   | Different    | Different    |
| Wages employees and labour only contracts | Same        | Same        | Same         | Same         |
| Other expenses                            | Different   | Different   | Different    | Different    |
| Total Overheads                           | Different   | Different   | Different    | Different    |
| Operating profit (% income)               | Same        | Different   | Same         | Different    |
| Operating profit                          | Different   | Different   | Same         | Different    |
| Net profit (% of income)                  | Different   | Different   | Different    | Different    |
| Net profit                                | Different   | Different   | Different    | Different    |
| Net profit per working owner              | Different   | Different   | Different    | Different    |
| Working owners (fulltime equivalents)     | Different   | Same        | Different    | Different    |
| Employed staff excluding owners           | Different   | Different   | Same         | Same         |
| Income revenues and fees per owners       | Different   | Different   | Different    | Different    |
| Gross profit per person                   | Different   | Different   | Different    | Different    |
| Overheads (excluding wages) per person    | Different   | Different   | Different    | Different    |
| Total Wages per number of staff           | Different   | Different   | -            | Different    |
| Operating profit per person               | Same        | Same        | Same         | Same         |
| Growth in total income                    | Different   | Different   | Different    | Different    |
| Rent of premises                          | Same        | Same        | Same         | Same         |
| Debt to total assets                      | Same        | Same        | Same         | Same         |
| Times interest earned                     | Same        | Same        | Same         | Same         |
| Return on assets                          | Same        | Same        | Same         | Same         |
| Working capital                           | Same        | Same        | Same         | Same         |

|                        |           |           |           |           |
|------------------------|-----------|-----------|-----------|-----------|
| Quick Ratio            | Same      | Same      | Same      | Same      |
| Debt collection period | Same      | Same      | Same      | Same      |
| Inventory turnover     | Same      | Same      | Same      | Same      |
| Assets per person      | Different | Different | Different | Different |

Ethical Attitudes in Small Businesses and Large Corporations: Theory and  
Empirical Findings from a Tracking Study Spanning Three Decades

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**ABSTRACT**

The current paper offers a theoretical framework of ethical behavior and a comparative analysis of ethical perceptions of managers of large, mostly publicly-traded corporations (those with 500 or more employees) and the owners and managers of smaller companies (those with fewer than 100 employees) across 17 years. The primary research provides basic data on the changing standards of ethics and as perceived by leaders of large and small businesses, where the cultures frequently fall into sharp contrast.

Our findings reveal the extent to which the message of business integrity is gaining or losing ground within large and small companies. It does this by means of respondents' judgments of acceptable responses to 16 scenarios profiling common business situations with questionable ethical dimensions. Respondents were surveyed by mail and represented each state in the United States. They were also asked questions about themselves and their businesses, as well as the ethical climate within their companies.

Based on responses from over 5,000 managers and employees (from firms of all sizes) to our scenarios at three points in time (1985, 1993, 2001), we found evidence of trends in expected ethical behavior. We test two research questions by creating an Ethics Index.

These questions were: *RQ1: For firms of all sizes, have business ethics improved or*

*declined between the years 1985 and 2001? RQ2: Comparing responses of large and small firm executives across the 1985-2001 time frame, is there a discernable difference in their ethical standards?* Our results suggest business leaders are making somewhat more ethical decisions in recent years.

## **INTRODUCTION**

In the wake of recent, well-publicized ethical failures, public attention and the concern of leaders in business and government have focused on the moral climate of corporate America. This awareness and concern is raising expectations for ethical behavior, including those codified into law (e.g., Sarbanes Oxley legislation), and creating societal pressures for reform. Business leaders need to understand the nature and scope of the problem.

The media's focus on business ethics has related primarily to large, publicly-traded corporations. However, the issue of ethical behavior and indiscretion in business is a concern for all companies, regardless of size. Indeed, the rising importance of entrepreneurial firms to economic growth and development around the world has prompted some to criticize the limited attention small business receives in the ethics literature (e.g., Carr, 2003; Sorrell, 1998; Spence & Rutherford, 2003). It is our intent to shed light on ethical realities in firms of all sizes, with a special emphasis on small companies.

After unfolding a framework reflecting common streams of business ethics theory, especially as they apply to firms of different sizes, we establish a baseline for ethical perceptions of American business professionals over a 17-year period. Our findings reveal the extent to which the issue of

business integrity has varied in importance within large and small companies. The results are based on respondents' judgements of acceptable responses to 16 scenarios profiling common business situations with questionable ethical dimensions. Specifically, we track responses to an extensive questionnaire mailed to firms of various sizes at three points in time over an extended period. The study then offers a comparative analysis of ethical perceptions of managers of large, mostly publicly-traded corporations (those with 1,000 or more employees) and the owners and managers of smaller companies (those with fewer than 100 employees) across the same time frame. The research provides basic data on the changing standards of ethics as perceived by leaders of large and small businesses, where the cultures and circumstances may be in sharp contrast. It also provides information concerning pressures to act in ways that may be harmful to the public good.

The current study is unique in several ways. First, the findings are based the largest sample size used in any study on business ethics, with over 5,000 respondents included in the analysis. Second, the survey was administered at three points in time (1985, 1993, and 2001), collecting data that spans three decades. This allows us to look for general trends as well as for the impact of events and scandals in specific time periods. Third, the questionnaire has changed little over this time frame and has been handled by the same research team, thus ensuring consistency and comparability of data. Finally, the data are arranged to allow specific tests of differences between large and small firms, which is the focus of the study. These features, among others, set the current study apart from other tests of ethical standards conducted to date.

## ETHICAL PERCEPTIONS IN CORPORATE AMERICA

Each decade presents its own high-profile scandals. The Watergate break-in and subsequent hearings in the 1970s, followed by insider trading and a rash of corporate raiding in the 1980s; the Lewinski affair and impeachment proceedings in the 1990s; and the meltdown of corporate giants such as Enron, Arthur Anderson, WorldCom, Tyco, and Adelphia (to name only a few) just after the start of the current century. Bruce Nussbaum of *Business Week* described the latest round of corporate debacles as being "...so vast and so penetrating that they profoundly shock our most deeply held beliefs about the honesty and integrity of our corporate culture" (Nussbaum, 2002: 31-32).

The foregoing events have spawned common perceptions of ethical behavior in the U.S. that are strikingly negative. A number of empirical studies support these perceptions. For instance, Vitell, Dickerson, and Festervand (2000) asked 153 business professionals how ethical standards compare with those of the past. They found that 50.3% of the respondents said ethics were currently lower than they were 10 years earlier, compared to only 14.3% who said they were higher. Even more profound, 65.2% said ethical behavior had declined over the past 20 years, versus a mere 12.5% who thought ethical standards had risen. These findings provide evidence of perceived degradation in ethical standards over time.

Baumhart (1961) found that most business executives believe they are more ethical than their peers. In a subsequent study, Brenner and Molander (1977) replicated Baumhart's study and concluded that ethical standards had declined during the time that had passed (though they surmised that the decrease may have been an artifact of higher legal standards and increased

government enforcement). Over the 1980s, Zinkhan, Bisesi, and Saxton (1989) studied the responses of MBA students to marketing dilemmas and found erosion in ethical attitudes and responses. For the most part, participants were more willing to use deceptive advertising, be dishonest in marketing research, and employ questionable intelligence gathering methods.

The findings above are certainly consistent with the prevailing perceptions of ethical decline over time. However, other research initiatives seem to lean in the opposite direction. In 1987, Vitell and Festervand (1987) replicated the 1977 study by Bremer and Molander and found that ethical standards seemed to be higher than in the past, exactly the reverse of the previous extension. And they are not alone. The pattern repeats in other replications of similar studies. Though the results have not been completely uniform across all issues and situations, empirical evidence of improvement in ethical standards exists. Clark (1966) used responses to 11 vignettes to assess the “personal ethics” (i.e., commitment to honesty and integrity, even if it reduced personal gain) of 103 business executives. Using the same vignettes to permit valid comparisons, Harich and Curren (1995) surveyed 76 executives after a 30-year lag and found statistically significant improvements in ethical commitment.

While its studies mentioned above, found both positive and negative trends, other studies have not found any significant intertemporal changes. For example, Arlow & Ulrich, (1988), and Stevens, (1984) failed to find any statistically significant differences in responses after substantial time lags.

Taken together, the studies described above seem to represent a mixed bag of findings, at best. Given that no definite pattern or cogent theoretical position has emerged, we re-examine the issue of changing ethical standards by drawing on a sample of unequal size in earlier studies.

Therefore, we set up our test around the following research question:

*RQ1: For firms of all sizes, have business ethics improved or declined between the years 1985 and 2001?*

### **A FRAMEWORK FOR ETHICAL RESPONSES IN LARGE AND SMALL FIRMS**

Factors that influence ethical perceptions and behavior are multidimensional; that is, they are rooted in differences between individuals, variations in their organizational settings, and the interplay between the two. This orientation finds a firm foundation in recent psychological theory, as expressed by Kendrick, Maner, Butner, Li, Becker, & Schaller (2002: 347).

Rather than focusing exclusively on factors inside the person or in the environment, psychology is an increasingly interactionist discipline. Psychologists now envision internal predispositions interacting with environmental inputs to affect ongoing thoughts and feelings in a continual and dynamic manner.

Succinctly stated, ethical behavior does not emerge from the value sets of individuals in isolation from external influences, which is the upshot of established models in the ethics literature.

Trevino's (1986) "person-situation interactionist" model is one form of an ethical decision-making model that incorporates this perspective. She avers that these choices arise from personal variables (e.g., cognitive moral development, ego strength, locus of control), situational factors (e.g., the organization's normative structure, reward systems, and accountability emphases), and reflexivity between the two. Indeed, this general formulation is found in other frameworks in the ethics literature (Weaver & Agle, 2002). Though some suggest organizational influences overpower personal values in ethical decision making (e.g., Jackall, 1988), other

researchers argue for the critical role of individual factors and their interaction with situational circumstances. We offer below some of the highlights of this research to inform our discussion of the differences between entrepreneurs or small business managers and their large firm counterparts. The major factors described below are presented in Exhibit 1 and are discussed in the following two sectors.

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Insert Exhibit 1 about here  
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### **Personal Factors**

As reflected in Exhibit 1, there are a number of personal factors that may have an impact on an entrepreneur's ethical values and behavior. Let's consider each in turn.

**The Entrepreneurial Act.** Entrepreneurs are clearly unique individuals. And at the heart of the entrepreneurial act is the identification of opportunities that have not been tapped, often because of obstacles that stand in the way of their exploitation. However, overcoming these impediments can require the entrepreneur to walk a fine line between creative practice and maintaining the boundaries established by social convention—or even staying within the law. Nonetheless, entrepreneurs are often celebrated because of their creative solutions and “rule bending” efforts, many of which are effective precisely because the entrepreneur is willing to enter regions of opportunity that can be accessed only by passing through behavioral gates that most people would hesitate to open (Morris, Schindehutte, Walton, & Allen, 2002).

Bhide and Stevenson (1990) mention the deceptive practices employed by Philippe Kahn, founder of Borland International, a startup launched to develop and market programming

languages and software applications for personal computers. At a critical juncture in its history, the company would not have survived if it had not placed a full-page ad in the November 1993 issue of *BYTE* magazine to reach a critical market and drive demand for its product. However, there was no way the company could afford the ad, and the venture was so high-risk that the magazine would not have extended credit terms—that is, if they had known the true condition of the business. Kahn describes, with apparent relish, how he solved the problem.

...before the ad salesman came in—we existed in two small rooms, but I had hired extra people so we would look like a busy, venture-backed company—we prepared a chart with what we pretended was our media plan for the computer magazines. On the chart we had *BYTE* crossed out. When the salesman arrived, we made sure the phones were ringing and the extras were scurrying around. Here was this chart he thought he wasn't supposed to see, so I pushed it out of the way. He said, "Hold on, can we get you in *BYTE*?" I said, "We don't really want to be in your book, it's not the right audience for us." You've got to try," he pleaded. I said, "Frankly, our media plan is done, and we can't afford it." So he offered good terms, if only we'd let him run it just once. We expected we'd sell maybe \$20,000 worth of software and at least pay for the ad. We sold \$150,000 worth (Bhide & Stevenson, 1990: 122-123).

This story illustrates how the entrepreneurial act, at its core, can sometimes spawn its own ethical dilemmas, and long-time or serial entrepreneurs may find it difficult to separate the entrepreneurial from that which is arguably unethical. These issues are less likely to arise in large corporations.

**Cognitive Moral Development.** Lawrence Kohlberg's (1969) theory of cognitive moral development (CMD) is often mentioned in discussions of ethical decision making. This theory posits that each person, as a result of life experiences, develops cognitive skills that guide decision making related to moral issues. It follows that individuals make different moral judgements about an issue depending on their level of CMD. Those who are at the preconventional level (stages one and two) make decisions based on concrete personal

consequences (i.e., anticipated rewards and punishments). The conventional level (stages three and four) emphasizes conformity mostly to societal expectations. The principled level (stages five and six) is the highest, and at this point the focus shifts to broad ethical principles. In accord with Kohlberg's theory, Trevino and Youngblood (1990) used an in-basket experiment to show that higher CMD participants made more ethical decisions, and research by Stratton, Flynn, and Johnson (1981) found that students who rejected an expense-padding practice used higher levels of CMD to support their decisions.

Expanding the application of this framework, Teal and Carroll (1999) assessed the CMD level of a sample of entrepreneurs and compared their scores to a baseline established by previous research (Rest, 1986). They found that 30.77% of the owner/managers in their sample had *P*-scores (a common measure of CMD) above 50. Because Rest reports that *P*-scores above 50 are relatively rare, Teal and Carroll concluded from the performance of their sample that entrepreneurs may operate at a higher level of CMD than others and thus are likely to maintain higher ethical standards (Solymossy & Masters, 2002).

**Locus of Control.** Research also has shown that entrepreneurs tend to have a strong internal locus of control (Shaver & Scott, 1991); that is, they believe their destiny or experienced outcomes are a function of the effort they expend, rather than the result of life factors that are beyond their power (an external locus of control). This may have ramifications for ethical behavior. According to interactionist logic, the influence of environment can be substantial; however, because entrepreneurs tend to have a stronger internal locus of control, it follows that they are more likely to make decisions based on their personal ethical standards, rather than

rationalizing their behavior by attributing it to external factors (Hegarty & Sims, 1978).

However, research on the issue is mixed. Zahra (1989) and McCuddy and Peery (1996) found that external locus decision makers are less sensitive to problems with unethical behavior, but Hegarty and Sims (1978, 1979) did not find support for such a linkage with ethical standards. Implications for ethics in small versus large firms thus appear to be equivocal.

**Need for Achievement.** Entrepreneurs often have a high need for achievement (Begley & Boyd, 1987; McClelland, 1961; Miller, 1983; Solymossy, 1998), which may have ramifications for ethical decision making. Need for achievement may negatively impact ethics by the influence it has on business priorities. If entrepreneurs are focused on achievement, then they may be inclined to sacrifice other concerns, including their personal ethics. Offsetting this line of reasoning, research has indicated a positive link between need for achievement and moral development (e.g., Glover, Bumpus, Logan, & Ciesla, 1997; McClelland, 1961), where the latter is associated with higher ethical standards. Thus, the connection between achievement need and ethics is unclear.

**Machiavellianism.** Another personal factor hypothesized to play a role in ethical perceptions and decision making is machiavellianism, which relates to a willingness to influence others for the sake of personal achievement. Entrepreneurship is often associated with machiavellian tendencies that can lead to the bald exploitation of others and ethical compromise. King and Roberts (1992) caution that entrepreneurs can be master manipulators who are quick to take advantage of others unless they are restrained by adequate accountability. The profile suggests that entrepreneurs are less likely to be guided by high ethical standards than others who are less

imbued with machiavellianistic inclinations (Morris et al., 2002). This is consistent with Longenecker, McKinney, and Moore's (1988) speculation that entrepreneurs are more inclined toward egoism (i.e., viewing an act as moral if it promotes the individual's best long-term interests) and are thus less ethical in their behavior.

**Social Costs.** Some researchers focus on the social dimension of small business as a factor that differentiates the ethical practices of entrepreneurs from those of their large firm counterparts. They emphasize that small companies have unique needs and circumstances, and studies show that they are very sensitive to some ethical issues and much less so to others (Longenecker et al., 1989; Vitell et al., 2000). Furthermore, small firms are likely to be owner-managed, which sets up very different dynamics from those found in large corporations, where ownership and management are separated for the sake of gains from specialization. As a result, the ethical values and inclinations of the small business owner have a far more direct affect on the practices of the business as a whole (Spence & Ruthrefoord, 2003).

It is also true that the business relationships and personal networks of small company owner-managers often overlap substantially, which increases the social cost of unethical decisions. Brass, Butterfield, and Skaggs (1998) refer to this as "multiplexity" (i.e., the degree to which individuals share more than one relationship, such as those who have business dealings but also are close friends, neighbors, or members of the same church) and describe how this tends to constrain business behavior. If multiplexity is present, then maintaining high ethical standards in the marketplace can reduce the probability of strained relationships in other contexts, which discourages unscrupulous behavior. In addition, an owner/manager's sense of personal identity

tends to be tightly coupled with the enterprise, so reputation is highly prized and carefully guarded. In fact, Mayo (1991) reports that entrepreneurs are often more concerned about the impact of their business conduct on their reputations than on the performance of their ventures. And given the crucial role of trust in building relationships with suppliers, customers, creditors, and others, reputation can be an essential platform for enterprise growth (Aldrich & Fiol, 1994). Based on these arguments, it follows that the social dimensions of entrepreneurship play an important role in promoting ethical behavior in small companies.

### **SITUATIONAL FACTORS**

As indicated by Trevino's (1986) person-situation interactionist model, there are also situational factors, as well as personal factors (some of which are outlined above), that impact the ethics of organizational decision makers. Some of these relate to the environment of entrepreneurial firms, broadly defined, while others are institutional in orientation or relate to the agency relationships that are established in organizations. We will discuss each of these in turn.

**Environmental Factors.** Morris et al. (2002) outline a number of "environmental forces" to which entrepreneurial firms are uniquely subject, including cash reserve limitations, dependence on a narrow range of product or service offerings, and limited market presence, which leaves the firm vulnerable to disabling fluctuations in demand, competitive attacks, and supplier or distributor neglect. Added to this list of contextual factors is the liability of smallness and the liability of newness, which recognize, respectively, that entrepreneurial firms often lack scale advantages and are prone to make mistakes as a result of inexperience (Aldrich & Auster, 1986;

Morris & Zahra, 2000). Morris et al. (2002: 333) explain that these factors are relevant to ethics in entrepreneurial firms because

... [they] often result in conditions that encourage or justify ethical compromises. These conditions include time pressures, cash shortfalls, the fact that making compromises can mean the difference between venture survival and failure, the power position of the entrepreneur, the lack of reference points for acceptable and unacceptable behaviors, and the reduced public visibility of the firm. Further, and contrary to arguments made by both ethicists and economists, there may be no payoff for ethical behavior.

Indeed, the circumstances faced by entrepreneurs are often so hostile and challenging that the incentive to compromise ethically may seem impossible to overcome, especially when slack resources are limited and the margin for error is squeezed. And these pressures are only intensified by the fast-paced environment of the Internet age.

**Institutional Factors.** There is no question that large firms have had more time to develop the institutional infrastructure necessary to guide decision making. In fact, this can work against the organization when it engenders inertia that moves the corporation along a stable vector that precludes adjustment to changing trends and emerging conditions. However, when it comes to ethical standards and actions, at least “institutional scaffolding” can be set up to support and engender responsible decisions.

Ethical decision making enhancement can either be formal or informal in nature. Formal systems often emerge as ethics policies or an established code of ethics guide and normalize decision making, but research indicates that these are far more prevalent in large corporations than in small businesses. Robertson (1991) found that 60% of the large firms in her study had a written code of ethics and 38% had ethics training programs. This finding stands in stark

contrast to small firms in her sample, where only 33% had a written code and a mere 7% had organized for ethics training. This difference suggests that decision making in large firms is more likely to be constrained by an established ethics framework, and thus its managers should be more ethical, and consistently so, than those of small companies.

In contrast, informal systems evolve naturally and are not so much a product of deliberate design. As a venture grows and develops, the founder gains managerial experience and additional managers are hired to join the enterprise. Decision making then becomes a group effort, and the focus shifts from a solo entrepreneur to a management team that that may be less likely to compromise its ethical standards to create gains that will flow toward someone else (in this case, the founder/owner). Also, with growth comes public accountability, professional management, and organizational norms and reward systems, all of which tend to shape decision making to be more consistent and more ethical. Taken together, these factors suggest that established (larger) firms will have a more developed sense of ethical standards, and the formal and informal systems to promote these standards.

**Agency Factors.** One of the distinctive features of small business is that there usually is no separation between ownership and management. When the firm grows and develops to the point where an agency relationship becomes necessary—i.e., the owner(s) decide to delegate decision-making authority to professional management—the dynamics of decision making inevitably shift (Jensen & Meckling, 1976). According to agency theory, this new arrangement opens the door to managerial opportunism, which is the risk that managers will make decisions that serve their own interests, often at the sacrifice of those of the owner(s). The misalignment of incentives

(managers working to maximize their compensation and other personal benefits while owners seek greater returns on their investment) can lead to a variety of problems (Jacobides & Croson, 2001).

The implications of agency problems for ethical standards in decision making are not readily apparent. On the one hand, the separation of ownership and management (especially if the firm goes public) may encourage the lowering of ethical standards. If a manager's sense of personal identification with the firm is not as great as a founder's, the incentive to compromise for the sake of increased compensation increases. But on the other hand, Morris et al. (2002) point out that as the founder develops as a manager and hires others to join the business, the focus often shifts from self-interest to ethical correctness, which may mitigate against the ethical downside of managerial opportunism. In any case, evidence exists to suggest that agency effects impact ethical perceptions. In a study of the ethical perceptions of respondents from both large and small firms, Longenecker, McKinney, and Moore (1989) found that agent/managers and owner/managers differed in their responses to 12 of the 16 scenarios in the researchers' questionnaire. Specifically, support for differences in ethical sensitivity was split between the two groups—owner/managers indicated higher ethical standards on six scenarios and lower standards on the remainder. As these findings illustrate, the impact of agency effects is not monolithic.

### **Summary of Ethical Theory**

Taken together, the personal and situational factors outlined above present a mixed picture of the influence firm size should have on ethical standards and practice. While features of the

entrepreneurial act itself and the tendency of entrepreneurs to lean toward machiavellianism suggest that small firms' decision making is likely to be *less* ethical, evidence of higher levels of cognitive moral development among entrepreneurs and the reputational and social capital they have at risk in their enterprises should lead them to act *more* ethically. The remaining factors (locus of control and need for achievement) seem to fall somewhere in between. Situational factors (environmental, institutional, and agency) argue more for lower ethical standards in small businesses, but the evidence is still quite equivocal. Overall, we see no overwhelming argument for or against higher ethical standards in small companies vis-à-vis their large firm counterparts, and therefore we intend to test the following research question:

*RQ2: Comparing responses of large and small firm executives across the 1985-2001 time frame, is there a discernable difference in their ethical standards?*

## **METHODOLOGY FOR BASELINE STUDIES**

### **Source of Primary Data**

Attitudes concerning ethical issues were probed in three nationwide mail surveys of managers and professionals in both large and small firms. The database used for analysis of our two research questions was based on surveys conducted in 1985, 1993, and 2001. In all three surveys, identical methodology was used. A questionnaire was sent to ten thousand individuals each year identified as business professionals by publishers of major business periodicals. A systematic sampling procedure was used by the mailing list vendor to generate the mailing list, excluding from the sampling frame anyone identified as a student subscriber.

## **Measurement of Ethics**

The six page questionnaire developed for our ethics research contained sixteen vignettes, each involving a business decision having ethical overtones. See Exhibit 2 for a list of the vignettes used in the 1985 survey. The dollar amounts included in Vignette A were adjusted upward in the 1993 and 2001 questionnaire to reflect inflation. Otherwise, the wording of all vignettes were identical from survey to survey. Respondents were asked to indicate the degree to which they found each action compatible with their own ethical views. They recorded their opinions by circling a seven-point scale ranging from 1 (never acceptable) to 7 (always acceptable). The midpoint on the scale, 4, was labeled “sometimes acceptable”; points 2, 3, 5 and 6, which were not labeled, represented intermediate positions between those defined.

The vignettes dealt with a wide variety of business situations and were designed to address ethical issues of varying loyalty in different functional areas of business. Some are clearly illegal, whether recognized as such by respondents or not, while others involve questionable or debatable ethical characteristics.

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Insert Exhibit 2 about here  
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The use of scenarios or vignettes, according to Fritzsche and Becker (1982), permits one to inject more background information and detail into an ethically questionable issue. A questionnaire incorporating vignettes into its design, therefore, is thought to elicit a higher quality of data in this type of research than is possible from simple questions (Alexander and Becker, 1978). The

potential for systematic bias was minimized by having knowledgeable individuals assess the content or face validity of the vignettes prior to their inclusion in the questionnaire.

Additional questions classified respondents according to age, size of firm, employment level, and other customary survey classification variables.

Once the survey responses were accumulated, edited and entered into a database, an overall Ethics Index was computed for each individual by summing their responses to the sixteen vignettes and computing an arithmetic mean.

## **ANALYSIS AND RESULTS**

### **Responses to Surveys**

As can be seen in Exhibit 3, the response rates to the three surveys ranged from a high of 22.7% in 1985 to a low of 12.3% in 2001. We recognize the ever present possibility of non-response bias in databases when response rates are not near 100%. Unfortunately, financial constraints precluded the additional mailings that researchers sometimes use to build higher overall response rates. We would note, however, that response rates in and of themselves do not indicate whether the respondents are representative of the original sample (Malhotra, 1999). Furthermore, all analyses in this paper focus on differences in the sample. No claim is made that the means of the entire sample represent those of the sample population. Therefore, while a higher response rate would certainly have been desirable, for the analysis conducted here it is not crucial. We were encouraged that respondents came from every state in the United States and represented a wide range of management levels, professions, ages and business sizes, and that we do have large absolute numbers for all our analyses.

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Insert Exhibit 3 about here  
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A brief profile of the three samples is shown in Exhibit 4. Notice that some characteristics, such as gender, were not identified in the 1985 survey. Size of the firm, which is one major focus in this paper was measured in each survey.

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Insert Exhibit 4 about here  
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### **Analytical Techniques**

SPSS was used to analyze the data and to generate frequencies and other descriptive statistics. The ANOVA routine in SPSS for Windows was used to determine statistically significant differences between the Ethics Index measures.

### **Evaluation of Research Question 1**

In an earlier section we discussed the issue of overall change in the attitudes of business regarding ethics. We proposed the following research question:

*RQ1: For firms of all sizes, have business ethics improved or declined between the years 1985 and 2001?*

Exhibit 5 displays data representing the Ethics Index for all respondents by survey date regardless of firm size. As you can see, the Ethics Index for 2001 is mathematically less than the Index for 1993 and the 1993 Index is mathematically less than the one for 1985. An ANOVA F-test reveals that these differences are also statistically significantly different ( $p < .000$ ).

Remember, a lower Ethics Index value carries the meaning of a more ethical stance. *Our database shows a trend toward higher ethical standards over this 17 year period!*

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Insert Exhibit 5 about here  
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## **Evaluation of Research Question 2**

Our second interest was whether we might see a difference in the ethical changes when we compared large against small firms. The research question stated again is:

*RQ2: Comparing responses of large and small firm executives across the 1985-2001 time frame, is there a discernable difference in their ethical standards?*

To address this question we compared the Ethics Index of large firm respondents (1,000 or more employees) with small firm respondents (100 or less employees). Exhibit 6 displays the Ethics Index scores for this comparison. Although there are slight mathematical differences in the 1985 and the 2001 surveys, they are not statistically significant. However, in the 1993 survey the Ethics Index for the large firms (2.42) is statistically different from the small firm Ethics Index (2.56). Note that the Indexes for 1993 indicate a more ethical stance among the large firms.

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Insert Exhibit 6 about here  
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## **DISCUSSION AND IMPLICATIONS**

Our initial results suggest that business owners and managers are making more ethical decisions in recent times. The respondents show increasingly positive selections in their responses to the 16 vignettes across the time frame examined, as reflected in an Ethics Index. We also observed that small business respondents showed a propensity to be less ethical when responding to our vignettes in the 1993 study. Otherwise, there are no significant differences in responses between small and large firms.

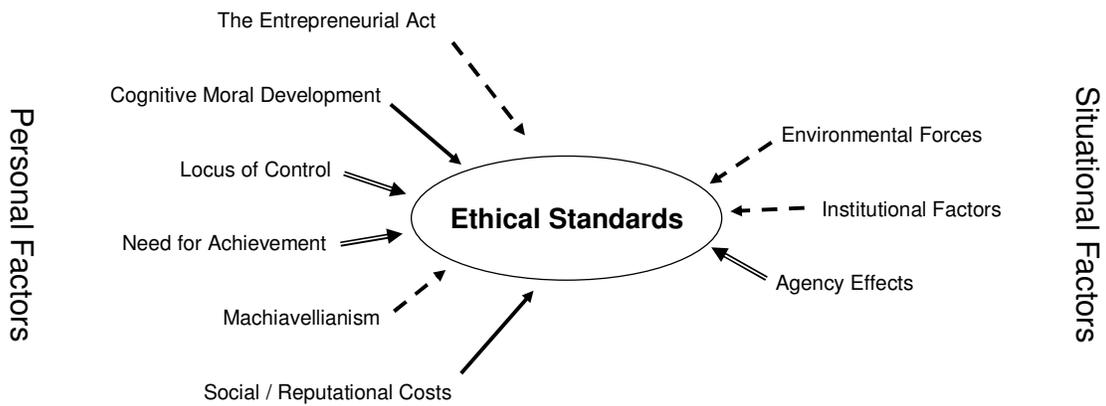
Given that the Ethics Indexes were significantly different between small and large firms only in 1993, and not in 1985 and 2001, we cannot draw a general conclusion that owners and managers of smaller firms are more or less ethical than executives in larger companies. Thus, we are left to conclude that personal factors and situational factors described previously may not always yield general differences in ethical values and behavior between leaders in small and large companies.

The fact that small owner/managed firms are very different from large corporations where ownership and management are separated, does not appear to result in different perceptions about ethical behavior. While the ethical values and inclinations of the small business owner should have a far more direct consequence on the practices of the business as a whole, they do not seem to be fundamentally different from their larger counterparts. Moreover, the findings suggest that the overlap of business relationships and personal networks of small company owner-managers do not lead to material differences in ethical behavior from managers in larger firms.

### **FUTURE RESEARCH**

Given the amount and richness of the data compiled over the 17-year time period, there is opportunity—and need—to extend the research. We believe several issues deserve attention. First, we can examine the informational content found in the individual vignettes, rather than relying only on an overall Ethics Index. In doing so, there may be differences that are not apparent in an overall index measurement. Second, we could use the data to compare the perceived pressures for managers/owners to act unethically and whether the pressures have changed over the 1985-2001 period overall and by firm size. This information should allow us to draw conclusion about the impact of situational factors in small versus larger companies.

**Figure 1. Personal and Situational Factors Impacting Ethical Standards**



*Note:* Arrows represent the nature of the impact for small firms. A negative linkage (dashed arrows) indicates that the factor has an unfavorable influence on ethics for small firms compared to large firms, while a positive linkage (solid arrows) shows a favorable impact for the same. Inconclusive effects are represented with double-lined arrows.

**Exhibit 2**  
**Ethical Vignettes Used in Survey**

- A. An executive earning \$50,000 a year padded his expense account by about \$1,500 a year.
- B. In order to increase profits, a general manager used a production process which exceeded legal limits for environmental pollution.
- C. Because of pressure from his brokerage firm, a stockbroker recommended a type of bond which he did not consider a good investment.
- D. A small business received one-fourth of its gross revenue in the form of cash. The owner reported only one-half of the cash receipts for income tax purposes.
- E. A company paid a \$350,000 “consulting” fee to an official of a foreign country. In return, the official promised assistance in obtaining a contract which should produce \$10 million profit for the contracting company.
- F. A company president found that a competitor had made an important scientific discovery, which would sharply reduce the profits of his own company. He then hired a key employee of the competitor in an attempt to learn the details of the discovery.
- G. A highway building contractor deplored the chaotic bidding situation and cutthroat competition. He, therefore, reached an understanding with other major contractors to permit bidding which would provide a reasonable profit.
- H. A company president recognized that sending expensive Christmas gifts to purchasing agents might compromise their positions. However, he continued the policy since it was common practice and changing it might result in loss of business.
- I. A corporate director learned that his company intended to announce a stock split and increase its dividend. On the basis of this information, he bought additional shares and sold them at a gain following the announcement.
- J. A corporate executive promoted a loyal friend and competent manager to the position of divisional vice president in preference to a better qualified manager with whom he had no close ties.
- K. An engineer discovered what he perceived to be a product design flaw which constituted a safety hazard. His company declined to correct the flaw. The engineer decided to keep quiet, rather than taking his complaint outside the company.
- L. A controller selected a legal method of financial reporting which concealed some embarrassing financial facts, which would otherwise become public knowledge.

- M. An employer received applications for a supervisor's position from two equally qualified applicants but hired the male applicant because he thought that some employees might resent being supervised by a female.
- N. As part of the marketing strategy for a product, the producer changed its color and marketed it as "new and improved," even though its other characteristics were unchanged.
- O. A cigarette manufacturer launched a publicity campaign challenging new evidence from the Surgeon General's office that cigarette smoking is harmful to the smoker's health.
- P. An owner of a small firm obtained a free copy of a copyrighted computer software program from a business friend rather than spending \$500 to obtain his own program from the software dealer.

**Exhibit 3**  
**Frequencies and Response Rates to the Three Ethics Surveys**

| <b>Survey Year</b> | <b>Number of Respondents</b> | <b>Response Rate</b> |
|--------------------|------------------------------|----------------------|
| 2001               | 1,234                        | 12.3%                |
| 1993               | 1,875                        | 18.8%                |
| 1985               | 2,267                        | 22.7%                |

**Exhibit 4  
Sample Profile**

| <b>Age Group</b>                                  | <b>Percentage Respondents</b> |                |                |
|---|-------------------------------|----------------|----------------|
|   | <b>2001(%)</b>                | <b>1993(%)</b> | <b>1985(%)</b> |
| 21-30   | 3.4                           | 10.5           | 9.5            |
| 31-40   | 14.1                          | 30.1           | 29.8           |
| 41-50   | 34.6                          | 35.4           | 29.2           |
| 51-60   | 34.5                          | 18.5           | 22.8           |
| 61-70   | 13.4                          | 5.5            | 8.7            |
|   |                               |                |                |
| <b>Industry</b>                                   |                               |                |                |
| Manufacturing                                     | 13.5                          | 23.3           | 43.5           |
| Construction                                      | 18.1                          | 8.9            | 6.3            |
| Retail/Wholesale                                  | 5.3                           | 5.5            | 4.6            |
| Services  | 16.7                          | 15.5           | 8.7            |
| Finance/Insurance                                 | 5.2                           | 8.6            | 5.2            |
| Government  | 5.3                           | 6.7            | 3.4            |
| Transportation/Communication/<br>Public Utilities | 11.7                          | 13.1           | 11.6           |
| Other   | 24.2                          | 18.4           | 16.7           |
|   |                               |                |                |
| <b>Size of Firm<br/>(number of employees)</b>     |                               |                |                |
| Under 20  | 35.4                          | 24.4           | 19.4           |
| 20-99   | 18.6                          | 13.3           | 16.7           |
| 100-249   | 9.1                           | 8.9            | 10.6           |
| 250-999   | 13.3                          | 12.9           | 14.1           |
| 1,000-10,000                                      | 14.3                          | 20.9           | 21.0           |
| Over 10,000                                       | 9.3                           | 17.6           | 18.2           |
|   |                               |                |                |
| <b>Current Employment Status</b>                  |                               |                |                |
| Top Management                                    | 53.3                          | 32.9           | 27.0           |
| Middle Management                                 | 29.4                          | 35.4           | 24.5           |
| Lower Management                                  | 7.0                           | 17.1           | **             |
| Non-Management                                    | 10.3                          | 14.6           | **             |
| Other   | -                             | -              | 48.6           |
|   |                               |                |                |
| <b>Gender</b>                                     |                               |                |                |
| Female  | 16.4                          | 14.7           | **             |
| Male  | 83.6                          | 85.3           | **             |

\* Percentages computed based on absolute frequencies in categories shown.

\*\* Not identified in 1985 survey.

**Exhibit 5**  
**Ethics Index for Respondents: 1985, 1993, and 2001 Surveys**

| <b>Survey Year</b> | <b>Mean Scores*</b> | <b>Sample Size(n)</b> |
|--------------------|---------------------|-----------------------|
| 2001               | 2.40                | 1,227                 |
| 1993               | 2.49                | 1,870                 |
| 1985               | 2.69                | 2,267                 |

\*Summed average of responses to sixteen vignettes on interval scale.

**Exhibit 6**  
**Comparison of Ethics Index for Respondents Associated with Large or Small Firms: 1985, 1993, and 2001 Surveys**

| <b>Survey Year</b> | <b>Ethics Index Scores</b>                              |   | <b>Sample Size (n)</b> |              |
|--------------------|---|---|------------------------|--------------|
|                    | <b>Large Firm Respondents (1,000 or &gt; employees)</b> | <b>Small Firm Respondents (100 or less employees)</b> | <b>Large</b>           | <b>Small</b> |
| 2001*              | 2.36  | 2.42  | 342                    | 634          |
| 1993**             | 2.42  | 2.56  | 784                    | 711          |
| 1985***            | 2.67  | 2.68  | 960                    | 763          |

\* Sig. value = .277 for test of difference in the two means

\*\* Sig. value = .000 for test of difference in the two means

\*\*\* Sig. value = .745 for test of difference in the two means

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**ACCEPTING THE UNACCEPTABLE – INSTITUTIONAL AND BEHAVIORAL  
PATTERNS IN ADVISING SMALL  
AND MEDIUM SIZED FIRMS**

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**ABSTRACT**

Although a majority of all small and medium sized enterprises (SMEs) need advice the preparedness to accept advice among SMEs is often low. In what we call the formal institutionalized advice setting the SME owner finds him- or herself in a setting where the dispositions have been set before hand. In this system the main institutional context is that of standardization, formalized interaction and bureaucratic interaction processes. In this paper we investigate how banks, as one of the actors belonging to the formal institutionalized advice setting, are perceived as advisors by Swedish SMEs. The empirical material upon which our hypotheses will be tested emanates from a survey targeting the CEOs of 1130 randomly sampled Swedish SMEs with up to 200 employees. A total of 343 surveys were returned giving a response rate of 30.4 percent. LISREL, which is a structural equation modeling method, was used to analyze the survey data. The findings indicate that the failure of banks, and other actors belonging to the formal institutionalized advice setting, in providing advice can be found in the type of interaction they conduct with SMEs. These organizations are institutionalized in a way that does not correspond well to the type of behavior shown by SMEs. However, these actors have the potential to become better SME advisors. This could be achieved if the principles of non-standardization, non-formalization and personal responsibility were to be advocated and followed by those in charge of SME interaction in these organizations.

## INTRODUCTION

Advising is rarely easy for anyone, advising people, on touchy subjects, is even worse. Advisors to the owners of small-and medium-sized enterprises soon find that almost any subject can be touchy when the advice is geared towards the running of a lifetime achievement operation. The grand old man of Swedish banking Jan Wallander of Handelsbanken tells the story of when he, during a visit to a successful firm forty years ago, heard that the competitor had been thrown out of the firm in the harshest of manners. The competing banker had bluntly kicked on an old machine and muttered something about “poor resale value on that piece of junk”. Of course, that piece of junk proved to be the affectionate starting point for the entire enterprise. The preparedness to accept advice seems to be as important, or even more important, than the advisors competence in providing advice. A mediocre advisor can provide some clues to an interested listener, but not even the best advisor can reach a target that simply will not listen. And owners of small- and medium-sized businesses happen to have both extremely good reasons for listening to advice, and extremely good reasons not to listen. As for the reasons for SMEs listening to advice is the predominant feature that many owners of SMEs display an eagerness to find good advisors. One common craving for SME owners is for someone to listen and to provide, in fact, quite basic advice on how to act in different circumstances. Advice is a service that both relates to task-interactive and personal-interactive aspects, which requires close interaction to exist for a fruitful advising relationship to emerge (Bennett and Robson 2004). At the same time, running a small business requires a lot of self-confidence. Not every SME owner actually knows why he or she is successful, and they actually would prefer not to have someone criticizing their behavior. Especially since that critique would inevitably be taken as personal criticism. In general, SME owners are reluctant to listen to advice due to fear of losing control of their firm

(Storey 1994). In short, SMEs listen to advice in order to overcome the basic problem of learning more tricks to their trade (in research terms generally called the problem of information asymmetry (Nayyar 1990; Gallouj 1997)), but they prefer not to have the teacher using their role to suppress the free will and choice of the entrepreneur. Thus, advisors have to advise people who will eagerly listen if the right things are said, but that may suddenly lash out if the advice is seen as stinging critique of the listener. Apart from this, SME owners tend to listen to advice that is seen as personal, informal and provided in a way that the owner feels that the advisor has every reason to personally take responsibility for advice provided (Harvey and Fischer 1997 single out shared responsibility as a main propriety of why individuals take advice).

### **The formal institutionalized advice setting**

In what we call the formal institutionalized advice setting the SME owner finds him- or herself in a setting where the dispositions have been set before hand. There are in Sweden more than 40 different government agencies providing advice to small businesses. In addition, the major banks constitute a large part of the financing for smaller businesses, as business angels and other informal investors are scarce. Together these agencies and banks form formal institutions that tend to present advice in a way that most small businesses find themselves at trouble with. The formal institutionalized advice setting is characterized by high standardization in the advice provided, a formal protocol of how advice is provided and generally the officers in charge fail to personally take responsibility of the advice provided. Government agencies and banks are what may be termed as highly institutionalized in the vein of Meyer and Rowan (1977) in the sense that they are one part of a larger system infused with value. In this system the main institutional context is that of standardization, formalized interaction and bureaucratic interaction processes. The basis of action tends to be “legalism,

the mechanical following of rules and procedures without regard for purposes and effects” (Selznick 1996). These institutions typically use coercive power (DiMaggio and Powell 1983) based on rules in order to handle non-compliance, both within and outside of the organizations. Not surprisingly much of the research within the field of the new institutionalism has been conducted in government agencies and organizations (Tolbert and Zucker 1983; Meyer, Scott and Stang 1987) or on large corporations (Fliegstein 1985).

Among the government agencies in Sweden, Almi is the largest in terms of financing provided to small businesses. In conjunction with this they also provide advice, actually they demand that the SME owners accept their advice in order to receive the funding. Naturally, many SME owners regard this piece of advice as a necessary evil in order to obtain the capital, thus lowering their readiness to accept advice. Almi provides financing on top of bank loans and actually charge more in interest than the banks. The advice they provide is highly standardized as the SME owner needs to fill out a form based on a business plan. Even if business plans in themselves are quite handy for SMEs, they are in this case presented, as something the SME owner must do. Many SME owners find the entire process quite alienating. The government officer provides some advice, but is still, to the SME owner, an employee whose advice in all certainty is the same advice provided to every SME owner in the same type of industry. In other government agencies the same holds true, government officials provide standardized advice in a formalized fashion without really accepting personal responsibility for advice provided. Business firms in general tend to be reluctant towards the government in supporting firms on the basis that the help provided is deemed as not necessary, not suitable, and that government authorities in general can not be relied upon to provide continuous support (Fischer and Reuber 2003).

Swedish bankers are historically in the same category. During the last decades bankers have been on the offensive as bank deregulations have swept over the bank market.

The only practical effect of this has been that bankers tend to spend more time selling products. Again, from the SME owner perspective the bankers seem rather uninterested about their business. Some SME owners argue that bankers are rather cowardly figures hiding behind tons of bank regulations and refusing to provide any flexibility whatsoever. In any case, the story is virtually the same when it comes to the setting of the meeting between banker and SME owner. The banker is part of a banking institution, and provides a fixed set of products for the firms. It is the SME owner who has to adapt to the forms provided by the banker and to the standardized contract written out by the bank. If the banker takes a selling attitude, then the SME owner will be subjected to the same sales talk as every other SME owner who enters the bank. The bankers do judge the firms creditworthiness, and thus assess both strengths and weaknesses of the firm. But they usually will not discuss what they find out with the owner, other than perhaps presenting some conditions that may provide a clue as to what the problem may be.

Both government agencies and banks are organizations that model themselves after similar organizations in their field that they believe are more successful (DiMaggio and Powell 1991). In the case of government agencies advising SMEs, being successful means the ability to persuade the state to allocate more resources to the agency. For banks, successful to a large extent means a business that makes huge earnings while maintaining the goodwill of regulating authorities. In both cases inertia and herd behavior typifies the organizations in the field. In general, most SME owners feel at a loss when it comes to interacting in the formalized institutional setting. They constantly feel that they are subordinate to the requests of the institution. Either the SME owner accepts the preconditions and the standards set by the institution or they will have to leave. This way of force-feeding advice naturally makes the already reluctant SME owner want to leave the discussion. At the very least, any advice provided will be promptly disregarded.

### **The informal institutionalized advice setting**

There are advisors who seem at ease providing advice in a manner more fitting to the volatile mentality of the SME owners. Auditors in particular have a high reputation as sound advice providers by SMEs. It poses something of a problem due to the fact that the auditors providing the much sought after advice actually are not allowed to do so. A single auditor may not both provide advice and audit a specific firm at the same time. But in fact they do. When investigated it turns out that auditors provide advice in a most spectacular range of interests. They will certainly provide advice on taxation, or on ownership issues. They also provide advice on how to use computers to aid the SME operation. In addition however, auditors also provide advice on legal issues, marketing problems, negotiation practices, leadership issues, how to use external boards etcetera. Of course, auditors are paid by the hour and thereby have every incentive to idling their days providing advice to eagerly anticipating SME owners. But the fact is that the SME owners seem to appreciate the advice provided. A vital clue to understanding why SME owners appreciate the auditors apparently all-encompassing knowledge is the fact that in this situation it is the SME owner who decides what to talk about and when. This is important, as most SME owners tend to learn by doing, and thus appreciate to handle problems as they appear. The auditor simply answers the questions as best as he or she can, without standardizing responses, with no formal contracts and by accepting that poor advice may lead to a situation where the SME owner chooses to look for a new auditor. An interesting aspect on institutionalism is that the audit industry is an example of a profession that has been highly institutionalized over the years (DiMaggio and Powell identifies professions as typically highly institutionalized, see Scott 1985 as well). In the case of the audit industry, however, as is the case with medical professionals, lawyers and researchers, the institutionalism serves as protection from outside intervention. Thus, even if

auditors are highly institutionalized they are able to use this to safeguard their informal interaction with their customers, SME owners in particular. The audit industries practices to a large extent survive by seeking to minimize inspection from government supervisory authorities (see Meyer and Rowan 1991).

Other informal advisors include venture capitalists and business angels, who typically appear in the IT business and biotech industries. Venture capitalists in particular actually set a standard in the industries in which they work since most of them will only invest if the SME owner accepts advice. In these types of industries the SME owners all but have to accept external advice, as they often need venture capital to grow. Thus the initial skepticism towards external advice is abruptly shattered. The positive aspects are that the SME owners will be more open to external influence, the negative aspects include that the SME owners may see the firm as a short-term investment. In any case venture capitalists use different approaches in handling their customers. Some almost force advice upon their investment, others mainly stay in the boardroom, and some are actually heavily involved in the business. They always provide a mix of contractual aspects and informal agreements. Venture capitalists that provide standardized solutions and refrain from informal practical advice tend to be disliked by the SME owners in whose operations they invest. Some find venture capitalists to be stimulating if rather imposing advisors. At times venture capitalists have been referred to as vulture capitalists (Bygrave & Timmons, 1992). Many SME owners have difficulties with venture capitalists, but at least they take the dullness out of their life. Venture capitalism as an institution is an interesting phenomenon as the industry is far less regulated than either government agencies, the banking industry or the audit industry, and yet the industry is still tremendously influenced by management philosophy and herd behavior. Syndication behavior, incentive programs, the theories on inventors and entrepreneurs, all indicate a strong unifying bond within the industry. Business angels are basically all very

informal advisors and are generally as appreciated as auditors. Business angels are far less institutionalized than the other actors and represent an amazing variation in shape, size and form.

External boards are, when functioning properly, good venues for exerting professional, informal advice for SME owners. An external board consisting of benevolent and interested board members provides excellent opportunities for discussing the operations in the SME. The costs may seem prohibiting, but if the board is accurately set up the returns may prove to be very positive indeed. External boards that work best include people who foremost act as friends of the SME owner. It is beneficial to have professional expertise, but the simple and friendly assurance that a decision taken was correct seems to be even more important. The board meetings are places where, at their best, informal discussions take place where the SME owner can discuss matters that needs resolving and where there is an uncertainty in what is the best course of action. External board culture is to an extent institutionalized in the sense that it mimics the processes in larger corporations. Interestingly enough, since the board in an SME have far different purposes (mainly advice) than in larger corporations (owners safeguarding their investments).

In the informal institutionalized advice setting the SME owner finds a situation where he or she controls the tempo and where the advice provide is adapted to the circumstances faced at the time. The advisor clearly accepts some personal responsibility and refrains from using protocol or standardized solutions. In this environment most SMEs will accept advice provided. In cases where the set up seems ideal, but the SME owner will not accept advice, then in all likelihood the personal chemistry fails to work.

## **Institutional advisory competence**

The perception of what constitutes an able advisor is not entirely clear. In financing firms banks need to establish a format enabling them to provide products and advisory capabilities at a reasonable price. In a bank organization geared at providing reliable and relevant advisory functions for the firm, what may be called the enabling organization, the bank makes sure that the organization enables its frontline staff to provide advice applicable to the customer they are advising. Most banks as we have seen appear less than willing to provide informal advice. The institutional format of the bank lends itself toward formal interaction. As is always the case with large organizations there are always deviations to the norm. There are bank officers who emphasize problem solving rather than product sales, and these can be expected to generate a more positive response from SME owners. The perceived problem solving capacity can be seen as an effective measure of institutional advisory competence. In order to appreciate this kind of problem-solving the advice institutions shared knowledge needs to be specific enough for the SME to blend the advice with the SMEs own understanding of the situation (Chrisman and Mc Mullan 2004). As SME owners recognize the cost/benefit value of financial problem solving, the SME owners will appreciate high institutional advisory competence.

A high institutional advisory competence will result in two different strands of customer appreciation. Firstly, the institutional advisory competence will result in a high degree of interaction and flexibility in the encounter between the advising institution and the SME. Secondly, the institutional advisory competence will result in a high general customer satisfaction level. The above reasoning leads to the following hypotheses.

**H1:** We hypothesize that a higher degree of institutional advisory competence will be positively correlated to a higher degree of informal professional advice.

**H2:** We hypothesize that a higher degree of institutional advisory competence will be positively correlated to a higher degree of customer satisfaction.

### **Informal professional advice**

The interaction between an institution, in this case a bank, and SMEs is often characterized by a certain distance. However, these interactions have a potential to occur more frequently and result in more meaningful discussions if the advice delivered is perceived as relevant to the specific situation and needs of the firm, and if the advisor is perceived as someone to turn to when facing problems. The set up of the institution, the enabling organization, will result in its personnel being far more likely to generate positive outcomes in their dialogue with their customers. In an institutional setting characterized by informal provision of relevant advice, and where the advisor clearly shows that the SME owner can rely on the banker in harsher times, SME owners will generally create a favorable climate for communication between banks and SMEs.

As was stated previously the interaction at the meeting between SMEs and their advisor is crucial for the SMEs acceptance of external advice. If advisors behave in a way signifying that the SME is at the mercy of an infallible, rule-bound institution, the SME will generally refrain from interaction. Swedish SMEs normally act in an environment where informality and personal responsibility is at the core of trust-enhancing processes. SMEs tend to prefer to rely on personal interaction rather than strict contractual arrangements in relating to other SMEs and customers. In fact, many SMEs survive by their ability to provide deeper relationships than their larger competitors. In the meeting between two SME owners personal

trust plays an important role in cementing relationships (Chell and Baines 2000). The lack of time for networking activities means that for SMEs every encounter with outsiders is a potential networking enhancing activity, however they do shy away from activities that creates dependencies (Curran et al 1993). This creates a stark contrast to the environment in which an SME owner meets a strictly rule-bound official of a larger organization.

If SMEs do find informal personal advice they will invariably rely heavily on this environment to foster a high level of personal interaction. This interaction is the result of the SME opening up towards the advisor and engaging in a type of relationship that SMEs otherwise reserve for actors in their own environment. As the SME opens up to the advisor the advisor is granted access to additional information about the SME, which enables the delivery of accurate advice based on the firm specific situation. This will lead to a situation where the SMEs trust for the advisor increases further enabling the information exchange between the parties to improve. In the end this will lead to a situation where the SME perceives the relation as a partnership. This partnership is characterized by the SME perceiving the relation to the advisor to be close and personal as well as a perception of the advisor as a source of moral support. This leads to the following hypothesis.

**H3:** We hypothesize that a higher degree of informal professional advice will be positively correlated to a high level of perceived partnership.

### **Customer satisfaction**

General customer satisfaction in the case of SME owners facing advisory institutions depend upon the advisory institutions ability to provide a reasonable working environment. As long as the institution remains focused on what the SMEs perceive to be important points of departure for discussion the higher will the level of satisfaction be. In general, SME owners

prefer to discuss their financial situation from their own perspective. In order for an advisory institution to achieve a high mark in customer satisfaction its officers will need to display the ability to discuss the SMEs problem out of the SMEs own perspective. This is clearly not easily achieved, as it usually tends to be easier for bankers in this case to remain on safe ground and rely on procedures and product information in their interaction with the SME. To actually take a step out of the institutional role is a major one for many bank officers.

Customer satisfaction depends on the perception of the customer of intrinsic values in the relationships. Customers anticipating that the seller only has the capability to offer standardized solutions may be quite content to receive that. Many SMEs anticipate banks to offer only standardized solutions and rarely expect anything else. When confronted with the option to choose between advisors providing different sorts of settings for providing advice the differences are more profound. When comparing auditors with bankers nearly all SMEs will prefer their auditors as advisors. Even if both bankers and auditors generally work in large organizations, bankers will be referred to as “the bank”, whereas the auditor will be referred to as “Mr. Knowles”. That SMEs typically prefer the latter type of relationship is augmented by the large amount of literature pointing out the importance of social networking for SMEs, especially in weak tie relationships (Aldrich and Zimmer 1986; Bryson et al 1993). In an advisory situation customer satisfaction seems to be directly correlated to level of formalization.

The customer satisfaction level stems from an ability to recognize the ability of the advisor to actually portray themselves as partners rather than sellers in the interaction. Customer satisfaction will thereby be a crucial ingredient in promoting a high level of personal interaction. The above reasoning leads to the following hypothesis.

**H4:** We hypothesize that a higher degree of customer satisfaction will be positively correlated to a high level of perceived partnership.

## **METHODOLOGY**

The empirical material presented in this paper emanates from a survey targeting Swedish small and medium sized enterprises (SMEs). As we have already mentioned there are a vast number of advisors that in many cases, at least partly, focus on providing advice to SMEs. However, for the purposes of this study, the empirical data upon which our hypotheses will be tested concerns how SMEs perceive banks as advisors. Since SMEs are the target a definition of what constitutes a small firm, for the purposes of this paper, is needed. There appears to exist a lack of actual consensus regarding the definition of what constitutes a small and medium sized firm. Different researchers have been known to use differing definitions (Storey, 1994). Earlier Swedish research (Davidsson, 1989) has defined small and medium sized enterprises as independent firms with 200 or fewer employees. As regards surveys, a common way of defining SMEs is to use some sort of size measure such as number of employees or turn over. Even though other measures than number of employees occur our definition of small and medium sized enterprises will in this study be, Swedish privately owned firms with up to 200 employees that are not part of a corporate group, a definition also in line with contemporary research on SME's in Sweden as well as abroad (Cressy and Olofsson, 1997; Storey, 1994; Wiklund, 1998).

### **The survey and the sample**

The random sampling of the firms was made by Statistics Sweden. A total of 1130 Swedish companies, with up to 200 employees, were chosen. A further criterion for the random

sampling was that the firms had to be stratified not only with regards to industry but also to size.

The target for the questionnaire was the CEOs in the small firms. According to Oppenheim (2003) some of the main disadvantages associated with questionnaires are low response rates and response biases. In order to improve the response rate a few approaches were used that have been found to increase response rates in the past (Oppenheim, 2003). Accompanying the questionnaire was a covering letter. The covering letter included, among other things, explanations of the purpose and context of the study and an introduction of the researchers and their institutions. Furthermore, the covering letter also included comments on the issues of confidentiality and the possibilities for (interested) respondents to get a summary of the results of the study. In a further attempt to improve the response rate a reminder was sent out to the firms who did not answer the questionnaire the first time. This reminder was sent out 4 weeks after the first questionnaire had been sent out.

A total of 343 surveys were returned giving a response rate of 30.4 percent. Two drop out analyses were performed in order to check for possible biases among the respondents. First, when the companies were selected for the sample background data was obtained on their characteristics from Statistics Sweden. Consequently, the first analysis consisted of comparing respondents with non-respondents as regards size, main industry, start week and municipality code. We could not, however, find any statistically significant differences between the respondents and non-respondents. The second dropout analysis consisted of using a method put forward by earlier researchers who argued that late respondents and non-respondents share many of the same characteristics (Armstrong and Overton, 1977). Therefore the sample was divided into early and late respondents enabling a comparison of

the two groups of firms. We were unable, however, to find anything that could indicate a statistically significant difference between the groups.

### **Analysis using LISREL**

LISREL, which is a structural equation modeling method, was used to analyze the survey data. Structural equation modeling, which is a way of studying causal effects in a data sample (Jöreskog & Sörbom, 1993), has recently been used in small business research (Bennet & Robson, 2004; Soriano, 2001). The use of structural equations modeling enables the investigation of causalities in real business settings instead of having to infer them by the logic of arguments (Jöreskog & Sörbom, 1993). The creation of a LISREL model involves two steps. The first step consists of the identification of latent variables, in structural modeling referred to as constructs. A construct captures underlying commonalities of a set of indicators and is thus a variable of a higher order and more abstract than the indicators related to it (Jöreskog & Sörbom, 1993). In the second step causal relations between the constructs are defined in a structural model (Eriksson et al, 1997).

The validity of the constructed LISREL model is estimated by testing for nomological, discriminant and construct validity. Nomological validity, refers to the validity of the entire model, and is assessed by the  $\chi^2$  and degrees of freedom measure, together with a probability estimate ( $p$ -value) (Jöreskog & Sörbom, 1993). Although there are no definite threshold values for  $\chi^2$  and degrees of freedom it has been argued that the fit is good when the values of  $\chi^2$  and degrees of freedom are roughly the same (Jöreskog & Sörbom, 1993). However, other authors argue that such a rule of thumb can be difficult to apply and that a  $\chi^2$  that is lower than the value of the degrees of freedom is acceptable. The value of  $\chi^2$  should not, however, be

substantially higher than the degrees of freedom value. As regards the probability estimate the  $\rho$ -value of the model should be 0.05 or higher to indicate a non-significant distance between the model and the data at the 5% level.

According to Jöreskog and Sörbom (1993), a number of other statistical measures that enable assessment of nomological validity exist but they are all functions of  $\chi^2$ . Some of the most frequently used measures are GFI, RMSEA and CFI. The first measure, GFI, or goodness of fit index, checks for sample size effects and should be above 0.90. The RMSEA, or root mean square of approximation, measures population discrepancy per degree of freedom, and should be below 0.08. The CFI measure, or comparative fit index, checks for non normal distributions and should be above 0.90.

The second validity test is discriminant validity, which consists of an assessment of the separateness of the constructs (Jöreskog & Sörbom, 1993). Discriminant validity is assessed in two ways. First, we make sure that the constructs are separate and not correlated to each other. This is done by forming an approximate confidence interval by taking the standard error term times two (Anderson and Gerbing, 1988; Jöreskog and Sörbom, 1993). All values that fall within this interval are not significantly different from the correlation coefficient. The second way of controlling for discriminant validity is performed in cases when the  $\rho$ -value of the model is non significant. This is done by investigating the modification index in the LISREL software. This index suggests changes in the model if the indicators are related to more than one construct.

The final test for validity is convergent validity. This test checks for the homogeneity of the indicators and their constructs and is assessed by looking at three estimates: coefficients, t-

values and R2-values. The coefficients normally referred to as factor loadings, reflect the strength of the relationship between two variables (Bollen, 1989). According to Jöreskog and Sörbom (1993), there are no definitive limits for factor loadings, instead the numbers should be judged in association with theoretical considerations. If the theory suggests a weak relationship then a low coefficient is acceptable. The t-value is a standard estimate of statistical significance and should be 1.96 or above to be statistically significant at the 5% level. Finally the R2 value is an estimate of the strength of the linearity in a relationship. Although there are no definitive threshold values of what constitutes an acceptable R2 value, as in the case with coefficients, an R2 value of 0.20 or above indicates an acceptable linearity of a relationship (Jöreskog & Sörbom, 1993).

In order to account for missing values pairwise deletion was used. The number of missing values ranged from 1 to 7, depending on the indicator. The results were also tested by listwise deletion with similar results (See Appendix, Correlation Matrix).

## **RESULTS**

The first assessment of the model regards its convergent validity, which is analyzed by using the factor loadings, t-values and R2 values. These values are presented in table I. The correlation matrix for the constructs, including error terms and t-values for the constructs, is presented in table II in the appendix.

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Table I about here

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The construct “Institutional advisory competence” represents the banks knowledge about its SME customers. Two indicators were used to capture the Institutional advisory competence construct. The first is the perception of whether the bank is able to provide financing at reasonable conditions; that is if the bank provides good value for money (factor loading 0.79, t-value 23.61). The second indicator regards the banks competence in solving financial problems for SMEs (factor loading 0.88, t-value 25.96). The values suggest good convergent validity for the construct.

As in the case with the first construct we have again used two indicators to capture the “Informal professional advice” construct. The indicators concern the respondents evaluation of the banks ability to give good advice (factor loading 0.79, t-value 19.92), and their evaluation of whether they can turn to the bank in times of trouble (factor loading 0.92, t-value 34.63). Again the values suggest good convergent validity for the construct.

The “Customer satisfaction” construct consists of one indicator. The construct is meant to capture the SMEs overall level of satisfaction with the bank. Since the question directed to the respondent is direct it is assumed that it captures the respondents perceived level of satisfaction with the bank in a clear way.

The final construct, “Perceived partnership”, is intended to capture the SMEs perception of whether the relation to the banker can be characterized as a partnership in terms of closeness and if the bank provides moral support. The construct consists of two indicators. The values of the first indicator, the perception of having a close relation to the banker, are 0.78 for the

factor loading and 19.20 for the t-value. As regards the second indicator, the perception of whether the banker is a source for moral support, the values are 0.95 for the factor loading and 29.21 for the t-value respectively. The values suggest good convergent validity for this construct as well.

The model was also found to be discriminantly valid in that the constructs are separated from each other. Firstly, the modification index of the LISREL software did not suggest any changes in the model, which means that the indicators are not related to more than one construct. Neither did the approximate confidence interval, which is computed by taking the standard error term times two, for the coefficients in any case include the value 1 (See Appendix, Table II).

Figure 1 shows the structural model in its entirety. The model illustrates the relations between Institutional advisory competence, Informal professional advice, Customer satisfaction and Perceived partnership as well as the relations between the constructs and their indicators. The results of the analysis indicate that the model is nomologically valid, in other words, the entire model holds together. The model has a p-value of 0.209, an  $\chi^2$  of 14.45 and 11 degrees of freedom. As regards the other measures GFI, RMSEA and CFI the values were in these cases 0.98 for GFI, 0.030 for RMSEA and 0.99 for the CFI. These values also indicate a good fit between the model and the data. The model shows that the causal relations between Institutional advisory competence and Informal professional advice (0.85, 14.72), and between Institutional advisory competence and Customer satisfaction (0.64, 11.20) are positive and strong, thus supporting Hypotheses 1 and 2. The model also shows that the Perceived partnership construct is influenced by the Informal professional advice construct (0.49, 6.29) as well as the Customer satisfaction construct (0.24, 3.28), which supports

Hypotheses 3 and 4. Furthermore, the analysis shows that there is no direct relation between the Institutional advisory competence and the Perceived partnership construct. The construct of Institutional advisory competence operates only via the Informal professional advice and Customer satisfaction constructs.

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Figure 1 about here

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### **FINAL ANALYSIS**

The final model of analysis shows that advising SMEs successfully requires an interlocking scheme of activities on part of the advisor geared at conveying a sense of understanding for the SMEs situation. In order to create a fruitful advisor relationship it is impervious for advisors to create an understanding based on the fact that the advisor will in fact take personal responsibility for advice provided. In addition, the advisor needs to make sure that the advice is perceived as problem-solving for the individual firm in question, merely advising in the same manner for thousands of similar firms of equal size and shape routinely will not build strong advisor relationships. Finally, the degree of formalization is an aid in transferring advice in a manner that is easy to digest for the SME owner. When stated like this it all seems to make perfect sense. However, in practice, government authorities and to a large extent banks fail in providing advice based on these simple principles. In the end, both government authorities and banks have a hard time finding trust among SMEs. Some may say that this is due to the nature of the business. That small enterprises generally do not trust larger enterprises. A statement that does not sound all that great when comparing SMEs relationships with bankers belonging to large enterprises and relationships with auditors

belonging to large enterprises. It may also be argued that small firms do not trust financiers. But in fact they do, especially private investors such as business angels.

Our analysis is that the failure of government agencies and banks in providing advice can be found in the type of interaction they conduct with SMEs. These organizations are institutionalized in a way that does not correspond well to the type of behaviour shown by SMEs. In terms of research the institution of government agency and the institution of the banking industry utterly fails to match with the institution of SMEs. These institutions are simply ill equipped to understand each others needs. The audit industry has taken upon their own to shield themselves from outside influence from supervisory authorities and thereby manages to interact better with SMEs. It is hard to imagine either the government agencies or the banking industry institution to change in order to better fulfill their role as advisors. Either they will continue as rather poor advice options for SMEs, apart from a small number of independent-minded bankers, or they will have to find a way to improve their way of communication with SMEs.

### **MANAGEMENT IMPLICATIONS**

The management implications of this study are to suggest that in fact both banks and government authorities can become better SME advisors. This could be achieved if the principles of non-standardization, non-formalization and personal responsibility were to be advocated and followed by those in charge of SME interaction in these organizations. In order to achieve such a goal the officer in charge of interactions with SMEs needs to have a position of flexibility and a supporting organization.

Non-standardization is best achieved if the organizations supporting officers in charge of SME interaction refuse to authorize specific manuals and instructions for how these officers are going to relate to SMEs. Instead the officer needs to be fully knowledgeable about

the SME perspective, and able to actually analyze a SME out of it's own perspective. In addition, product sales should be downsized in favour of general sales targets. In this way, officers will not be tempted to go for simple short-term solutions.

Non-formalization can be achieved by lowering demands for SME owners to fill in specified forms in order to interact with the advising institution. The comparison between auditors and bankers are profound in the way that bankers make SMEs fill in the forms where auditors tend to do fill them out themselves. SME owners are by their very nature quite uninterested in financial solutions, they would preferably like to be guided through the system. Guided, however, not necessarily forced-marched through a pre-specified route.

Personal responsibility is absolutely crucial in gaining the trust of SME owners. Both government officials and bankers tend to hide behind their rules and regulations in order to maintain a low profile in relating to SME owners. In the end the SME will, entirely correctly, assume that they are dealing with the henchmen of an uncaring colossus of an organization where a tiny SME counts for nothing in the end. It will in all probability not be enough for government authorities and bankers to appoint "personal bankers", as no SME owner will fall for such an easy lure. Instead these organizations must attempt to actually find a way to encourage and emphasize a genuine personal responsibility.

In the end many SMEs need advice. SMEs furthermore need an array of potential advisors, instead of having to rely on a single source. This need is accentuated by their need to overcome their natural reluctance to accept external advice. If the advisors show enough commitment to persuade the SME owners of their genuine benevolence, then SMEs will be able to share information more readily, to the benefit of all concerned.

## APPENDIX

**Table II.**

The coefficients between the constructs, error terms in parentheses and t-values.

| <b>Constructs</b>                 | Institutional advisory competence | Informal professional advice | Customer satisfaction   | Perceived partnership |
|-----------------------------------|-----------------------------------|------------------------------|-------------------------|-----------------------|
| Institutional advisory competence | 1.00                              |                              |                         |                       |
| Informal professional advice      | 0.85<br>(0.058)<br>14.72          | 1.00                         |                         |                       |
| Customer satisfaction             | 0.64<br>(0.057)<br>11.20          |                              | 1.00                    |                       |
| Perceived partnership             |                                   | 0.49<br>(0.078)<br>6.29      | 0.24<br>(0.072)<br>8.05 | 1.00                  |

### Correlation Matrix

| <b>Sample size = 343</b>   |              |              |              |              |              |              |              |
|----------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
|                            | <b>V1003</b> | <b>V1208</b> | <b>V1209</b> | <b>V2101</b> | <b>V2102</b> | <b>V1201</b> | <b>V1205</b> |
| <b>V1003</b>               | 1.00         |              |              |              |              |              |              |
| <b>V1208</b>               | 0.44         | 1.00         |              |              |              |              |              |
| <b>V1209</b>               | 0.54         | 0.72         | 1.00         |              |              |              |              |
| <b>V2101</b>               | 0.45         | 0.35         | 0.39         | 1.00         |              |              |              |
| <b>V2102</b>               | 0.48         | 0.47         | 0.54         | 0.74         | 1.00         |              |              |
| <b>V1201</b>               | 0.51         | 0.50         | 0.59         | 0.36         | 0.48         | 1.00         |              |
| <b>V1205</b>               | 0.52         | 0.59         | 0.67         | 0.41         | 0.48         | 0.70         | 1.00         |
| <b>Mean:</b>               | 3.425        | 1.677        | 2.304        | 2.317        | 1.734        | 2.840        | 2.125        |
| <b>Standard deviation:</b> | 1.570        | 1.253        | 1.744        | 2.043        | 1.725        | 1.662        | 1.311        |
| <b>Missing values:</b>     | 7            | 4            | 2            | 0            | 1            | 1            | 0            |

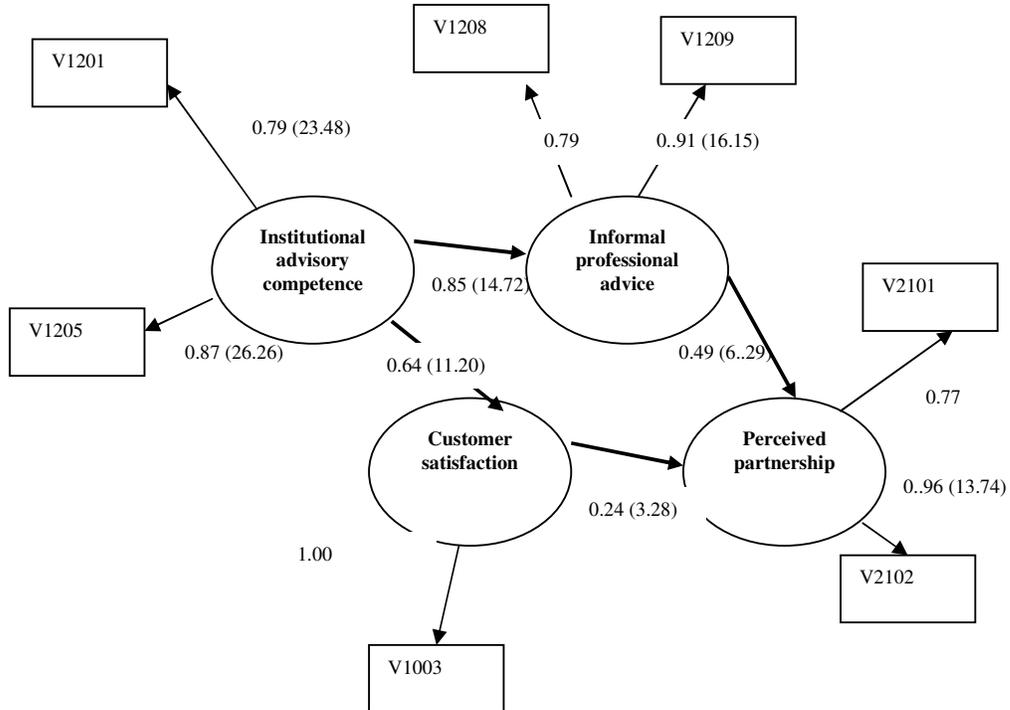
## FIGURES AND TABLES

**Table I**

The constructs and their indicators

| <b>Constructs</b>                 | <b>Indicators.</b> In figure 1. the names of the indicators have been replaced with V1003-V2102 to save space. | <b><math>\lambda</math></b> | <b><math>R^2</math></b> | <b>t</b> |
|-----------------------------------|--|-----------------------------|-------------------------|----------|
| Institutional advisory competence | The bank provides financing at reasonable conditions for SMEs (V1201)  | 0.79                        | 0.63                    | 23.61    |
|                                   | The bank is good at solving financial problems for SMEs (V1205)  | 0.88                        | 0.77                    | 25.96    |
| Informal professional advice      | The bank provides good advice to our firm (V1208)  | 0.79                        | 0.62                    | 19.92    |
|                                   | Our firm can turn to the bank in times of trouble (V1209)  | 0.92                        | 0.84                    | 34.63    |
| Customer satisfaction             | Overall level of satisfaction with the bank (V1003)  | 1.0                         | 1.0                     |          |
| Perceived partnership             | Perception of having a close and personal relation to the banker (V2101)                                       | 0.78                        | 0.61                    | 19.20    |
|                                   | Perception of the banker as a source of moral support (V2102)  | 0.95                        | 0.91                    | 29.21    |

**Figure 1. The Structural Model**



$\chi^2 = 14.45$ ,  $df = 11$ ,  $\rho\text{-value} = 0.209$ ,  $RMSEA = 0.030$ ,  $GFI = 0.98$ ,  $CFI = 0.99$

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Note: The figures given are factor loadings (between indicators and constructs) and coefficients (between constructs) of causal relations with t-values in parentheses.

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# **THE INFLUENCE OF HUMAN CAPITAL ON SMALL MANUFACTURING ENTERPRISE DEVELOPMENT IN TANZANIA**

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## **ABSTRACT**

SMEs and their associated entrepreneurship are currently the focus of considerable policy and academic interest globally. They are major contributors to job creation, economic growth and development in an economy.

Previously Tanzania pursued a socialist approach to development. This has failed there, as in most other countries. Consequently, since the 1990s Tanzania has started to focus on actively promoting entrepreneurship through new venture creation at the SME level as a way of fast-tracking its economic development.

Human capital is a critical input to the development of firms and nations. A lack of human capital can hinder development just as a shortage of physical capital. This study examines the influence of human capital elements of entrepreneurs and workers on the performance and conduct of new small manufacturing firms in Tanzania over the period 1997 – 2001. Relevant data was collected by means of questionnaires administered to a nationally-drawn sample of 200 firms, obtained by random selection procedure. Performance is measured in terms of growth in real sales. Multivariate regression and Cobb-Douglas production function analyses were undertaken and these confirm that human capital of both labour and the entrepreneur together with physical capital are critical predictors of performance, with evidence of increasing returns.

Business conduct is examined in terms of recruitment practice, training of employees, keeping of records and access to bank financing. The results show that small manufacturing enterprises with more educated and trained entrepreneurs are better in all conduct attributes under study relative to their less educated or trained counterparts. The policy implications are clear. If Tanzania wants more output, employment and growth, this would not happen through the socialist route. Instead the way forward is through vigorous entrepreneurship as reflected by venture creation and a strong small-firm manufacturing sector with caring concerns for empowerment of both labour and the entrepreneur.

## INTRODUCTION

Tanzania adopted a socialist approach to its development after gaining independence from Britain in 1961. Manufacturing industries, banks, insurance, wholesale trading, medical care and agriculture and other activities were nationalized and farms organized as collectives. With its implementation of the 'ujamaa' development strategy, living conditions in Tanzania did not progress. Government ownership of most enterprises coupled with a distrust of private sector initiatives led to a collapse of the Tanzanian economy in the 70s and part of the 80s and to rising poverty (Paulson and Gavin, 1999: 61). Macroeconomic instability, rising unemployment and worsening living conditions forced the Tanzanian government to abandon its socialist strategy and adopt reforms coupled with World Bank structural adjustment programmes to revive its economy. An important measure of the revival strategy was the promotion of entrepreneurship which began in the 1990s. Tanzania thus started to focus on developing SME entrepreneurship as a way of fast-tracking its economic development.

There can be no private entrepreneurial activities without entrepreneurs and it is through their value-adding activities that individual and national prosperity can be obtained, particularly in terms of economic growth, development, innovation, tax revenue and employment generation. Entrepreneurship flourishes in a market-oriented environment, favourable to employment of human and physical capital by entrepreneurs, and in which there is respect for law and order, property rights, good governance and incentives to risk-taking activities. A lack of human capital can hinder development just as a shortage of physical capital. Against this background, this paper examines the influence of human capital elements on the development of small and micro manufacturing firms in Tanzania.

The paper consists of five sections. Section one briefly covers the nature and significance of human capital to development. Section two examines the research design. Sections three and four present a discussion of the findings and this is followed by some policy recommendations.

## HUMAN CAPITAL ELEMENTS

Human capital plays an important role in the economic and social development of a nation. It enhances workers' and entrepreneurs' ability to exploit business opportunities, to work smarter and to improve business performance. According to Schultz (1975: 833), human capital enhances the individuals' efficiency in responding to changes when they work for the market or even carry out household activities. Employees who invest in education and training will raise their knowledge and skill, be more productive, and earn higher wages than the less skilled (Becker, 1993:24). Better knowledge and human capital improves individual and organizational efficiency and this generates positive externality benefits to economy.

In the traditional Keynesian analysis, much emphasis was placed on physical capital, relative to human capital, as the driving force behind output growth. Entrepreneurship was regarded as part of the residual factor in the growth analyses. In recent times,

however, the literature based on the pioneering works of Milton Friedman, Theodore Schultz, Jacob Mincer and Gary Becker, together with those of other economists and management scientists have shown that investment in human capital is critical to the generation of economic growth and productivity of nations. In effect the endogenous growth models have further brought the human capital to the forefront of wealth creation process (Romer, 1966; Lucas, 1988; Hall and Jones, 1999; Artadi and Sala-i-Martin, 2003).

Physical capital is therefore necessary but not sufficient to generate economic growth. Skilled workers, managers, and entrepreneurs are needed to operate machines, manage the production and distribution of goods and services, develop new products and new production methods, and utilize innovations (Becker, 1995: 1). The pouring of physical capital into developing countries during their post-independence years did not show much positive results. This implies that at a certain level, human capital needs to be matched with non-human capital; otherwise a low level of human capital development becomes a limiting factor in economic growth.

Researchers have been somewhat reluctant to analyse the contribution of human capital to organizational performance and economic growth, due to measurement difficulties Schultz (1961:7). Measurement of business performance often varies from one firm to another. Financial and accounting measures as well as time frames are used in varying ways. Although measurement issues of human capital are problematic, it is important to specify key human capital dimensions, assess their characteristics, and examine their impact on organizational performance.

Human capital encompasses learning, education, training, health care expenditure and any other form of expenditure that increases productivity of an individual and the performance of the firm (Burger, 2003). Becker (1993:43) claims that human capital can take the form of skills and abilities, personality, appearance, reputation and appropriate credentials.

Certain skills may be acquired while an individual performs an activity, such as a production process, or solves a problem – learning by doing (Arrow, 1962: 156). Human abilities can be either innate or acquired. Griffin and Knight (1990:38) stress that through long-term human resource policies, countries can enhance the capabilities of their people to do more things and lead fuller lives. In this regard, emphasis should be placed not only on national income per head or its distribution, but also on investment on relevant education and training.

Lucas (1988) and Shane (2003:75) argue that human capital formulation is a spin-off effect of production, and experience is the major source of acquiring knowledge and skills. Experiential learning contributes to enhanced productivity (learning effect). The learning effect, taking place consciously or unconsciously, manifests itself when the time expended in production is a decreasing function of the cumulative number units produced. Schultz (1963:8) identifies five main elements of human capital: health, migration, on-the-job training, formal education, and experience.

A 'new' aspect of capital in the modern entrepreneurship literature relevant to venture development is social capital. This refers to the entrepreneurial competence in terms of networking relationships, exercise of trust, reciprocity, conflict resolution, focus on team goals, and exchange relations with others (Bridges et al, 2003:95). While acknowledging the significance of social capital, this study does not examine this variable. However, the influence on another variable on enterprise performance is considered- n-Ach level of the entrepreneurs. N-Ach is described as a desire to well so as to obtain an inner feeling of personal accomplishment or to be successful in competitive situations (Mahadea, 1994: 95). McClelland (1961) associates n-Ach with a desire for personal responsibility, problem-solving, moderate goals and risk-taking, and concrete feedback on performance. The n-Ach levels of individuals and hence the supply of effective entrepreneurs can be enhanced through appropriate training, experience and schooling (Holmes and Schmitz, 1990).

For the purposes of this study, human capital is defined as the knowledge, skills, competence, and other attributes embodied in entrepreneurs and workers, through education, training and experience that are relevant to economic activity. An entrepreneur is regarded as someone who has, individually or jointly, started up a business enterprise and is running the venture (for at least 5 years).

## **METHODOLOGY**

Relevant data were gathered through interviews and questionnaires administered to a sample of 200 small-scale manufacturing entrepreneurs. They were randomly selected from the list of registered firms operating in Tanzania and proportionately drawn from 18 regions of mainland Tanzania. The data were analysed using SPSS.

The subjects were 200 indigenous business persons, 173 males and 27 females, aged between 19 and 65. Of the surveyed entrepreneurs, 33 engaged in tailoring and sewing, 43 in edible food, another 43 in woodwork, 51 in metalwork, 24 in leatherwork and 6 in animal food processing. The subjects' n-Ach level was measured by using the Mehrabian scale of achieving tendency (1975). This instrument consists of a set of 26 questions that is administered to male and female respondents, measured on a nine-point scale from +4 to - 4. The overall n-Ach score of each surveyed entrepreneur was obtained by adding up the scores of each question. A higher positive value indicates a greater nAch level, and the reverse is also true.

This study uses multiple regression analyses and a Cobb-Douglas production function to examine venture performance, with output, proxied by real sales (after discounting for inflation) as the dependent variable and the entrepreneurs' nAch, education, training, experience, and employees' education and training as well as physical capital, as the independent factors. Generally firms with more physical and human capital tend to perform better than those with less of these inputs. Education, training and experience

were measured in years, and output and physical capital were expressed in the Tanzanian currency (Tzs).

The independent variables were initially regressed on output growth using OLS. A parsimonious model was initially arrived at, but it did not satisfy the assumptions of OLS, and the role of the entrepreneur was found to be insignificant in the enterprise, making the firm seemingly entrepreneurless. Accordingly, to overcome this limitation, the set of data relating to the dependent and independent variables was transformed logarithmically, and an alternative model based on a Cobb-Douglas production was developed. Residuals of the predictors after transforming the data logarithmically were also plotted. The model gave a better fit, which seems not to violate the 'homoskedasticity' assumption.

## FINDINGS

### Parsimonious multiple regression model

In accordance with economic theory, it is hypothesized that physical capital and the human capital of workers and entrepreneurs coupled with physical capital can predict venture performance and the beta coefficients of the independent variables are, therefore, expected to be positive.

SPSS's backward linear regression approach was used to arrive at an initial model that 'best' explains enterprise performance. This entails entering all the independent variables in the model, and then removing the 'weaker' ones in subsequent stages, according to certain criteria. The basic criterion is to retain the independent variable that has a high explanatory influence, usually shown by a t-value that is statistically significant. Koop (2000: 88) argues that it is a common practice to initially use as many explanatory variables as possible, and then discard those that are not statistically significant.

Using the above approach, four variables were found to be significant: capital, employee education, employee experience, and employee training. The results of the fitted regression model are summarized below.

$$\text{Sales} = -120857.2 + 0.308(\text{Capital})_{t=4.661} + 0.290(\text{Employee education})_{t=4.802} + 0.292(\text{Employee experience})_{t=4.93} + 0.154(\text{employee training})_{t=2.36}$$

$$\text{R-square} = 0.343$$

$$\text{Adjusted R-square} = 0.329$$

$$\text{F-value} = 25.4$$

$$\text{N} = 200$$

t = t-value, statistically significant at the 5 % level of significance

The role of the entrepreneur is critical to the formation and performance of any firm. But the above model, although explaining about a third of the variation in output, does not capture the influence of the prime decision-maker (entrepreneur) in the development of

the manufacturing firms. It simply shows the influence of employee human capital and physical capital as significant predictors of venture performance.

To overcome this limitation, an alternative and preferred regression model was developed based on a Cobb-Douglas production function. The absence of the significance of entrepreneurs in a model is tantamount to ‘Hamlet without the Prince of Denmark’.

### **The preferred model**

Parametric methods assume that the sample is drawn from a population where values have a normal distribution. The above regression model did not satisfy the OLS assumptions of normality and homoskedasticity (error terms having equal variances). This is evident from the shape of the histogram of residuals.

To overcome the technical inadequacy and heteroskedastic limitation, an alternative model was developed to predict venture performance, with the earlier data relating to the dependent and independent variables, being transformed logarithmically.

Using OLS method, the double-logarithmic transformation gives a regression model of the following form:

$$\text{Log } Y = \alpha + \beta_1 \log(X_1) + \beta_2 \log(X_2) + \beta_3 \log(X_3) + \dots + \beta_n \log(X_n) + e$$

where

|                                    |  |
|------------------------------------|--|
| Y                                  | = Output   |
| $\alpha$                           | = Intercept  |
| $\beta_1, \beta_2, \dots, \beta_n$ | = Elasticities of output with respect to independent variables |
| $X_1, X_2, X_3, \dots, X_n$        | = Independent variables, and                                   |
| e                                  | = error term   |

The new model could be viewed as a multiplicative relationship between sales and the selected variables. Considering sales of the surveyed manufacturing ventures as a proxy of output, the above logarithmic function could be converted into a power function, often referred as the standard Cobb-Douglas production function.

$$Q = aX_1^{\beta_1} X_2^{\beta_2} \dots X_n^{\beta_n}$$

where

Q = Total output (real value of sales)

$X_1, X_2, \dots, X_n$  = Independent variables

$\beta_1, \beta_2, \dots, \beta_n$  = Output elasticities of  $X_i$

To arrive at the preferred model, all independent variables were again initially entered, and then through the backward elimination procedure, sequentially a weaker variable was excluded until all the remaining predictors are found to have statistically a significant contribution to venture performance. In this case, the entrepreneurs’ nAch and experience, employee education, and number of employees were found to be not significantly contributing to the model, and were thus excluded in stages until the ‘best’ model was reached (presented in table 1).

[Insert Table 1 here]

The developed model can be presented as follows:

$$\begin{aligned} \text{Log(Output)} &= .243 + .481\log(\text{capital})_{(t=7.409)} + .571\log(\text{entrepreneur education})_{(t=2.851)} + \\ &1.039\log(\text{employee experience})_{(t=9.551)} + .221\log(\text{employee training})_{(t=1.929)} \\ &+ .135\log(\text{entrepreneur training})_{(t=2.189)} + \text{error term} \\ \text{R-squared} &= 0.511 \\ \text{Adjusted R-squared} &= 0.499 \\ \text{F-value} &= 40.495 \end{aligned}$$

The results clearly indicate that output is found to be influenced by physical capital, entrepreneur education, entrepreneur training, employee experience, and employee training. A summary of the preferred model with collinearity diagnostics is presented in table1. The estimated coefficients 0.481, 0.571, 1.039, 0.221, and 0.135 refer, respectively to output elasticities of capital, entrepreneur education, employee experience, employee training, and entrepreneur training

From the above, the following deductions can be made:

- Output is likely to increase by about 5% for a 10% change in capital
- Output is likely to change by about 6% for a 10% change in entrepreneur education
- Output is likely to increase by about 10% for every 10% increase in employee experience
- Output is likely to increase by about 2% for every 10% change in employee training and
- Output is likely to change by about 1% for every 10% change in training of the entrepreneur.

Since the sum of elasticities (2.447), is greater than 1, there is evidence of increasing returns to scale in manufacturing firms. This implies that an increase in capital, entrepreneur education and training, employee experience and employee training by 10% is likely to cause output to increase by a greater amount, almost 25%.

The developed multiple regression model has the following strengths:

- It explains more than 50% of the variation of sales (R square = 0.511, adjusted R square = 0.498).
- Overall, the model is statistically highly significant (F = 40.495; p = 0.000).
- The elasticities of almost all variables are significant at 5% level.
- The histogram of residuals shows a normal curve, implying that the technique used and OLS assumptions for multiple regression analyses were satisfied.
- The model captures human capital elements of both the entrepreneur and labour, and physical capital- all found to be significant predictors of manufacturing enterprise performance.
- The model can be converted into a power function, allowing marginal production of a given predictor to depend on all other variables in the model, a condition that usually holds in real life situations.
- Overall the results accord with and support the human capital theory.

## HUMAN CAPITAL AND CONDUCT OF MANUFACTURING VENTURES

With regard to conduct of business, the results show that small manufacturing enterprises with more educated and trained entrepreneurs tend to employ more educated workers, keep more business records and have greater access to finance from banks than their counterparts with lower levels of human capital. Further, business individuals with more accumulated human capital tend to be more entrepreneurial in that they are more likely to own another business.

## RECOMMENDATIONS AND CONCLUSION

This study clearly shows that physical capital is necessary but not sufficient for the development of manufacturing firms. Critical also is the knowledgeable, skilled and experienced human factor. The accumulation of entrepreneurs' and workers' capital operating jointly in a production function with physical capital can propel the small Tanzanian manufacturing firms into a virtuous spiral of sustainability and success, so long as they competitively meet the needs of the market. Increasing returns to output are likely to emerge from an increase in investment in human and physical capital.

If Tanzania wants more output, income and employment expansion, this would not happen through the socialist route. Instead, the way forward is through entrepreneurship, as partly reflected by a strong manufacturing sector with caring concerns for capital investment and human empowerment. An educated or trained entrepreneur is a more productive business person. Likewise a skilled workforce is a more productive labour, capable of adjusting fast to industrial and technological changes in a global environment. In order to enhance its economic growth, Tanzania cannot afford to neglect neither physical capital nor human capital. Evidently this has wider implications with respect to education, training and experience and institutions at the firm and national level.

**Table 1: Summary for the developed model (Cobb-Douglas production function)**

| Model | R    | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|------|----------|-------------------|----------------------------|
| 1     | .715 | .511     | .498              | .47742                     |

ANOVA of the preferred model (Cobb-Douglas production function)

| Model |            | Sum of Squares | Df  | Mean Square | F      | p    |
|-------|------------|----------------|-----|-------------|--------|------|
| 1     | Regression | 46.150         | 5   | 9.230       | 40.495 | .000 |
|       | Residual   | 44.218         | 194 | .228        |        |      |
|       | Total      | 90.369         | 199 |             |        |      |

Coefficients of the preferred model (Cobb-Douglas production function)

|                             | Unstandardised coefficients |            | Standardised Coefficients | t     | p    | Collinearity Statistics |       |
|-----------------------------|-----------------------------|------------|---------------------------|-------|------|-------------------------|-------|
|                             | B                           | Std. Error | Beta                      |       |      | Tolerance               | VIF   |
| (Constant)                  | .214                        | .424       |                           | .506  | .614 |                         |       |
| Log(capital)                | .481                        | .065       | .412                      | 7.360 | .000 | .806                    | 1.240 |
| Log(entrepreneur education) | .571                        | .201       | .159                      | 2.843 | .005 | .811                    | 1.233 |
| Log(entrepreneur training)  | .135                        | .060       | .119                      | 2.252 | .025 | .899                    | 1.113 |
| Log(employee training)      | .221                        | .118       | .101                      | 1.881 | .062 | .879                    | 1.138 |
| Log(employee experience)    | 1.039                       | .110       | .497                      | 9.464 | .000 | .916                    | 1.092 |

Predictors: (Constant), Log(employee experience), Log(entrepreneur training), Log(employee training), Log(entrepreneur education), Log(Capital).  
 Dependent Variable: Log(Output)

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**KEEPING IT IN THE FAMILY: INVESTIGATING THE IMPACT OF IDENTITY  
AND CEO FAMILY TIES ON FAMILY COMMITMENT**

**ABSTRACT**

Drawing upon psychological ownership theory, social identity theory, kinship theory, the upper echelon perspective, and commitment literature, this study proposes a model of family members' identification with their family's business. We argue that social factors such as family representation in the top management team, family and shareholder meetings, and percentage networth invested in the business will determine perceived identification with the business, which, in turn, affects family members' commitment to continue the family business. We further propose that these relationships are influenced by the CEO's ties to the founding family. A structural equation model of these relationships is cross-validated using data drawn from two large-scale, national surveys of family businesses.

# **KEEPING IT IN THE FAMILY: INVESTIGATING THE IMPACT OF IDENTITY AND CEO FAMILY TIES ON FAMILY COMMITMENT**

## **INTRODUCTION**

Researchers suggest that a primary goal of family business owners is to pass the business on to another family member (Casson, 1999; Ward, 1991). Associated with the desire to pass on the business, the family is said to bring a long-term perspective in the business that emphasizes firm survival over short-term performance (Anderson & Reeb, 2003a). While family businesses have been found to outperform similar non-family businesses (Anderson & Reeb, 2003a), this performance advantage does not appear to directly translate into long-run survival, as less than 10 % of family businesses survive through the third generation (Kets de Vries, 1993).

Various arguments have been proposed to explain the low survival rate of family businesses, including increased conflict among later generation of family members (Davis & Harveston, 1999), and incompetent heirs (Morck & Yeung, 2003; Shleifer & Vishny, 1997). Some researchers argue that a lack of commitment among current and/or later generations of family members may also affect survival (Aronoff, 2004; Chua, Chrisman and Steier, 2003). However, the lack of research on commitment in the context of family business has led to a gap in our understanding of what triggers commitment among family members towards continuing the family business. We define family's commitment to business, here after referred to as family commitment, as the desire of family to preserve and continue the business as a family business (e.g. Davis, Allen, Lahiri, & Mahto, 2004).

Recently, Davis et al. (2004) examined the extent to which commitment varied across family firms based on a variety of factors including social interactions (e.g., family and

shareholder meetings), financial dependency (e.g., the amount of the family's net worth tied up in business), family control of the top management team (TMT), and dispersion of family ownership (e.g., the number of family owners). However, in this paper we argue that identification with the family business mediates the relationship between commitment and its previously proposed antecedents. We draw upon the commitment literature (e.g. Meyer & Allen, 1997) and social identity theory (e.g. Ashforth & Mael, 1989) to link identification with business and identity with family commitment. We use the upper echelon perspective (e.g. Hambrick & Mason, 1984), psychological ownership (e.g. Pierce, Kostova, & Dirks, 2001), and organizational commitment (Porter, Steers, Mowday, & Boulian, 1974) to link family representation in the TMT, the number of owners, meetings (family and shareholders), and investment to identity and family commitment.

The defining characteristic of family business is the involvement of family members in the business (Chua et al., 2003). Family members generally have a large stake in the business providing them substantial control and influence over the firm's behavior. As a consequence of this, roles from two distinct domains, family and business, spillover in each other (Chrisman, Chua, & Litz, 2003) thereby closely linking the family with the firm. We argue that in such family-owned businesses, the impact of the CEO's ties to the founding family extends beyond the purely economic. CEO family ties should have an impact on the psychological bonds that link family members to their family business. Prior research suggests that a leader's (e.g., the CEO) ties to the family have a substantial impact on business outcomes (e.g. Anderson & Reeb, 2003a; Morck, Shleifer, & Vishny, 1988; Schulze, Lubatkin, Dino, & Buchholtz, 2001). Unfortunately, prior research does not guide us on the question, "Does the CEO's relationship with the founding family affect the

development of family commitment?” In this study, we propose that the presence or absence of CEO ties to the founding family will act to moderate relationships in our proposed model.

The progression of the rest of the paper is as follows. We start with a brief review of family businesses. In the next section, we present our model and offer an explanation of the CEO’s influence on the relationships proposed in our model. We then provide a description of our data, methods, and analysis. The paper ends with a presentation and discussion of results and suggestions for future research.

## **FAMILY BUSINESS**

The complexity of family entanglement with the business has led to the lack of a precise definition for family business (Dupuis, 1994). However, researchers are unanimous in their view that the founding family has substantial influence and control in family businesses (Morck & Yeung, 2003). Thus, researchers in the different disciplines of finance, management, marketing, and strategy have used the involvement of the founding family to categorize organizations into family and non-family business (e.g. Morck, Strangeland, & Yeung, 2000; Anderson & Reeb, 2003a; Anderson & Reeb, 2003b; Anderson, Mansi, & Reeb, 2003). By family, we mean “a group of people related by blood, adoption, or marriage” (e.g. Edwards & Rothbard, 2000). In effect, the role the family plays is crucial in distinguishing family firms from non-family firms.

Family firms are ubiquitous in the U.S. economy; with estimates suggesting that family businesses comprise an estimated 65 % to 85 % of all businesses (Gersick, Davis, Hampton, & Lansberg 1997), employ over 85 % of the labor force (Gomez-Mejia, Larrazakintana, & Makri, 2003), and contribute over 50 % of gross domestic product (McCann, Leon-Guerrero, & Haley, 1997). Despite their overwhelming presence in the economy, their

representation in academic research has been lacking (Dyer, 2003; Schulze et al., 2001), resulting in a critical gap in our understanding of this critical component of the U.S. economy.

Of the many complex problem and dilemmas faced by family business, the survival of the family business is paramount. Yet, the statistics suggest that less than 30% of businesses survive beyond the life of their founders (Kets de Vries, 1993). Related to survival is the problem of ensuring the involvement and commitment of family members in the business. Commitment is viewed as a necessary condition for the continuous involvement of family members, independent of potential profit expectation from the business (Astrachan, 2003).

### **MODEL DEVELOPMENT**

The concept of commitment has captured the attention of organizational researchers for many years (Hom & Griffith, 1995). Organizational commitment, defined as an individual's involvement, identification, and attachment with the organization (e.g. Allen & Meyer, 1990), has been found to influence organizationally valued outcomes such as turnover (Hom & Griffith, 1995) and performance (Somers, 1993). Researchers have generally agreed that commitment has three forms (i.e. affective, normative, and continuance) which generally affect organizations at both organizational and individual levels and produce different outcomes (e.g. Meyer & Allen, 1997; Somers, 1993). Family commitment as presented here is a group level (i.e. family) construct and is different from the three forms of organizational commitment. Despite having common roots with notions of organizational commitment (for reviews of the organizational commitment see Mathieu &

Zajac, 1990; Meyer & Allen, 1997), the literature does not provide much guidance regarding the drivers of commitment in family businesses.

In the family business, founding families are expected to exhibit varying levels of commitment towards maintaining family ownership and control of the business. The development of family commitment may be crucial to intergenerational succession in family businesses. However, the limited research in family commitment does not provide a clear direction. It is tempting to propose that mere ownership creates commitment among family members following the intrinsic model of employee stock ownership plan (ESOP) literature (e.g. Klein, 1987), which argues that ownership alone is sufficient to create commitment. However, it may be dangerous to apply this concept directly given the vastly different context and level of analysis. According to psychological ownership theory (Pierce et al., 2001), the symbiotic relationship between the family and the business, in which there is significant overlap in family and business subsystems (Chua et al, 2003), may create identification among family members. Identification may be antecedent to the development of family commitment, warranting a closer examination of this relationship.

*Identity-Commitment Relationship.* Work in the commitment research suggests that identification is a distinct construct and not a dimension of commitment (e.g. Mael & Tetrick, 1992). Tannenbaum (1983) in his work on ESOP proposed that identification is the key to understanding changes in employee attitudes like commitment. Since then, a stream of research has continued to suggest that identity produces positive attitudinal changes in individuals, such as higher commitment (Ashforth & Kreiner, 1999; Ashforth & Mael, 1989; Foreman & Whetten, 2002; Whetten, Lewis, & Mischel, 1992). Ashforth and Mael defined “social identification as the perception of oneness with or belongingness to some human

aggregate” (1989: 21). The close involvement of the family in the business makes it normal for the family role to spillover into the business and vice versa, implying that family members’ perceptions of self could be based on their affiliation with their family business. To some extent, family members’ self-esteem may be related to the continuance of the family business (Brown, 1997; Elsbach & Kramer, 1996). As the family members’ identity links the reputation of the family with business survival (Anderson et al., 2003) any threat to the business’s reputation will appear as a threat to individual’s identity. Once the family members’ reputations are linked with the business, a threat to the business’s survival becomes a threat to the existence of the family itself (Kets de Vries, 1993).

Stronger family identification with the business is also reinforced by the association of the family’s name with the business. It is quite common that the family name (e.g. last name) is shared by the business (Kets de Vries, 1993), thereby visibly linking the family to the business in the external environment. Over time the linkage becomes so strong that people outside the business fail to differentiate between “the family” and “the business”. This construed external image (Dutton & Dukerich, 1991) not only creates a strong cognitive connection between the family and the business in individuals outside the family but also creates a similar cognitive effect in family members. In constructing a particular organizational identity for presentation to outsiders, family members reinforce the inseparable part of family and business.

This higher identification or the perception of “oneness” with the business (Ashforth & Mael, 1989) encourages family members to maintain the business in family ensuring the legacy for future generations (Anderson et al., 2003). Thus, the commitment to preserve the family business will be higher. The expectation that identification with the family business

will affect family members' commitment to continue their family business provided the basis for the first hypothesis.

Hypothesis 1: *Family identification with the business will positively impact family commitment.*

*Family involvement and Identity Relationship.* Family members' common genetic origin provides them a sense of shared common identity. The family business is often the primary, even the sole source of the livelihood and wealth for family members. Because their fortune is associated with the business, family members meet to discuss future business directions and plans (Habbershon & Astrachan, 1997). During these family meetings, family members often discuss their common history and heritage, beliefs and values, thus reinforcing feelings of shared identity and increasing the potential for collective action (Habbershon & Astrachan, 1997).

Ownership among the family members reinforces the feelings of shared identity among them (Gomez-Mejia et al., 2001) as well as ensuring that family members share in the pecuniary advantages related to business ownership. Because of this direct linkage between their wealth and the business, the family's perceived identification with the business increases as their net worth invested in the business and their meetings (family and shareholder) increase.

A defining characteristic of family businesses is that family members are involved in the business and they assume various roles at different levels of the organizational hierarchy. In most cases, the family is represented in the organizational decision-making by the virtue of their participation in the top management team (TMT). Top managers have a special role for other family members because they are representatives of the other family members. The more family members assume responsibility for the management of the business, the more

their decisions and actions will affect the welfare of the family business. Having family members in the top management team reinforces to the family owners that they own and control their family business. It is likely that family members' identification with their family business would be enhanced by their participation in the top management of the firm. The above discussion leads to our second hypothesis.

Hypothesis 2: *Family investment, participation in the top management team, and family and shareholder meetings will positively influence the extent of family identification with the business.*

Previous research suggested that family investment, participation in the TMT, and family meetings are all positively correlated with family commitment (Davis et al., 2004). As shown in Figure 1, we propose that the family members' identification with the business mediates the relationship between the family social interaction and investment variables. Greater participation by the family in top management, more frequent family and shareholder meetings and greater financial dependence on the family business lead to increased identification with the business by family members. This increased identification, in turn, will increase the commitment of the family to continue the business as a family business. Consistent with prior research and with our two previous hypotheses, we propose following hypothesis.

Hypothesis 3: *Family identification with the business mediates the relationship between family variables (family investment, participation in top management team, and meetings) and family commitment.*

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Insert Figure 1 about here  
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*CEO Family Ties.* One common theme in family business research is the influence exerted by the CEO or top leadership on the firms' behavior and performance (Morck & Yeung, 2003; Anderson & Reeb, 2003a). In particular, much of the literature in this area has focused on the CEO's ties to the family as affecting organizational outcomes. Anderson & Reeb (2003a) argued that while the founding CEO is good for business performance, successors and non-family CEOs are not good for business performance. Morck and Yeung (2003) indicated that the CEO's ties to the family influences the risk assumed by family business, while Anderson and Reeb (2003b) suggested that CEO ties to family influence the cost of the debt financing. Shleifer and Vishny (1997) argued that non-family CEOs can cause dissatisfaction and feelings of alienation among family members. Thus, the CEO's ties to family can have a critical impact on the family business. However, the literature in family business does not provide clear guidance regarding the impact of a CEO's family ties on the relationships investigated in this study. Although theory and evidence are meager we offer the following arguments regarding the impact of the CEO's family ties on organizational identity and commitment.

Having reached the apex of the organization, the CEO is not just an average manager. According to Gioia and Chittipeddi "the CEO is typically portrayed as someone who has primary responsibility for setting strategic directions and plans for the organization, as well as responsibility for guiding actions that will realize those plans" (1991: 434). Therefore, the CEO has the major responsibility for the strategic success of the firm (Vance, 1983). In addition, the CEO influences employees' identification with the organization; furthermore, the CEO represents that organization when dealing with external organizational constituents (Norburn, 1989). The pervasiveness of the CEO's influence implies that family ties should

have an impact on the development of identity and commitment among employees (i.e. family members).

Family psychologists have suggested that family members are generally more attached to their closest genetic relatives such as mother, father, brothers, and sisters than more distant relatives such as a brother/sister in-law. When the CEO is also a member of the founding family, other family members may have a stronger psychological sense of ownership of family business causing a subsequent increase in their identity and commitment. Conversely, when a family firm hires a non-family member CEO, it begins to resemble a non-family business as it separates the family from the governance of the business. A non-family member occupying the most critical position in the family business might signal to both outsiders and family members that the family no longer desires to control the business. The lack of close familial ties at the apex of the organization may attenuate family members' emotional and psychological attachment or ownership. Hence, the level of identity and commitment among family members will vary depending on the CEO's relationship to the founding family.

Alternatively, it may be that the CEO family ties will not moderate the relationship. In order to survive in the competitive environment, hiring a competent CEO may be considered an inevitable step in firm survival. This could be necessary if the family does not have a qualified candidate. Indeed, the hiring of a non-family CEO to lead the firm may be the decision of family members most interested in continuing the legacy. Although there are competing arguments, we offer the following hypothesis for testing.

Hypothesis 4: *CEO ties to the founding family moderates the relationship between (1) family variables and identification with business, and (2) identification with business and family commitment.*

*Control Variables.* As the family size increases, the potential for conflict among family and the dispersion of business ownership increases (e.g. Davis & Harveston, 2001). This may affect family cohesion and the ability to take collective action (e.g. Habbershon & Astrachan, 1997). The lack of cohesion and unity in the family may have detrimental consequences on the family's identification with the business and family commitment. In order to remove the potentially biasing effect of ownership dispersion in the family, we controlled for the influence of the number of adult family owners on identification with the business and family commitment.

*Summary.* As shown in Figure 2, we propose that social factors, such as family representatives in the top management team, family and shareholder meetings, and the percentage of the family's net worth invested in the business, will determine perceived identification with the business, which, in turn, affects family members' commitment to continue the family business. We further propose that these relationships are influenced by the CEO's ties to the founding family.

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Insert Figure 2 about here  
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## **METHOD**

Two different sets of family business data were used to test the hypotheses proposed in this paper. The first data set was obtained from a national survey of family businesses conducted by the Arthur Andersen Center for Family Business with the assistance of the Loyola University of Chicago's Family Business Center and the Family Enterprise Center at the Kennesaw State University in 1997. The second data set was obtained from similar survey of family businesses conducted in 2002 by almost the same group of organizations

except the George & Robin Raymond Family Business Institute and Babson College replaced the Arthur Andersen Center for Family Business. In both data sets, the sample of potential businesses was randomly drawn from a comprehensive, nationwide database of family-owned businesses maintained by Dun & Bradstreet.

To be included in either of the surveys, all firms had to meet the following criteria: the company had at least ten employees; the company had annual revenues of at least two million dollars; the company had been founded at least ten years prior to the survey; and the company had to self-identify the business as a family business.

The first data set (1997 survey) initially contained 3033 observations. After removing incomplete surveys, we obtained a final usable sample of 2154 family firms. In order to test the moderation effects of CEO family ties, we divided the first sample into three different sub-samples based on the CEO's relationship (ties) with the founding family. The first sub-sample contained 1891 family businesses led by CEOs who were related to founding family by blood or adoption (RB sample). The second sub-sample contained 152 family businesses led by CEOs who were related to founding families by marriage (RM sample), and finally, the third sub-sample contained 111 family businesses headed by non-family CEOs (NR sample). We used the RB sample for model refinement purposes.

Therefore, we divided this sample randomly into two different sub-samples with 945 observations each. We named the first sub-sample, used for testing the proposed model presented in Figure 1 (without moderation effects), the *calibration sub-sample*. The second sub-sample, used for testing the refined model, was named the *validation sub-sample*.

The second data set (2002 survey) initially contained 1143 observations but it did not have enough observations for family businesses led by CEOs related to the family by

marriage or non-family CEOs. We used the second data set to establish the convergent and discriminant validity of our commitment scale measures and the organizational commitment scale (OCQ) measures developed by Porter, et al. (1974). A listwise deletion for missing observations provided us a final usable sample of 845 family businesses.

## MEASURES

*Family Variables.* We used four different indicators of family participation in the business: family meetings (FMEET), shareholder meetings (SMEET), family members in the TMT (FAMTMT), and family investment in the business (NETWORTH). Family meetings was measured by asking respondents, “How many formal family meetings (other than shareholder meetings) are held each year?” Respondents indicated their preference on four available options: 0, 1-2, 3-4, and 5 or more. These same options were used to measure shareholder meetings. The respondents were asked to provide number of shareholder meeting held each year by asking, “How many shareholder meetings are held each year?” Respondents indicated the number of family members in the TMT of the family business in response to the question, “How many family members are on the company’s top management team?” Finally, the family’s extent of financial involvement or investment in the business was operationalized by asking respondent to indicate, “Approximately what percentage of the family’s net worth is tied up in the business?” Answers were provided using a quintile scale, where 1 indicated less 20% and 5 indicated greater than 80%.

*Family identification with business.* In order to measure the family’s identification with the business respondents were asked, “How much does the business contribute to the family’s identity in the community and elsewhere?” They indicated their preference on a 5-point Likert-type scale ranging from 1 = Not at all to 5 = Very much so. The use of a global

measure of identity for this study allowed us to capture an overall assessment without focusing on other dimensions of identity (e.g. Dutton et al., 1994; Goldberg, Riordan, & Schaffer, 2004).

*Family Commitment.* Many measures have been proposed to assess commitment (see Reichers, 1985; Van Dick, 2001) however, their applicability for our purposes was questionable. Two arguments in particular swayed us from prior measures. First, unlike most previous studies that largely assumed the relationship between the employee and the firm to be of a strictly contractual nature, we specify the presence of a familial relationship. Hence, our sampling frame is restricted to family businesses. Secondly, the unit of analysis is different. Most previous measures of the notion of continuance commitment addressed an individual's intent to remain with the firm. Here, we assess family commitment as a group-level psychological construct, rather than an individual level construct. These differences are reflected in the items and composite scale used to tap the domain of family commitment.

To represent family members' attitudes towards the continuance of the family business, herein referred to as COMMIT, we constructed a composite measure that consisted of two items. The first item tapped the expressed level of commitment among the senior generation towards continuing the family business, while the second item tapped the level of commitment perceived to exist among the next generation of family members. Both items measured the extent of commitment present using a five-point Likert-type scale from 1 = not at all to 5 = very much. To capture the combined level of commitment across generations, responses on the two items were summed.

*Organizational Commitment Questionnaire (OCQ).* An eight-item version of the Organizational Commitment Questionnaire (OCQ) scale developed by Porter et al. (1974),

was adapted to the family business context in the second sample. One sample question from this scale is, “As family, we support the family business in discussions with friends, employees, and other family members.” The respondents indicated their agreement with items of the scale on a five-point Likert-type scale that ranged from 1 = Strongly Disagree to 5 = Strongly Agree.

*Control Variables.* To operationalize our control variable, ownership dispersion (OWNER), respondents were asked to indicate the number of adult family owners.

### **ANALYSES AND ASSESSMENT OF MEASURES**

*Analysis.* Initially we used exploratory maximum likelihood factor analysis for establishing the convergence and discriminant properties of our family commitment scales measures versus organizational commitment (OCQ) scale measures developed by Porter et al. (1974) in the second data set. Later, we used structural equation modeling using LISREL 8.51 (Joreskog & Sorbom, 1993) for conducting confirmatory factor analysis, model generation, and assessing the stability of the final model. We used the sample covariance matrix as input for LISREL 8.51 and fixed measurement loading (square root of the scale reliability times standard deviation) and error variances (one minus reliability times the scale variance) (Bollen, 1989; Joreskog & Sorbom, 1983) in the *initial* and *revised* model. Following Donovan, Brown, & Mowen (2004), single item measures were assumed to have a reliability of .85 while testing the *initial* and the *revised models*. We first evaluated the fit of the initial model with the *calibration sub-sample* to arrive at the revised model. While assessing the fit of the model with the data, we examined chi-square statistics as well as the root-mean-square-error of approximation (RMSEA), standardized root-mean-square-residuals (RMR), the goodness of fit index (GFI), the adjusted goodness of fit index (AGFI)

(Joreskog & Sorbom, 1984), the normed fit index (NFI) (Bentler & Bonett, 1980), and the comparative fit index (CFI) (Bentler, 1980; Hu & Bentler, 1999). As chi-square is sensitive to sample size (Cudeck & Henly, 1991), it was necessary to examine other measures of fit to interpret the fit of the model with the data.

*Assessment of Measures.* Initially we conducted exploratory maximum likelihood factor analysis with ten items in the second data set (2002). These items included the eight-item organizational commitment scale (OCQ) (Cronbach's alpha,  $\alpha = .90$ ) and the two-item family commitment scale (COMMIT) (Cronbach's alpha,  $\alpha = .80$ ). As these constructs should be related, we examined solutions with oblique rotation. The results of this analysis supported our *a priori* two-factor solution and provided us two factors with eigenvalues greater than one. The resulting two-factor solution accounted for 64% of the variance in the sample. Consistent with our expectations, the two indicators of family commitment (COMMIT) and the eight indicators of OCQ loaded heavily on appropriate factors while the cross loadings were weak.

Later, we conducted confirmatory factor analysis using LISREL 8.51 (Joreskog & Sorbom, 1993) with the same ten items comprising the two scales (COMMIT & OCQ). The obtained fit statistics, with the exception of chi-square, suggested a moderate fit of the measurement model with the data ( $\chi^2_{34} = 327.01$ ;  $p < .05$ ; RMSEA = .094; RMR = .032; GFI = .94; AGFI = .92; NFI = .93; NNFI = .92; CFI = .94; Hu & Bentler, 1999; Bollen, 1990). Given the large size of the sample ( $n = 845$ ), the significance of chi-square is not surprising (e.g. Cudeck & Henly, 1991). However, the other measures indicated a moderate fit of the measurement model with the data. We also assessed the significance of each path in the measurement model by examining the associated t-value of the path. A t-value  $> 1.96$

indicates significance of the path at  $p < .05$ . The results of confirmatory factor analysis suggested that all paths were significant. The average variance extracted (AVE) for OCQ and COMMIT scale items were .54 & .65, respectively. This suggested that the measures of the two items satisfied the most constrained test of convergence validity established by Fornell and Larcker (1981). The shared variance between the two constructs was only .07, which was much lower than the AVE of measures of two constructs. This indicated that our measures exceeded the discriminant validity criteria established by Fornell and Larcker (1981). Discriminant validity was also established by imposing a single factor solution in the measurement model. The single factor solution deteriorated the model fit significantly as indicated by a significant increase in chi-square ( $\chi^2_1 = 399.56$ )<sup>1</sup>(see Anderson & Gerbing, 1988).

*Model Evaluation & Revision.* The proposed *initial model* without moderation, presented in Figure 1, was tested on the *calibration sub-sample*. The fit indices ( $\chi^2_4 = 37.86$ ,  $P < .05$ ; RMSEA = .092; RMR = .037; GFI = .99; AGFI = .93; NFI = .89; NNFI = .70; CFI = .90) indicated a moderate level of fit. With the exception of the SMEET  $\rightarrow$  COMMIT path, all paths included in the model were significant ( $t$ -value  $> 2.0$ ). The modification indices suggested the addition of a path from family TMT to family commitment (COMMIT). In the *revised model*, we added a path from FAMTMT  $\rightarrow$  COMMIT. This *revised model* was again tested on the *calibration sub-sample*. The fit indices ( $\chi^2_3 = 5.29$ ,  $P > .10$ ; RMSEA = .028; RMR = .01; GFI = 1.00; AGFI = .99; NFI = .99; NNFI = .95 CFI = .99) suggested an excellent fit between the *revised model* and the *calibration sub-sample*. Again all hypothesized paths with the exception of SMEET  $\rightarrow$  COMMIT were significant. Next, we tested the *revised model* on the *validation sub-sample*. The fit statistics ( $\chi^2_3 = 5.96$ ,  $P > .10$ ;

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<sup>1</sup> An increase of 3.84 in  $\chi^2$  for 1 df indicates the significant change in the model at the .05 level.

RMSEA = .032; RMR = .01; GFI = 1.00; AGFI = .98; NFI = .98; NNFI = .94 CFI = .99) suggested good fit of the *revised model* with the *validation sub-sample*. The fit statistics along with completely standardized path estimates for the initial and the *revised model* can be found in Table 1. We also examined the indirect paths in the model which are presented in Table 2.

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Insert Tables 1 and 2 about here  
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In order to test the moderation effect of CEO ties to the founding family on the relationships proposed in this study, we conducted simultaneous three group (RB, RM, & NR samples) analysis using LISREL 8.51 (Joreskog & Sorbom, 1993). We started with the most constrained three-group analysis. This model, in which all parameters were constrained to be equal across three groups, was used as the *base model* for testing the moderation effects. Although the chi-square statistic for the *base model* was significant ( $\chi^2_{29} = 49.62, P < .05$ ) the ratio of chi-square to the degrees of freedom was less than 3, indicating a good fit of the model with the data (e.g. Hughes, Price, & Marrs, 1986). The other fit statistics also indicated a moderate level of fit. The standardized path estimates along with fit statistics for three-group analysis can be obtained in Table 3. In order to test for moderation effects, we freed one path across two groups at a time in the *base model*, and examined the chi-square difference between the base model and the resulting less-constrained model. If the chi-square difference was significant, then the CEO's ties to the family moderates the freed path across the two groups. We repeated the chi-square difference test for all possible hypothesized paths two groups at a time. The summary of these results can be found in Table 4.

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Insert Tables 3 and 4 about here  
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## RESULTS

The means, standard deviation, and correlation among study variables from the first data set (1997 survey) are presented in Table 5. As shown in Table 5, IDENTITY is significantly correlated with all four family variables (SMEET, FMEET, FAMTMT, & NETWORTH). Family commitment is positively and significantly related to family identification with the business and three of the family variables (SMEET, FMEET, & FAMTMT). In general, the correlations among the study variables do not rise to a level evidencing multicollinearity.

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Insert Table 5 about here  
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The first hypothesis (H1) suggested a positive influence of identification with the business (IDENTITY) on family commitment (COMMIT). As can be observed in Table 1, IDENTITY has positive and significant ( $\beta = .27, .27$ ;  $t$ -value = 7.06, 7.18) impact on family commitment (COMMIT) in both the *calibration* and *validation sub-samples*. Even in the base model (Table 3), IDENTITY has a significant ( $\beta = .24$ ;  $t$ -value = 11.70) influence on family commitment. This indicates that the hypothesis H1 is strongly supported.

For the second hypothesis, we were expecting positive influences for the four family variables (SMEET, FMEET, FAMTMT, & NETWORTH) on family identification with business (IDENTITY). In both the *calibration* and *validation* sub samples, family meetings ( $\beta = .13, .18$ ;  $t$ -value = 3.22, 4.17) had a significant positive impact on IDENTITY. Family

TMT ( $\beta = .11, .16$ ; t-value = 2.77, 3.67) and NETWORTH ( $\beta = .12, .08$ ; t-value = 3.34, 2.03) also positively influenced the family's identification with the business. The significant positive impact of these three family variables (FMEET, FAMTMT, & NETWORTH) was also supported in the base model (Table 3). Shareholder meetings, although it had a positive influence on IDENTITY, its impact was not significant. In general, the results provide some support for hypothesis H2.

The third hypothesis (H3) suggested that IDENTITY mediates the relationship between family variables and family commitment. As can be observed in Table 2, family meeting ( $\beta = .04, .05$ ; t-value = 2.93, 3.60), representation in TMT ( $\beta = .03, .04$ ; t-value = 2.61, 3.33), and investment in the business ( $\beta = .03, .02$ ; t-value = 3.02, 1.96) had significant indirect effects on family commitment through IDENTITY. However, shareholder meetings did not have a significant indirect impact on family commitment. The majority of the indirect paths were significant, indicating support for hypothesis H3.

Hypothesis H4 proposed that CEO ties to the founding family would moderate the relationships investigated here, as shown in Figure 2. As can be seen in Table 4, CEO ties to the family moderated only the IDENTITY  $\rightarrow$  COMMIT path. It had no significant impact on other paths in the model. On balance, the preponderance of evidence suggests that the presence or absence of ties between the CEO and the founding family does not moderate the majority of relationships of interest here, thus we reject H4.

## **DISCUSSION AND CONCLUSION**

The primary objectives of this study were to investigate the link between identity and family commitment, and the impact of CEO ties to the founding family on revealed

relationships. We did this by focusing on identity as the antecedent to commitment and by treating the ties between the CEO and the founding family as a moderating variable.

Our results support the proposition that the family's identification with the family business affects their commitment to preserve the family business. Family meetings (number of family meetings), the degree of family involvement in the management of the firm (i.e., as members of the TMT) and the family's financial dependency on the business (i.e., the percentage of family net worth tied up in the business) were shown to have a positive influence on the development of the family's identification with the business. Unexpectedly, shareholder meetings were not a significant predictor of family identification (IDENTITY) with the business. Perhaps, shareholder meetings are not an antecedent of identity because they tend to be limited to discussions about business operations and future plans, which might increase the potential for conflict due to diversity in equity, opinions, and competing claims over business gains. In contrast, family meetings increase identification because business discussions are secondary to family issues (Habbershon & Astrachan, 1997). Discussion of family issues may reduce the appearance of conflict among family members and create conditions for collective action. Our study also provides support for the mediating effects of identity on the relationship between family variables and family commitment. All but one of the family variables (i.e., shareholder meetings) were shown to have a significant indirect impact on family commitment through identity.

The results also suggest that certain antecedents of identity are more important than others. Among the variables investigated here, the number of family meetings was the most important in determining family members' identification with the family business. This finding suggests that social interactions are essential to furthering identification among

family members. Researchers consider identity as a social construction (Gergen & Davis, 1985) as it is derived from repeated interaction with others. As suggested by Pierce et al. (2001), in the context of family business, communication and discussion of business and family issues among family members allows the group (family) to develop a sense of ownership toward the business. In effect, social interaction installs a strong feeling of “our” or “my” and reduces the tendency of “they” or “their” among family members. In addition, the active participation of the family in the management of the firm (e.g., as members of the TMT) significantly affected both identity and commitment. This finding was consistent with theories of psychological ownership, in that increased family representation in the business increased the family’s perceived influence and control over the business, providing a basis for the development of identification.

While the results of tests of moderation between the antecedent variables and identity were negative, there was some evidence that the presence or absence of particular forms of familial ties between the CEO and the founding family served to moderate the relationship between identity and commitment. The relationship between identity and commitment was stronger when the CEO was related by blood to the founding family or was a not a family member. There was no difference between these two groups. In contrast, lower family commitment was evident among firms that were led by a CEO who was related by marriage to the founding family. This is an interesting finding for understanding the impact of family ties on family commitment. Perhaps, the presence of a blood relationship between the founding family and the CEO (a family member) precipitates a common bond and a set of mutual expectations derived from common family experiences, values, emotions and sentiments than is possible when the CEO is related by marriage. Also, when the family

business hires a non-family CEO, the implication is that family members may not possess the required skills and expertise to successfully manage the business. In order to preserve their family business, family members may consider it is necessary to hire non-family member with the needed qualifications and/or credentials for the business to survive.

In contrast, when the CEO's relationship is based solely on marriage to a founding family member, they do not possess a familial bond or historic relationship with other family members. Divorce is a common phenomenon in the U.S., over 50% of marriages in the U.S. end in divorce (Braver & O'Connell, 1998; Sheets and Braver, 1996). As a result, family members' relationships with the CEO may not be viewed as stable, leading to some attenuation of commitment among members of the founding family.

We extended theory by assessing commitment among family business owners. In doing so, we went beyond most previous investigations that were limited to studies of commitment among employees/owners. In addition, our study supports extending the treatment of commitment beyond a merely individual level phenomenon, to considering it as existing at the group-level (i.e., family) as well. In the family business context, we also demonstrated the importance of including identity when examining family commitment.

Our findings suggest that when examining the role of family ties in organizational relationships, we should recognize the complex nature of the family. Previous research on family ties has examined the difference between family and non-family leadership (Anderson and Reeb, 2003a; Gomez-Mejia, et al., 2001) our findings suggest that within the family the nature of the relationship (related by blood vs. related by marriage) may play an important role.

The results of this study need to be evaluated through additional research. The samples used here were cross-sectional and the family variables were reported by an individual respondent representing the family. However, we attempted to address the measurement issue by including the probability of error in our measures. Despite these limitations, the results provide a clearer picture than was previously available of the conditions that affect the complex relationship between family ties and organizational outcomes.

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Table 1. Completely standardized path estimates for the initial and revised models in the calibration and validation sub-samples.

| Paths                     | <i>Calibration Sub-Sample<br/>Initial Model<br/>(n = 945)</i>  |                 | <i>Calibration Sub-sample<br/>Revised Model<br/>(n = 945)</i>   |                 | <i>Validation Sub-sample<br/>Revised Model<br/>(n = 945)</i>   |                 |
|---------------------------|--|-----------------|---|-----------------|--|-----------------|
|                           | Path estimate  | <i>t</i> -value | Path estimate   | <i>t</i> -value | Path estimate  | <i>t</i> -value |
| <b>IDENTITY</b>           |  |                 |   |                 |  |                 |
| OWNER→IDENTITY            | .12  | 2.64            | .12   | 2.71            | .02  | .41             |
| SMEET→IDENTITY            | .03  | .63             | .03   | .63             | -.01   | -.23            |
| FMEET→IDENTITY            | .13  | 3.23            | .13   | 3.22            | .18  | 4.17            |
| FAMTMT→IDENTITY           | .12  | 3.01            | .11   | 2.77            | .16  | 3.67            |
| NETWORTH→IDENTITY         | .12  | 3.34            | .12   | 3.34            | .08  | 2.03            |
| R <sup>2</sup> (IDENTITY) | .08  |                 | .08   |                 | .07  |                 |
| <b>COMMITMENT</b>         |  |                 |   |                 |  |                 |
| OWNER→COMMIT              | .07  | 1.62            | .02   | .58             | .05  | 1.36            |
| IDENTITY→COMMIT           | .30  | 8.02            | .27   | 7.06            | .27  | 7.18            |
| FAMTMT→COMMIT             |  |                 | .22   | 5.75            | .29  | 7.25            |
| R <sup>2</sup> (COMMIT)   | .10  |                 | .14   |                 | .20  |                 |
| Fit-Statistics            | χ <sup>2</sup> <sub>4</sub> = 37.86, P < .05; RMSEA = .092; RMR = .037; GFI = .99; AGFI = .93; NFI = .89; NNFI = .70 CFI = .90 |                 | χ <sup>2</sup> <sub>3</sub> = 5.29, P > .10; RMSEA = .028; RMR = .01; GFI = 1.00; AGFI = .99; NFI = .99; NNFI = .95 CFI = .99 |                 | χ <sup>2</sup> <sub>3</sub> = 5.96, P > .10; RMSEA = .032; sRMR = .01; GFI = 1.00; AGFI = .98; NFI = .98; NNFI = .94 CFI = .99 |                 |

Note: *t*-value >= 1.96 indicates significance at the .05 level; *t*-value >= 1.65 indicates significant at the .10 level.

Table 2. Completely standardized indirect path estimates for family commitment.

|                       | <i>Calibration Sub-sample<br/>Revised Model<br/>(n = 945)</i> |                 | <i>Validation Sub-sample<br/>Revised Model<br/>(n = 945)</i> |                 |
|-----------------------|---|-----------------|--|-----------------|
|                       | Path estimate   | <i>t</i> -value | Path estimate  | <i>t</i> -value |
| <b>Indirect Paths</b> |   |                 |  |                 |
| SMEET→COMMIT          | .01   | .63             | .00  | -.23            |
| FMEET→COMMIT          | .04   | 2.93            | .05  | 3.60            |
| FAMTMT→COMMIT         | .03   | 2.61            | .04  | 3.33            |
| NETWORTH→COMMIT       | .03   | 3.02            | .02  | 1.96            |

Table 3. Completely standardized path estimates and fit statistics for simultaneous three-group test of equality.

|                           | <i>Base Model</i>   |                 |
|---------------------------|---|-----------------|
| Paths                     | Path Estimates  | <i>t</i> -value |
| <b>IDENTITY</b>           |   |                 |
| OWNERS → IDENTITY         | .03   | 1.50            |
| SMEET → IDENTITY          | .01   | .65             |
| FMEET → IDENTITY          | .14   | 6.47            |
| FAMTMT → IDENTITY         | .12   | 5.58            |
| NETWORTH → IDENTITY       | .09   | 4.21            |
| R <sup>2</sup> (IDENTITY) | .06   |                 |
| <b>COMMITMENT</b>         |   |                 |
| OWNERS → COMMIT           | .05   | 2.41            |
| IDENTITY → COMMIT         | .24   | 11.70           |
| FAMTMT → COMMIT           | .21   | 10.19           |
| R <sup>2</sup> (COMMIT)   | .16   |                 |
| Fit-Statistics            | $\chi^2_{29} = 49.62, P < .05;$<br>RMSEA = .035; RMR =<br>.08; NFI = .94; NNFI =<br>.94; CFI = .97; GFI = .97 |                 |

Table 4. Test for inequality of path coefficients across three groups (RB – Related by birth or adoption, RM – related by marriage, & NR – not related).

| Path Free Across three Groups | $\chi^2$ Difference :Baseline vs. less constrained Model* | $\chi^2$ Difference test conclusion |
|-------------------------------|---|-------------------------------------|
| OWNER → IDENTITY              | $\chi^2_1 = .99 - 1.42$                                   | RB = RM = NR                        |
| SMEET → IDENTITY              | $\chi^2_1 = 0 - .02$                                      | RB = RM = NR                        |
| FMEET → IDENTITY              | $\chi^2_1 = 0 - 2.73$                                     | RB = RM = NR                        |
| FAMTMT → IDENTITY             | $\chi^2_1 = .04 - .47$                                    | RB = RM = NR                        |
| NETWORTH → IDENTITY           | $\chi^2_1 = .01 - .04$                                    | RB = RM = NR                        |
| IDENTITY → COMMIT             | $\chi^2_1 = 3.32 - 6.01^{**}$                             | RM ? RB = NR                        |
| FAMTMT → COMMIT               | $\chi^2_1 = 0 - .32$                                      | RB = RM = NR                        |

\* Range of chi-square difference.

\*\*  $\chi^2$  was significant for just RM ? RB = NR case

Table 5. Correlation among study variables for the first data set (n=2154).

|          | 1      | 2      | 3      | 4      | 5      | 6     | 7    |
|----------|--------|--------|--------|--------|--------|-------|------|
| OWNERS   | 1      |        |        |        |        |       |      |
| SMEET    | .084** | 1      |        |        |        |       |      |
| FMEET    | -.047* | .261** | 1      |        |        |       |      |
| IDENTITY | .049*  | .076** | .176** | 1      |        |       |      |
| FAMTMT   | .175** | .142** | .223** | .172** | 1      |       |      |
| NETWORTH | .003   | -.025  | -.022  | .071** | .009   | 1     |      |
| COMMIT   | .094** | .069** | .144** | .283** | .266** | -.007 | 1    |
| Means    | 4.21   | 1.81   | 2.00   | 3.91   | 2.72   | 3.41  | 8.06 |
| S.D.     | 5.76   | .69    | 1.12   | 1.81   | 1.45   | 1.15  | 2.24 |

\*\* Correlation is significant at the 0.01 level (2-tailed).

\* Correlation is significant at the 0.05 level (2-tailed).

Figure 1. Initial proposed model (without moderation effect of CEO ties to family).

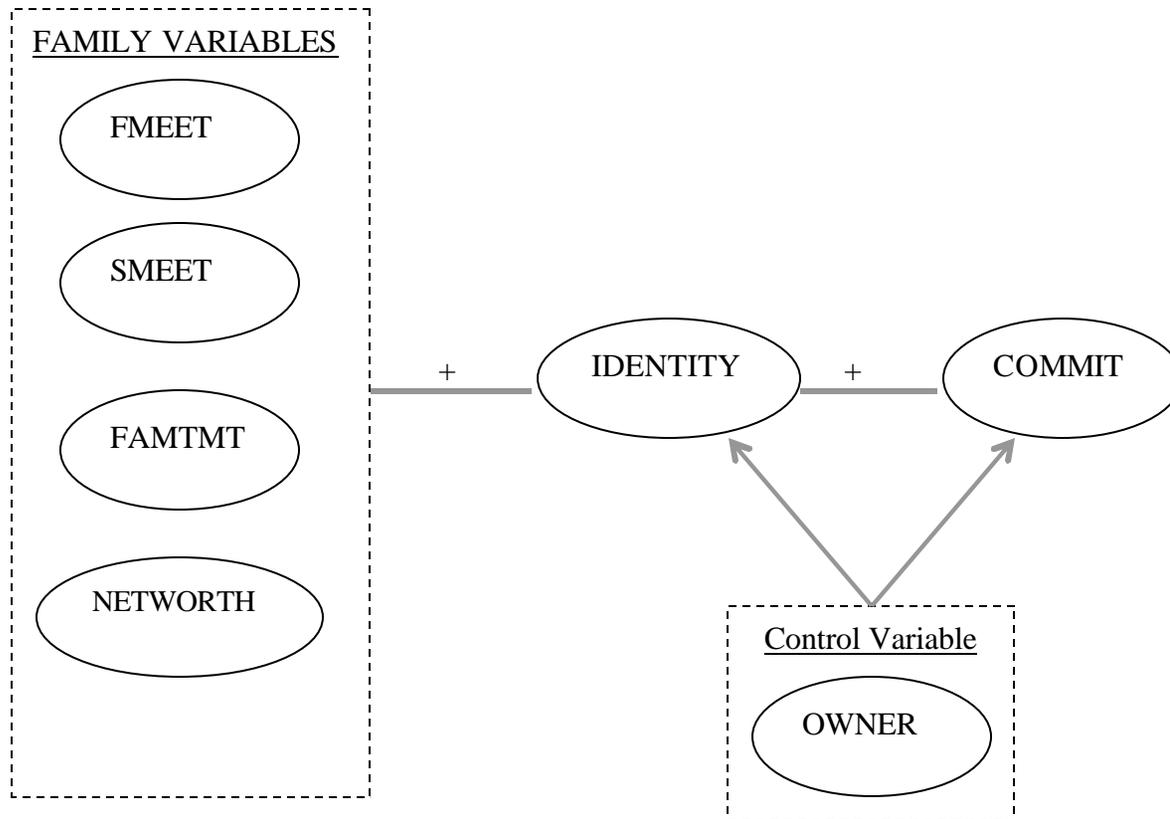
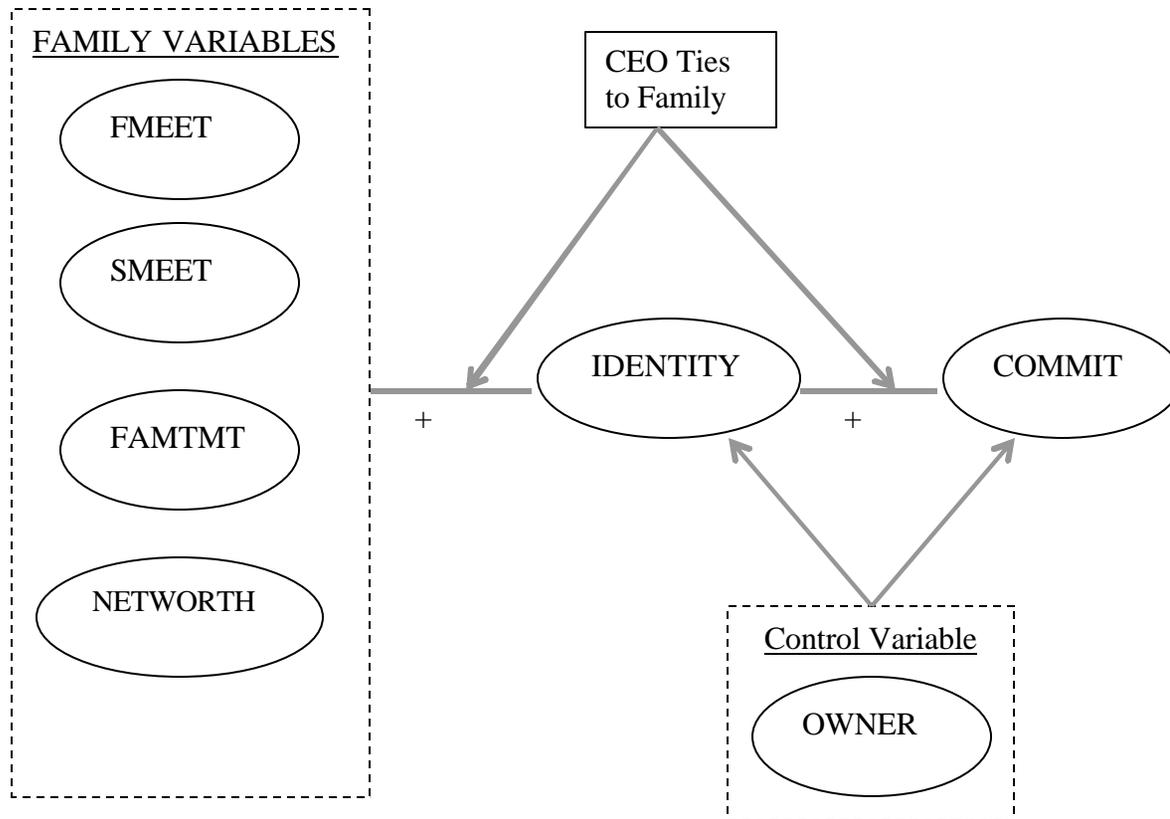


Figure 2. Proposed theoretical model.



# How Well SMEs Cope With Risk Management Issues: A Study In Singapore Context

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## An Abstract

Unmanaged business risk is the bane of businesses. We studied through an interview process the risk management processes of 61 organizations ie small/medium size businesses in Singapore and evidence showed that they( esp those in medium category) were adequately conscious of financial and operations risk management needs. Whilst that were re-assuring, the Tsunami in Asia starkly showed the unprepared-ness of small businesses to survive against business shocks. That happened after the paper was written and will probably be subject matter of yet another paper.

## Introduction

In all national economies, the majority of the business set-ups are Small and Medium Enterprises (SMEs). In the United States, of the 19 million businesses in the country, almost 97% of these are in the small business sector and many expect this sector to grow in view of the new economy fuelled by technological breakthroughs and downsizing of large corporations. Currently, about 99% of all businesses employ fewer than 100 workers.

SMEs are defined differently from one country to another. In the US, a small business has less than US\$20 million in annual sales and employs fewer than 500 workers. In the UK, government statistics focus on companies employing less than 200. Hong Kong limits the number of workers to less than 100 for manufacturing and less than 50 for non-manufacturing concerns.

In Singapore, an SME is one with minimum 30% local ownership that employs less than 100 in a service sector and for those in the manufacturing sector, fixed assets of less than \$12 million( a kind of Government accepted definition for all SME related assistance purposes). For our studies, we define an SME as one hiring less than 200, regardless of the percentage of foreign ownership. **The reason is: we wanted to identify small firms, but not micro-firms for our purposes, with whose senior enough officers we could**

**meaningfully discuss the issues of risk-management. These firms in a Singapore context hence are mid-size. And our interviews will be structured, but face to face, again to be meaningful and data meaningfully derived.**

Entrepreneurship is a dynamic process, which requires certain qualities and skills, and we assumed as variously identified in literature that entrepreneurship capacities/ qualities, are not necessarily innate. An awareness and knowing the ways to deal with risk will represent a fundamental factor that would speed up the transition to a successful business. Risk is extremely prevalent in a highly competitive economy such as Singapore is.

The focus of this study is on Singapore's SMEs' approach and their awareness level of risk management. We attempt to illustrate its characteristics and how SMEs manage risks with special regard to the operational and financial aspects of businesses.

### **Definition of Risk**

Risk is a condition in which there is a possibility of an exposure to adversity. There is a chance deviation from the desired outcome that is expected or hoped for. Risk has become an integral part of our personal and business life. It spans from the level of personal safety, health, accident and employment to corporate asset depreciation, production, inflation, foreign exchange rates, etc. Risk is an essential element in business, every time that a decision is made regarding an investment, the purchase of goods or services, spending marketing dollar on promotions, launching a new product etc, risks exist.

Companies have traditionally viewed risk as the potential occurrence of loss or failure. This is too narrow in scope and a tad too negative in perspective as risk could also represent the opportunity to take profits. Just as organizations need to take preventive steps to avoid or mitigate potential losses (hazard risk), they must take actions to achieve positive gains (opportunity risk). Meanwhile, unknown events are always acknowledged to be ever-present (uncertainty risk).

**A risk situation occurs when you are required to make a choice between two or more alternatives whose potential outcomes are uncertain and must be subjectively evaluated. A risk situation involves potential success and potential loss. The greater the possible loss or profit, the greater the risk involved.**

The Practice of Entrepreneurship, ILO, 1996, Geneva

Risk situations are characterized by the presence of uncertain events. **Uncertainty** exists when the probability of outcomes has to be subjectively assigned since there is not enough historical data to fully depend on. Common reasons for uncertainty are inflation impact on businesses, changes in technology, productivity and prices, consumers' demand, political, social, and business environment changes. Risks can also arise due to natural reasons ie draught, flood, earthquake or similar. Most of these risks are insurable; but risks arising from economic reasons, social upheavals and across the world events(

now that the world is becoming a global village) are the ones to which our businesses need to be more alert and responsive.

Risk should be assessed, warded and managed through proper **analysis and planning**. Speculative risk can be used in business, but it is important that entrepreneurs properly plan and monitor their use. Good managers try to reduce speculative risk through careful study and planning, putting in place measures to manage and hedge the inherent risks. They are always mindful that a successful speculative operation might bring large profits, but this poses danger for the company as speculation could bring about potential losses too if proper risk management is not in place. Risk awareness reduces but certainly not eliminates this possibility.

### **The Importance of Risk Management for SMEs**

Risk Management is a scientific approach to the problem of pure risk, and its objective is the reduction and elimination of pure risks facing the company. The field of risk management has evolved steadily from corporate insurance procurement and most recently been recognised as a distinct and important function for all businesses.

**Risk management contribute to the organisation's general goals in many ways.** A good example is having a fire insurance policy in place in case a fire may break out to destroy a factory. By ensuring the organisation's survival is enough to justify the existence of risk management practices in place. But risks can be much more complex than this, and complexity requires complex management.

**Risk should be viewed as a challenge and not an obstacle.** Growth and renewal is only possible for the entrepreneur and the organisation if there is a healthy approach to risk-taking and managing the business. With relative limited resources like financial and manpower, it is imperative that decision must be made as to how best risks are managed.

**Entrepreneurship requires a risk-taking culture and risk is an integral part of business' activities.** Security should therefore be more completely defined under the headings of assurance, integrity and availability. Rather than being a state of total peace of mind, security should mean risks have been reduced to an acceptable level.

**In business, as in life, there is clearly no way to avoid risk-taking. When you take risks, you discover your own abilities and you will become better able to control your own future will become more self-assured. You will have a more positive outlook towards risk-taking because you have faith in your own abilities. You will accept risks as challenges that require your best efforts to achieve goals.**

The Practice of Entrepreneurship, ILO, 1996, Geneva

## **2 Scope of our research**

In this study, we researched mainly the importance and significance of operational and financial risk in Small and Medium Enterprises (SMEs) in Singapore. The four forms of businesses surveyed were sole proprietor, partnership, private limited and public listed companies.

In an APEC Survey on Small and Medium Enterprises 1994, they defined SMEs used within Government departments in terms of “number of employees”, “turnover” or “accounting based”. The APEC survey went on further to define SMEs as all the enterprises employing fewer than 100 people, including the self-employed. In our scope of this study, we defined an SME as one having less than 200 workers for reasons earlier explained..

Operational and financial risk management is important, as a string of large and highly public corporate failures over the past 10 to 15 years has focused investors and regulators attention worldwide on the way in which companies are managing their risk. We are living in a connected world where events like 9-11, SARS, bird flu, Iraq war, Asian Financial Crisis have affected how we do business and the way we live. In Singapore, the bulk of the impact was borne by the small men, as probably elsewhere, or small businesses.

Many companies have focused on value creation as a key goal. But without adequate procedures in place to manage risk, many are unable to create a real sustainable value. Therefore operational and financial risk management is now a core business process and should be planned accordingly so as to reduce risk and volatility and improve returns.

Larger enterprises have generally accepted the strategic importance of effective risk management and set up risk management functions. *SMEs have lagged behind, partly due to the economic resources and cost/benefit analysis; it is difficult to justify the full-time employment of risk management professionals within SMEs especially the smaller ones.*

Our study focused on a few main themes including “awareness level”, “internal policy”, “identification of financial and operation risk”, “risk analysis, evaluation and treatment” and “risk monitoring and review”. This article however for space limitation does not deal with all of these items.

### **Past Research- Some discussion**

The Institute of Chartered Accountants in Wales and England has been, and continues to be, a major contributor to the debate on managing business risk.

In their briefing document on “*Risk Management for SMEs*” in October 2002, it summarises the recent work by The Faculty of Finance and Management looking at current practice in risk management. The Faculty first published a comprehensive guide

“Business Risk Management” in 1996 when the topic was in its infancy. This is one of the first documents to view business risk management as a cross-organisational technique rather than a narrow, mainly financial discipline. This work has influenced our questionnaire development.

Since that work, risk management has become established as a core business activity. However, there is little guidance on how companies should best manage risk, who should be responsible and where to turn to for advice.

### **Definition of Operational and Financial Risk Management**

Risk management is a central part of any organisation’s strategic management. It is the process whereby organisations methodically address the risks attaching to their activities with the goal of achieving sustained benefit within each activity and across the portfolio of all activities.

Major companies, together with academics and professionals, have produced control systems, which although varying in shape and detail between different industries, generally define the following two risks in this manner.

Operational risks arise from the various operational and administrative procedures that the business uses to implement its strategy.

Financial risks arise from the financial structure of the business, from transactions with third parties and from the financial systems in place.

### **Hypotheses & Analytical Model**

Given that the competitive level in Singapore is high and tough and the fact that all respondent companies are reasonably well established( they are mid-size by our small economy standard), we will make the following hypothesis or somewhat loosely, propositions, for our conclusions will be based mainly on subjective opinions, though widely collected through face to face interview:

**Hypothesis 1:** SMEs will manage their operational risk factors reasonably well. We define a null hypothesis as more than 50% awareness level or a score more than 18 in operational risk factors average( more explanation later).

**Hypothesis 2:** SMEs will manage their financial risk factors reasonably well. We define a null hypothesis as more than 50% awareness level or score more than 15.50 in financial risk factors.

**Hypothesis 3:** SMEs will manage their overall risk factors reasonably well. We define a null hypothesis as more than 50% awareness level or score more than 70 in overall risk management factors.

**Hypothesis 4:** SMEs in different sectors will show differences in regard to their risk management awareness eg financial organizations will be more aware of their risk exposures for the volatility factor, manufacturing in Singapore is almost entirely export dependent etc

Note that the hypotheses would be valid for more established SMEs, while they may not stand for less established ones.

The possible outcomes can be realized from our surveys; the actual findings either support or reject our hypothesis, or partially one or the other.

While this study is focussed on measuring the level of awareness of risk, actual use of risk management techniques are not part of this study, though were discussed generally.

### **Possible Errors of Results**

While every effort has been made to ensure the errors are kept to a minimum, we speculate the following potential problems:

- a. Accuracy of data- opinions are subjective though mostly derived from top management level
- b. Interviewing the right people
- c. Dealing with the wide scope of risk management- how well the respondents really understood them
- d. Limited to one person's view, in a company
- e. Risk management policy is not promulgated across the organization.

### **Research Methodology**

We have designed one survey instrument for this project, which is conducted to find out the awareness level of the SME on risk management issues. Interview was face-to-face, at the highest possible level in each firm we could reach, and one person in each( this had its merits and demerits). It was difficult to find a quite similar research in the literature, but our consultation of related literature helped developing the survey instrument and our discussion among ourselves. Our long experience in dealing with SMEs' various

insurance needs also helped, the long association with them. Hence the research is based more on the ground than literature alone. We are all practising men.

### **SME Survey- More Explanations**

We used a set of potential scale items rated on a 1-5 scale for each question. These items consist of the importance and significance of various operational and financial risk management techniques used in SMEs.

The rating we assigned to each of the item is as follow:

| Rating | Selection by Owner about the type of business insurance or other risk management techniques |
|--------|---|
| 1      | Strongly disagree   |
| 2      | Disagree  |
| 3      | Neutral   |
| 4      | Agree   |
| 5      | Strongly agree  |

The final score for the respondent on the scale is the sum of their ratings for all of the items (sometimes called a "summated" scale).

Altogether there were 23 questions in different sections. For each individual respondent, the minimum score is 23 and the maximum score is 115 (23 X 5).

We define the awareness level as follow:

|          |              |
|----------|--------------|
| 23 – 40  | Unacceptable |
| 41 – 60  | Fail         |
| 61 - 80  | Fair         |
| 81 - 100 | Good         |
| 101- 115 | Excellent    |

We define level of awareness to be high if a respondent score a rating above 70.

### **Sampling of Business Owners**

A sampling size of 65 business owners was selected using a combination of convenience(for we knew them) and the simple random sampling method, out of which, 2 were public listed company, 37 private limited companies, 8 partnerships and 18 sole-proprietorships. Finally however, 61 instruments could be used meaningfully, the rest rejected. We spent, on our reckoning, nearly 250 man-hours on data collection effort alone, collectively.

The possible outcomes below can be realized from our surveys: the actual finding either supports or rejects our hypothesis or partially one or the other.

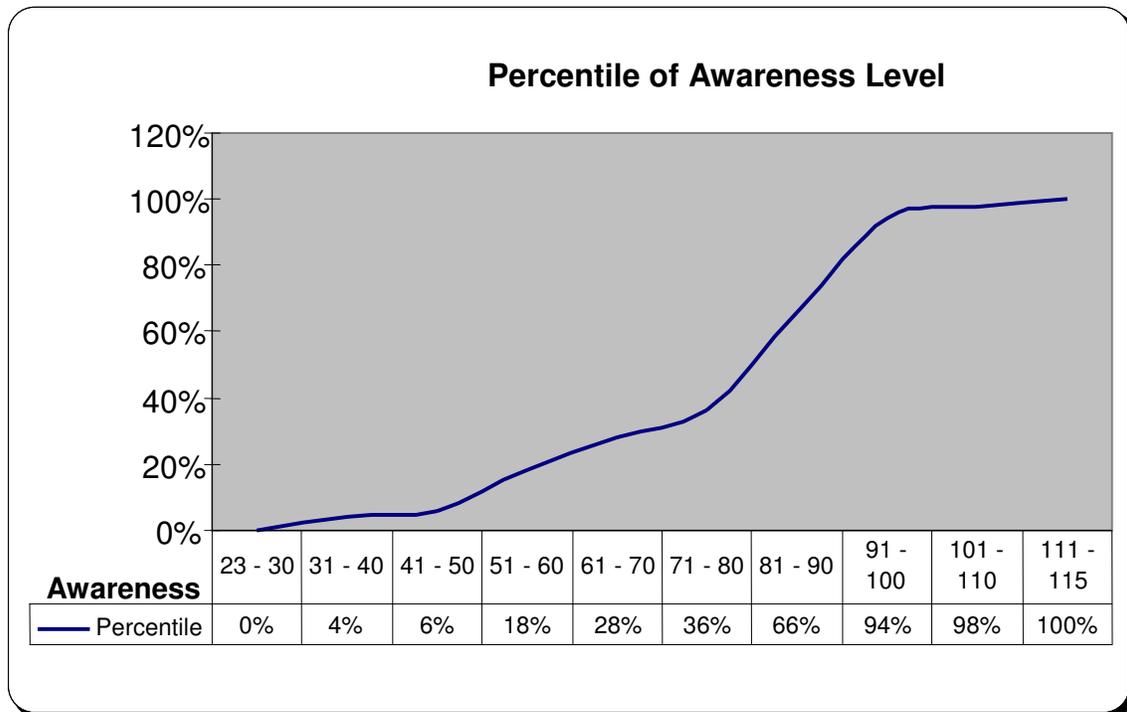
## Data Analysis

### Business Owners' Survey

The number of business owners involved in this survey is 61.

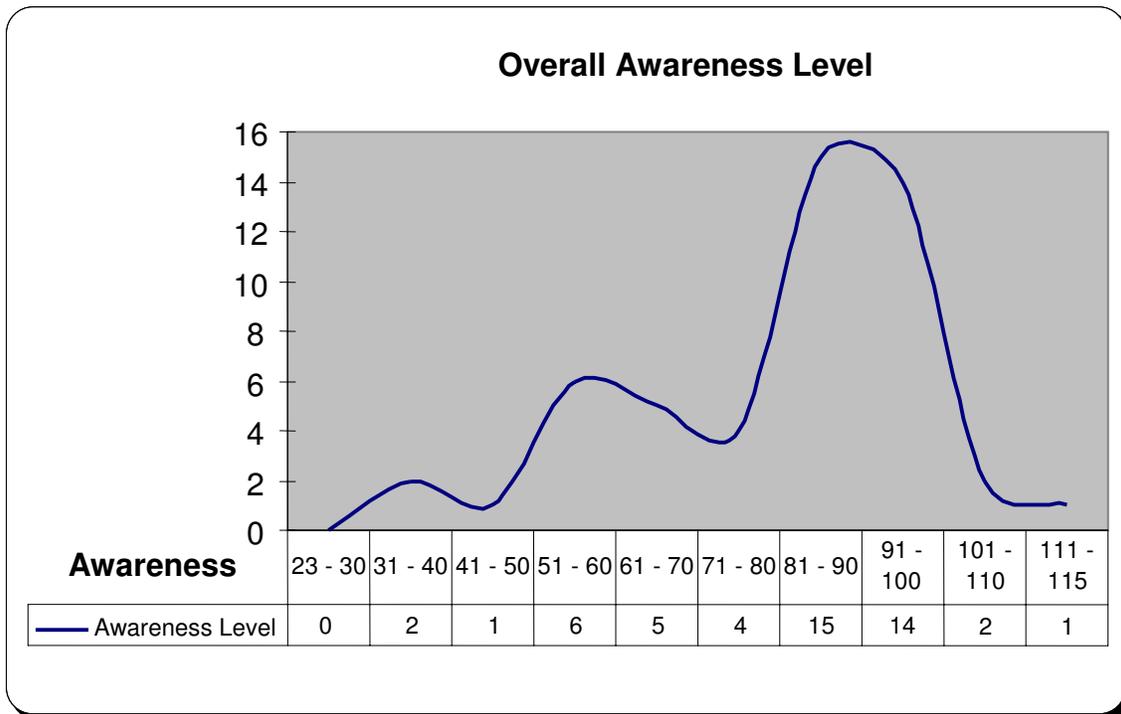
| Overall Awareness Level- Total score | Number | Percentage | Cumulative percentage |
|--------------------------------------|--------|------------|-----------------------|
| 23 – 30                              | 0      | 0%         | 0%                    |
| 31 – 40                              | 2      | 4%         | 4%                    |
| 41 – 50                              | 1      | 2%         | 6%                    |
| 51 – 60                              | 6      | 12%        | 18%                   |
| 61 – 70                              | 5      | 10%        | 28%                   |
| 71 – 80                              | 4      | 8%         | 36%                   |
| 81 – 90                              | 15     | 30%        | 66%                   |
| 91 – 100                             | 14     | 28%        | 94%                   |
| 101 – 110                            | 2      | 4%         | 98%                   |
| 111 – 115                            | 1      | 2%         | 100%                  |

**Table 1. Cumulative Percentage of the all respondents**



Based on the data collected, only 28% of the business owners' score below 70 points based on a scale of 21 - 120 for awareness level, which means that 72% of the respondents' awareness level is considered high. Thus, it is obvious that in general, business owners have a fairly high level of awareness on risk management issues.

### Hypothesis or Proposition Testing – Overall Awareness Level



Sample size = 61;    Mode = 85;    Mean = 80.08;  
 Median = 84;    Standard Deviation = 17.94

### Interpretation of Hypothesis Testing

|                            |              |
|----------------------------|--------------|
| <b>Sample Size:</b>        | <b>61</b>    |
| <b>Mode:</b>               | <b>85.00</b> |
| <b>Mean:</b>               | <b>80.08</b> |
| <b>Median:</b>             | <b>84.00</b> |
| <b>Standard Deviation:</b> | <b>17.94</b> |
| <b>Hypothesized Value:</b> | <b>70.00</b> |
| <b>Significance Level:</b> | <b>0.10</b>  |

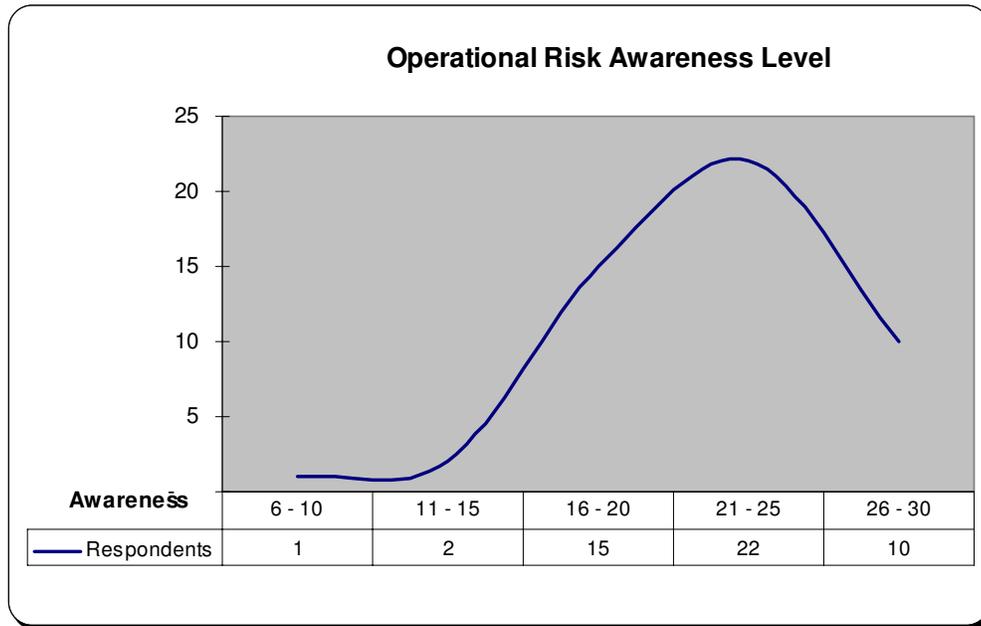
### Student's t-Distribution

$$\begin{aligned} \text{Acceptance Range} &= \text{Hypothesized Value} \\ &+ t\text{-Value (Std Dev}/\sqrt{\text{Sample size}}) \\ &= 70 + 1.299 (17.94/\sqrt{61}=2.3) = 72.99 \end{aligned}$$

*[Note: The t-value of distribution is 1.299 for one-tailed probability of 10% with 60 degree of freedom]*

The Sample Mean of 80.08 exceeds this range; therefore we accept the null hypothesis. This means that the level of awareness on Risk Management issues by SMEs in Singapore is high. However, this acceptance of a high level of awareness is based on subjective opinions which may or may not be fully informed, hence we would rather it a call it a proposition generally well proved. This observation remains valid throughout in this paper.

### Hypothesis Testing – Operational function



Sample size = 61;    Mode = 23;    Mean = 21.54;  
 Median = 22;    Standard Deviation = 4.99

### Interpretation of Hypothesis Testing

|                            |               |
|----------------------------|---------------|
| <b>Sample Size:</b>        | <b>61</b>     |
| <b>Mode:</b>               | <b>23.00</b>  |
| <b>Mean:</b>               | <b>21.54</b>  |
| <b>Median:</b>             | <b>22.00</b>  |
| <b>Standard Deviation:</b> | <b>4.99</b>   |
| <b>Hypothesized Value:</b> | <b>18.00*</b> |
| <b>Significant Level:</b>  | <b>0.10</b>   |

\* Hypothesized value, or acceptance cut-off point in each section is obtained by the section's number of questions, and using its mean value as a guidance. In this section there are 6 questions.

**Student's t-Distribution**

$$\begin{aligned} \text{Acceptance Range} &= \text{Hypothesized Value} \\ &+ t\text{-Value (Std Dev}/\sqrt{\text{Sample size}}) \\ &= 18 + 1.299 (4.99/\sqrt{61}=0.64) = 18.63 \end{aligned}$$

[Note: The t-value of distribution is 1.299 for one-tailed probability of 10% with 60 degree of freedom]

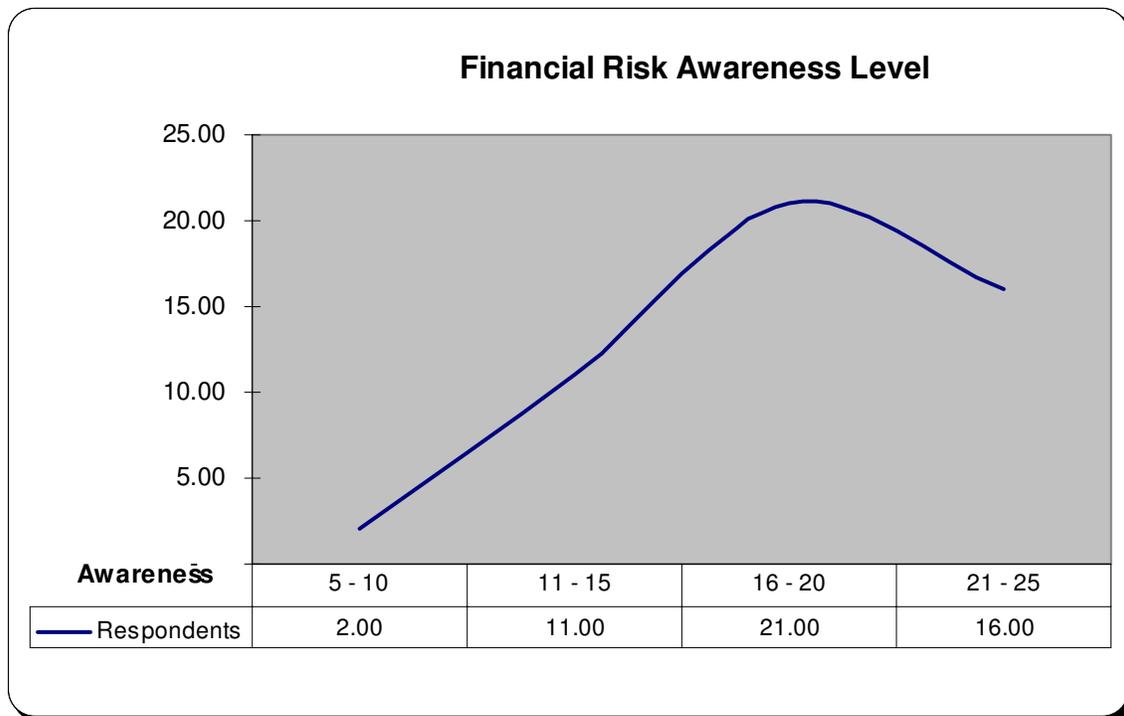
The Sample Mean of 21.54 exceeds this range; therefore we accept the null hypothesis. This means that the level of awareness on Risk Management issues in the area of operational functions by SMEs are high.

Alternatively, we can measure the Test Statistics to determine the acceptance level as compared to the appropriate t-value of distribution.

$$\begin{aligned} \text{Test Statistics} &= \frac{(\text{Sample Mean} - \text{Hypothesised Value})}{(\text{Std Dev} / \sqrt{\text{Sample Size}})} \\ &= (21.54 - 18)/(4.99/\sqrt{61}) = 5.0163 \end{aligned}$$

The t-value of distribution is 1.299 for one-tailed probability of 10% with 60 degree of freedom. Since the test statistic is more than t-value, we accept the null hypothesis. This means we can conclude that the SMEs are aware of the Risk Management issues in the area of operational functions.

### Hypothesis Testing – Financial function



Sample size = 61;    Mode = 18;    Mean = 18.54;  
 Median = 19;    Standard Deviation = 4.44

## Interpretation of Hypothesis Testing

|                            |              |
|----------------------------|--------------|
| <b>Sample Size:</b>        | <b>61</b>    |
| <b>Mode:</b>               | <b>18.00</b> |
| <b>Mean:</b>               | <b>18.54</b> |
| <b>Median:</b>             | <b>19.00</b> |
| <b>Standard Deviation:</b> | <b>4.44</b>  |
| <b>Hypothesized Value:</b> | <b>15.50</b> |
| <b>Significant Level:</b>  | <b>0.10</b>  |

### Student's t-Distribution

$$\begin{aligned}\text{Acceptance Range} &= \text{Hypothesized Value} \\ &+ t\text{-Value (Std Dev}/\sqrt{\text{Sample size}}) \\ &= 15.50 + 1.299 (4.44/\sqrt{61}=0.58) = 16.33\end{aligned}$$

*[Note: The t-value of distribution is 1.299 for one-tailed probability of 10% with 60 degree of freedom]*

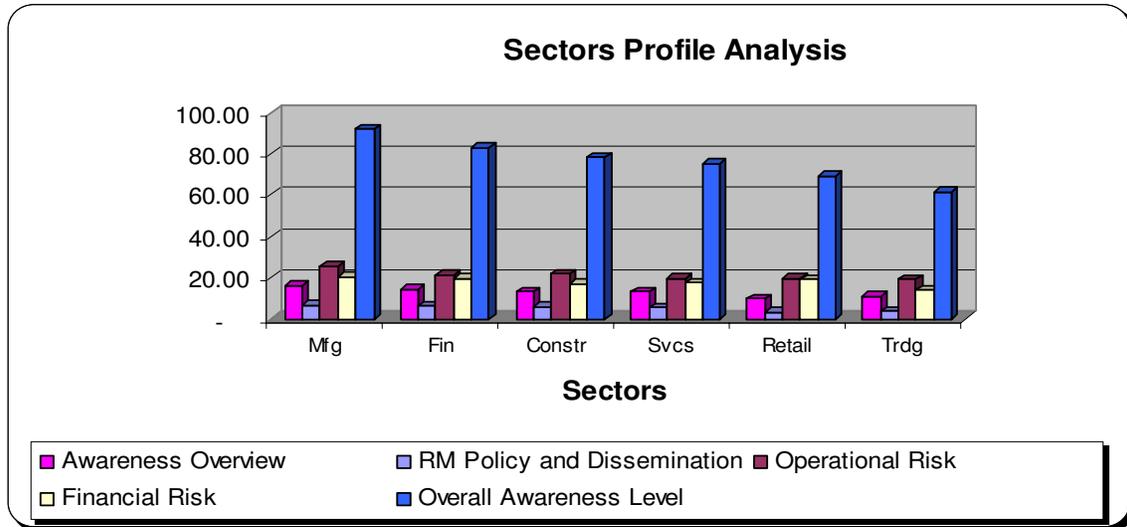
The Sample Mean of 18.54 exceeds this range; therefore we accept the null hypothesis. This means that the level of awareness on Risk Management issues in the area of financial function by SMEs are high.

Alternatively, we can measure the Test Statistics to determine the acceptance level as compared to the appropriate t-value of distribution.

$$\begin{aligned}\text{Test Statistics} &= \frac{(\text{Sample Mean} - \text{Hypothesized Value})}{(\text{Std Dev} / \sqrt{\text{Sample Size}})} \\ &= (18.54 - 15.5)/(4.44/\sqrt{60}=0.58) = 6\end{aligned}$$

The t-value of distribution is 1.299 for one-tailed probability of 10% with 60 degree of freedom. Since the test statistic is more than t-value, we accept the null hypothesis. This means we can conclude that the SMEs are well aware of the Risk Management issues in the area of financial functions.

### Business Sector Analysis

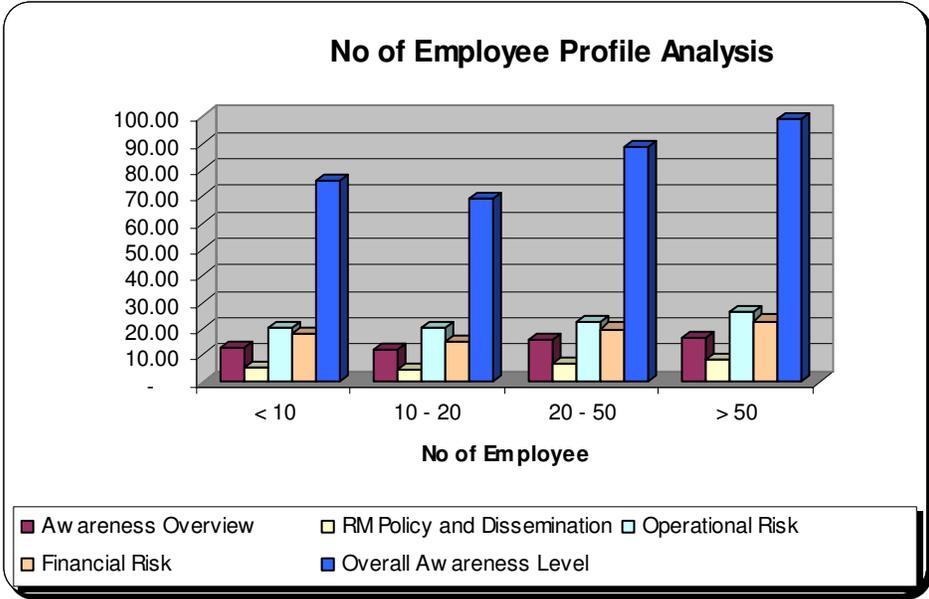


The awareness levels for the various industries shown above are as follows: manufacturing (92.08), finance (82.88), construction (78.00), services (75.32), retail (69.33) and trading (61.50). As predicted, the more sophisticated industry including manufacturing, finance and construction, which tend to be confronted with visible business risk factors and are more aware and actively managing business risk. On the other hand, less volatility-dependent sectors( in Singapore context) including services, retail and trading show somewhat less prepared for risk exposure. However, one limitation is that our sample in each sector was too small to confirm this finding more definitively. Hence, the related hypothesis is allowed with reservation.

### Other Analyses

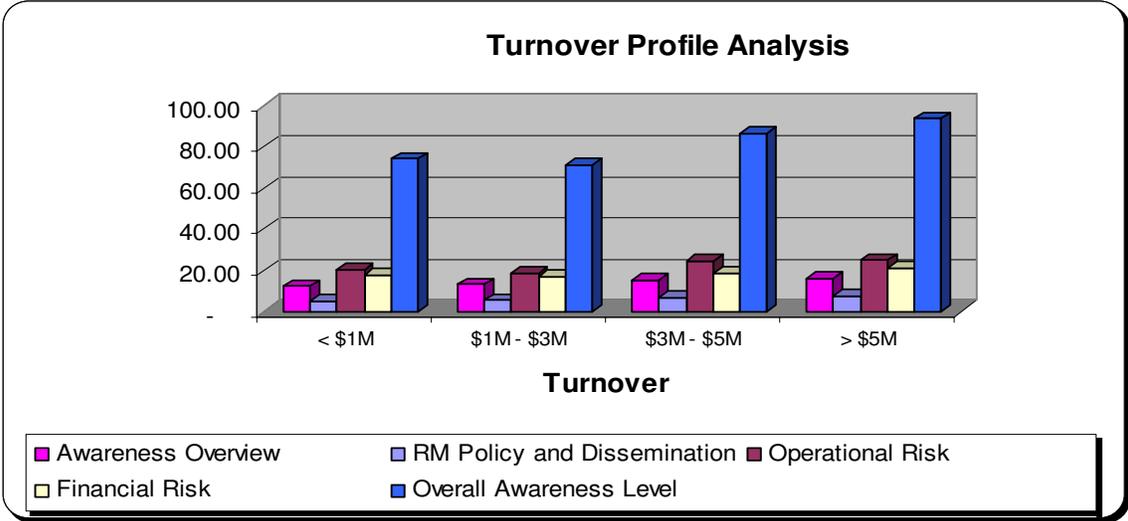
Surprisingly, the level of awareness on risk management issues are not significantly different when related to years in business. Statistics shows the following: those in business < 5 years scored 81.53; 5 to 10 years in business scored 78.78; 10 to 20 years in business scored 79.60 and greater than 20 years in business scored 79.44. From the results, we can conclude that there is no significant correlation between number of years in business and the awareness level of SMEs on risk management issues.

### Number of Employees



The chart indicates that there is increasing awareness as the number of employee increases. The statistics show the following: companies with less than 10 headcount scored 76.00; 10 to 20 headcounts scored 69.33; 20 to 50 headcounts scored 88.33 and those greater than 50 headcounts scored 98.83. We can conclude that risk awareness and number of employees in a company are correlated.

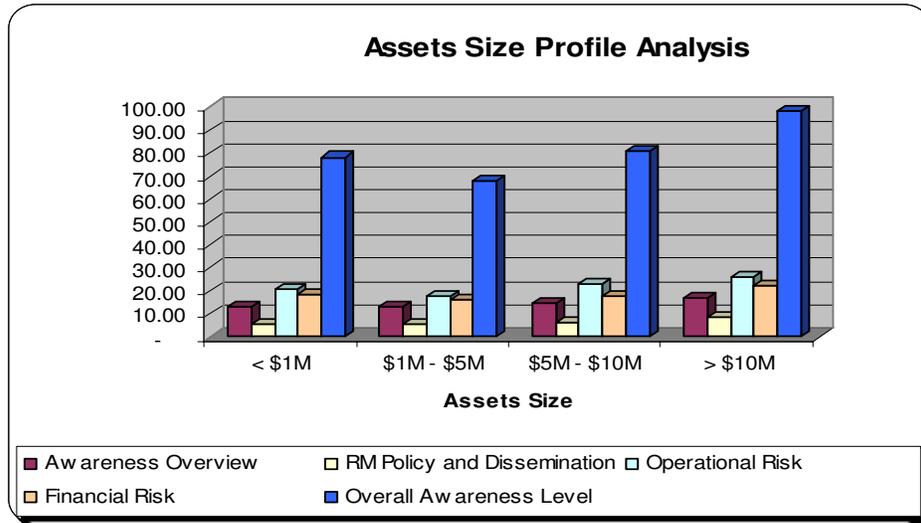
**Sales Turnover**



Generally, as annual sales turnover level increases, the awareness level of the companies on risk management issues also increases. Statistics show the following, companies with sales turnover of less than \$1 million scored 74.20; turnover of \$1 million to \$3 million scored 71.09; turnover of \$3 million to \$5 million scored 86.67 and turnover of greater

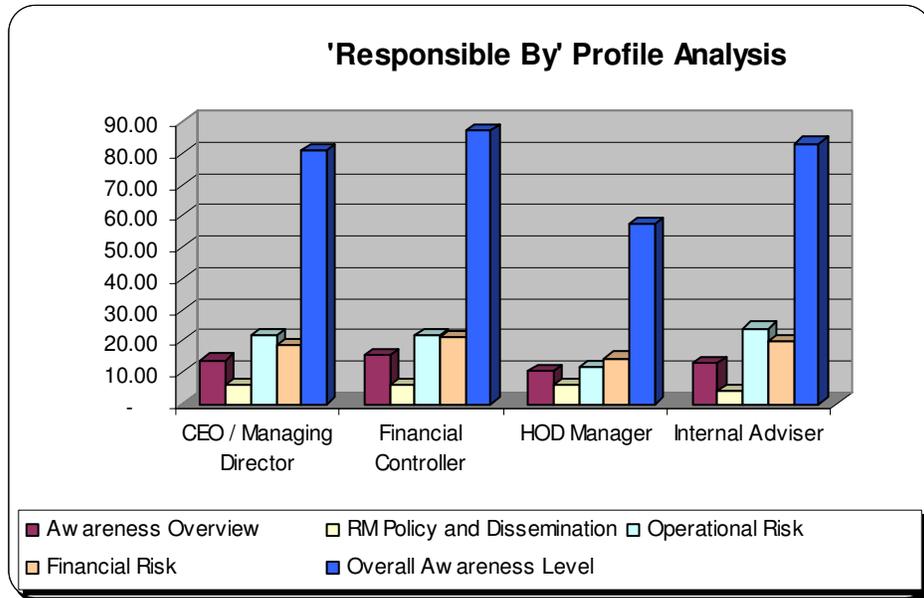
than \$5 million scored 93.69. We can conclude that that the size of business and risk awareness level is also correlated.

### Asset Size



As in sales turnover analysis, the awareness level of the companies on risk management issues also increases as assets size increases. Statistics show the following, companies with assets size of less than \$1 million scored 78.15; assets size of \$1million to \$5million scored 67.75; assets size of \$5million to \$10million scored 80.83 and assets size of more than \$10million scored 98.50. Hence, it is also possible to conclude that the size of assets employed in a business and its risk awareness level will be correlated.

### Person Responsible for Risk Management- as our discussions revealed



The chart above does not show any significant correlation between the companies awareness level and the personnel responsible for managing risk management issues with one exception. One finding that is significant in this analysis is that the awareness level scored is significantly lower when HOD( Head of Deptt) manager handles it. The score is at a low of 57.50 as compared to average score of 83.60. We can conclude that the level of authority vested in the HOD manager might have caused the implementation of risk management policy within the company to be less effective. Therefore it is critical that risk management policy should be placed under the responsibility of key officer(s) such as CEO, core management team or designated Internal Adviser in order for the policy to be effectively adopted and implemented throughout the company-wide. As if echoing this sentiment, writing to an accounting journal( Accounting & Business, Oct 2004,UK, Pp10), Gereme Howe, a senior business manager based in UK says “someone has to take the central role....tasked with coordinating risk assessment and mitigation across the business.. Without this role, organisations will struggle to demonstrate to their trading partners and customers that they are safe to do business with..”.

## Conclusion Findings

Based on our analytical studies of the survey results, it confirms our hypotheses that given the tough competitive business environment in Singapore, and given our respondents are generally well-established midsize companies, we conclude that:

- a. Overall Risk Awareness Level  
Our SMEs( as defined in this research in Singapore context) have scored satisfactorily, hence the hypothesis that they are sufficiently aware is accepted.

- b. Awareness Level in Operational Risk  
--Same observation as above
- c. Awareness Level in Financial Risk  
Same observation as above
- d. Operational awareness varies between industries, increases with the size of employees and assets.
- e. Level of management exercising control over risk management is a key issue.

As a general conclusion we can state that risk management has become and is increasingly becoming a major management issue for all businesses, and certainly for SMEs everywhere. Even then, it must be categorically stated that high enough level of awareness of risks does not necessarily mean appropriate actions always since they can be so varied and sometimes very expensive too coupled with the fact that in the SME sector especially, there may well be ignorance in some respects.

#### A Postscript on Tsunami and its effects on SMEs in Asia

What Tsunami has done to Asia is deadly. It's another gentle reminder of Risk Management that we could learn from all the researchers and scientists around the world. Tsunami affected area around Asia was scary and will be remembered by everyone around the world. Why were there no warnings? Why were there no signs? Why were there no immediate help by the local country authorities? Why there was not enough information from the time Tsunami hit Asia? Those and other questions are being looked at.

Our preliminary investigation in Sri Lanka and Thailand shows devastating losses suffered by coastal-based smes who suffered from lack of insurance against tidal waves. Many of them have been wiped off the slate and never to come back. It happened after the main paper was written already, but underlines the need for risk management by smes against shocks in business. Apparently, many large hotels in Maldives were unaffected for they had adequate protection but small businesses in Thailand were not protected, never indeed thought of it and paid a final price for un-managed risks, the bane of all businesses.

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“Risk Management for SMEs – A briefing document from the Faculty of Finance and Management of the Institute of Chartered Accountants in England and Wales” (2002)

.....The Article ends here, the rest are relevant Appendices-----

## Appendix A

### Risk Management Questionnaire

|          |             |
|----------|-------------|
| Company: | Interviewee |
| Date:    | Interviewer |

In our MBA dissertation project with Vancouver University, we are studying the awareness of SME owners with regards to the importance of managing risk in financial and operational aspects. In this survey, we assess your company on risk management from different perspectives.

The questionnaire covers the following segments:

1. Awareness Overview
2. Risk Management Policy

3. Risk Identification
4. Risk Analyses, Evaluation and Treatment
5. Risk Monitoring and Review

Only pay attention to the issues that are relevant to your company. As a memory arises, write down arguments, additional information and decisions concerning correctives measures on a separate piece of paper. All data collected will be kept confidential and used for analysis only.

**Profile of the Organization**

- 1) Business form
 

|                     |               |
|---------------------|---------------|
| Sole Proprietorship | Partnership   |
| Private Limited     | Public Listed |
  
- 2) Business Sector
 

|               |         |              |
|---------------|---------|--------------|
| Manufacturing | Finance | Construction |
| Service       | Retail  | Trading      |
| Other         |         |              |
  
- 3) Years in business
 

|            |                             |
|------------|-----------------------------|
| < 5        | 5 to < 10                   |
| 10 to < 20 | > 20: indicate total: _____ |
  
- 4) Total employees
 

|            |                             |
|------------|-----------------------------|
| <10        | 10 to < 20                  |
| 20 to < 50 | > 50: indicate total: _____ |
  
- 5) Sales Turnover
 

|                |                                |
|----------------|--------------------------------|
| < \$1M         | \$1M to < \$3M                 |
| \$3M to < \$5M | > \$5M: indicate amount: _____ |
  
- 6) Total assets
 

|                 |                                 |
|-----------------|---------------------------------|
| < \$1M          | \$1M to < \$5M                  |
| \$5M to < \$10M | > \$10M: indicate amount: _____ |
  
- 7) Percentage of foreign ownership
 

|                |               |
|----------------|---------------|
| ( 0 %          | ( 0 to < 25 % |
| ( 25 to < 50 % | ( 50 to 70 %  |

- 8) Who is responsible for risk management in your organization?  
 ( CEO / Managing Director ( Financial Controller  
 ( HOD Manager ( Risk Manager  
 ( Internal adviser ( External adviser  
 ( Field Safety Officer ( Others: \_\_\_\_\_

### Questionnaire

#### 1. Awareness Overview

This section seeks information on the awareness overview of risk management by your organisation.

|   | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|---|-------------------|----------|---------|-------|----------------|
| 1.1 Your organization's risk management is anticipatory. [i.e. matters are improved before the problem arises]?                       | 1                 | 2        | 3       | 4     | 5              |
| 1.2 Your organization's risk management is monitored and reported as part of the normal Management reporting system?                  | 1                 | 2        | 3       | 4     | 5              |
| 1.3 Your organization's adopts other risk management method are used as appropriate, in addition to insurance cover being considered? | 1                 | 2        | 3       | 4     | 5              |
| 1.4 Your organization uses consultants, insurance companies and other experts when need arises?                                       | 1                 | 2        | 3       | 4     | 5              |

#### 2. Risk Management Policy

This section seeks information about your policy for risk management and how that policy is promulgated throughout your organisation.

|                             | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|-----------------------------|-------------------|----------|---------|-------|----------------|
| 2.1 Your organisation has a | 1                 | 2        | 3       | 4     | 5              |

documented risk management policy approved by CEO and Board/Executive Management Team.

### 3. Risk Identification

This section asks questions about how your organisation identifies the risks it faces:

| 3.1 | In identifying risks, your organization does consider the following sources of risk:       | <b>Strongly Disagree</b> | <b>Disagree</b> | <b>Neutral</b> | <b>Agree</b> | <b>Strongly Agree</b> |
|-----|--|--------------------------|-----------------|----------------|--------------|-----------------------|
|     | Operational [risks associated with delivery of services]                                   |                          |                 |                |              |                       |
|     | ♦ compliance risk [the risk of failing to meet government standards/laws and regulations]? | 1                        | 2               | 3              | 4            | 5                     |
|     | ♦ public liability risks [public access, safety]?  | 1                        | 2               | 3              | 4            | 5                     |
|     | ♦ natural hazard risks [climatic conditions, earthquakes, bushfires, floods, vermin]?      | 1                        | 2               | 3              | 4            | 5                     |
|     | ♦ technological risks [innovation, obsolescence, explosions and dependability]?            | 1                        | 2               | 3              | 4            | 5                     |
|     | ♦ human risks [strike by employees, loss of key personnel]?                                | 1                        | 2               | 3              | 4            | 5                     |
|     | ♦ security risks [premises/computer breaches]?   | 1                        | 2               | 3              | 4            | 5                     |
| 3.2 | In identifying risks, your organization does consider the following sources of risk:       | <b>Strongly Disagree</b> | <b>Disagree</b> | <b>Neutral</b> | <b>Agree</b> | <b>Strongly Agree</b> |

**Financial** [risks arising from financial management and fraud]?

- |  |   |   |   |   |   |
|--|---|---|---|---|---|
| ♦ compliance risk [the risk of failing to meet government standards/laws and regulations]?   | 1 | 2 | 3 | 4 | 5 |
| ♦ capital structure risks [optimum financing structure comprising of equities, retained profits and debts]?  | 1 | 2 | 3 | 4 | 5 |
| ♦ markets risks [risk arising from exposure in stocks, commodities, foreign exchange markets and use of derivatives for hedging purpose]?                            | 1 | 2 | 3 | 4 | 5 |
| ♦ liquidity/credit risks [the marketability of assets to be converted to cash and the ability to honor contractual agreement for settlements.]?                      | 1 | 2 | 3 | 4 | 5 |
| ♦ reporting risks [capture timely and accurate data in meaningful format to provide information for decision-making purposes. Includes tax: regulatory, accounting]? | 1 | 2 | 3 | 4 | 5 |

#### 4. Risk Analyses, Evaluation and Treatment

This section seeks to establish the extent/scope and responsibilities for risk analysis, evaluation and treatment in your organisation.

- |     |   |                          |                 |                |              |                       |
|-----|---|--------------------------|-----------------|----------------|--------------|-----------------------|
| 4.1 | Does your company organise risks in terms of: | <b>Strongly Disagree</b> | <b>Disagree</b> | <b>Neutral</b> | <b>Agree</b> | <b>Strongly Agree</b> |
|     | ♦ Consequence: formally or                    | 1                        | 2               | 3              | 4            | 5                     |



**Risk**

The chance of some occurrences that will have an impact on the overall achievement of organisational objectives. It is measured in terms of the likelihood of something happening and the consequences if it happens. Risks can be negative [that is having an adverse impact such as loss or harm] or positive [that is a gain or advantage].

**Reputation Risk**

The risk associated with potential damage to the organization's credibility and reputation.

**Risk Alliance**

The risk associated with working with partnering organisations.

**Opportunity Risk**

The risk associated with lost opportunity.

**Compliance Risk**

The risk associated with failure to meet government standards and regulations.

**Risk Analysis**

Determining the level of risk following consideration of the sources, consequences and likelihood of risks.

**Risk Criteria**

Measures/standards set by the organisation to rank risks and decide whether they are acceptable or not.

**Risk Evaluation**

Comparing the level of risk with the risk criteria and deciding whether the risks are acceptable or unacceptable.

**Risk Financing**

The methods applied to fund risk treatment and the financial consequences of risk.

**Risk Identification**

The examination of all sources of risk facing the organisation from any activity, functions or processes undertaken.

**Risk Management**

A systematic and logical process of identifying, analysing, evaluating, treating, monitoring and communicating risks associated with any activity, function or process in a way that will enable an organisation to minimise losses and maximise opportunities.

**Risk Management Champion**

A senior executive, manager or similar person (or team) who supports the effective development, implementation and review of the risk management framework within the organisation.

**Risk Management Framework**

Management policies, procedures and practices applied by the organisation to the task of identifying, analysing, evaluating, treating, monitoring and communicating risks.

**Risk Management Plan**

A document which sets out the:

- strategic context and objectives for risk management
- risks identified/analysed/assessed/prioritised as having critical impacts on the organisation
- plan to manage strategic and important risks.

**Risk Management Policy**

A document that defines the organization's strategy and provides guidance for risk management.

**Risk Treatment**

The selection and implementation of appropriate options for dealing with identified risk.

**Stakeholders**

Individuals, groups, institutions etc (either internal or external to the organisation) who are or perceived to be affected by a decision or activity.

**Acknowledgement:**

Our MBA dissertation group would like to take this opportunity to express our sincere thanks to the following people and all others who have in one way or another help to contribute to the completion of the dissertation:

1. Prof B. C. Ghosh and Prof Tan Wee Liang for mentoring us through the dissertation.
2. SME owners and corporate executives for providing us the data to complete our survey.

# CHALLENGES TO THE GROWTH OF FINNISH WOODWORKING SMES

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## ABSTRACT

The present paper is based on series of woodworking SME studies that have addressed woodworking SMEs in various segments in Finland and in eight European countries. Finland has a relatively large number of woodworking SMEs whether calculated as enterprises per 1000 inhabitants, or as a proportion of all enterprises and so should have a basis for the development of SMEs in the woodworking sector. The challenge is how to create growth from this endowment of knowledge and experience.

The challenges of international restructuring of industrial production, with the customer demands for components on a JIT-basis have been recognised Finnish SMEs. The main business problems recognised in the international study were not considered to be serious in Finland, with the exception of economic performance. The institution environment for SMEs was also considered to be fairly good, although national level institutional support was considered to be weak in Finland, local, practical SME support was considered to be strong.

The future success of the Finnish woodworking industries depends on domestic demand. This can be stimulated by changes to planning legislation and building regulations to encourage the building of wooden single-family homes adjacent to the urban growth centres as well as encouraging the building of wooden apartment houses in towns.

The external economies that benefit firms in industrial concentrations are not to be found in the Finnish woodworking sector. Such industrial concentrations that currently exist are not expected to develop further. This creates a weakness that could effect the sectors' ability to grasp these new opportunities.

## INTRODUCTION

With its large forest resources, Finland has long been a strong player in the global forest industry, a situation that is set to continue in the foreseeable future. However, this success is largely based on the efficient, capital-intensive production primary manufactured goods (paper, pulp, sawn timber and wood-based panels) for the export market. The labour-intensive, secondary value-added production takes place in the export countries. Thus, the export of primary-manufactured products for secondary, value-added manufacturing elsewhere, is a *de facto* exportation of jobs. This is evident in the fact that 1000 m<sup>3</sup> wood raw material creates c. 2 jobs in Finland whereas in Denmark, for example, where the same amount of wood creates employment for 37 people. Denmark has only a small domestic forest industry, concentrating on secondary value-added manufacturing based imported semi-finished wooden products (Selby & Petäjistö 2002).

The Finnish domestic woodworking industry is largely dependent on the level of construction activity. A major component in this equation is the construction of domestic housing. Legislation, fashion and values each play a role in peoples' choices when purchasing or constructing a family house. Consequently, the promotion of wood as a building material is a major factor in the success of woodworking industries. In larger-scale buildings and constructions, wood has considerable potential, but it has to be made competitive with concrete and steel not only in terms of price and engineering, but also with respect to construction industry skills and logistics. Also until recently building legislation has been unfavourable for wooden housing. There were about 34 000 jobs in the woodworking industry at the turn of the century. These were located in just over 5000 enterprises with an average turnover of five million euros.

The present paper is based on a series of Finnish studies that have addressed domestic woodworking SMEs in various segments (Mäkinen & Selby 1995, Mäkinen 2002), as well as how the institutional environment for Finnish woodworking SMEs compare with those in some other EU member states (Selby & Petäjistö 2002). The latter study enabled the relative strengths and weaknesses of the institutional environment for SMEs to be assessed.

## CHALLENGES TO SMES IN A CHANGING BUSINESS ENVIRONMENT

### Changing business environment

The changing international markets for goods, and the speed of the capital markets, have led to a weakening of traditional location constraints and traditional divisions between capital, R&D, manufacturing and sales. These developments have changed the international small business environment over the past two decades, as large corporations and the manufactures of standard mass-production have downsized their operations and use sub-contractors (e.g. Howard 1990, Sengenberger et al. 1990, Rodríguez-Pose 1994). Industrial production is increasingly concentrated in SMEs(SMEs=less than 250 employees) that are re-emerging in a post-Fordian industrial regime based on innovative technology, skilled labour and high value-added products. In this context, a country's capacity to build strong production networks constitutes a new kind of competitive advantage (Porter 1990).

The rapidly changing business environment nevertheless creates considerable uncertainty and increased complexity that, in turn, presents greater challenges to both individuals and firms as they try to understand and cope. The main challenges, following Gibb (2000) occur at every level of the business environment, global, societal, organisational and individual. The changing environment for business therefore presents a number of challenges to which entrepreneurs and enterprises will need to respond as they will affect not only the factors of production structure of the firm, but also the structure of their industrial segment or even perhaps the structure of the whole sector of industry.

To survive and grown in this dynamic environment, the firm has to be able to acquire and assimilate a large amount of information, and to achieve this it has to become a “learning organisation”. Social and political institutions can help firms adopt or invent new procedures and so create conditions that encourage industrial enterprise both nationally and in specific regions.

### **National and local institutional contexts**

The allocation of economic activity (whether public or private) is very much a question of political organisation (Urry 1984;53). Regionally-based, or sector-oriented, organisations can therefore play an important role in the process of economic change. Existing start-off conditions, which are part of a historical process, may play an essential role in an area’s receptivity to and assimilation of innovative trends and process (Rodríguez-Pose 1994;329).

Innovation not only relies on the capacities of a few individuals and companies to invent new procedures and compile masses of information, but also on the capacity of new industrial production structures to supersede old ones and their ability to respond to challenges. The current development of a nation, region or a locality is the outcome of how different production systems, social and political regimes, and cultures have been successfully combined spatially (Rodríguez-Pose 1994;329).

Local industrial development can, however, only operate in the context of the parameters which define the national production systems within which firms and workers operate. These differing modes of production will have resulted from variations in labour-management relations, production strategies, systems of industrial financing, and public-private sector relations. Uncompetitive national models of production may be slow to change. Consequently, local economic development becomes a question of how to overcome the national structural constraints by the development of small-scale co-operative networks at the local community level (Ettlinger 1994, Ettlinger & Patton 1996).

### **Information and knowledge acquisition**

Because the R&D resources of SMEs are invariably limited, to acquire the necessary knowledge, information and skills, SMEs must rely on having access to information and knowledge flows. Such flows can be accessed on a random, or “need to know” basis, or they can have regular and continual access to information flows. One way to secure such flows is membership of a branch or sector organisation that is committed to developing both the sector, the segment and its members interests. Another solution has been the formation of geographical concentrations of industry (industrial districts) (Marshall 1920, Markusen 1996, Parc 1996). These have succeeded because of the external benefits that are to be obtained from the social, economic and technical synergies that result from proximity effects. A major benefit of the agglomeration process is the development of a milieu that stimulates localised

learning - the local flow of knowledge and information within a sector or branch (e.g. Trigilia 1992, Lorenzen 1998). The means employed by firms to acquire knowledge and information are many and varied, being passive (trade fairs, the media) or active (proximity effects,) to active sources (courses, R&D projects). Sources may be informal (customers, family & friends, neighbouring firms) or formal (financial institutions, R&D projects, etc.). Firms also have varying degrees of receptiveness to knowledge as well as varying abilities to benefit from the knowledge they have (Selby 1989, Cohen & Levinthal 1990). Informal sources of information and knowledge are not to be underestimated, as research on weak-ties have demonstrated (Grannoveter 1973). As these linkages develop, inter-firm trust is established which becomes a cumulative process further advancing the synergy effects of the agglomeration (e.g. Sabel 1992, Lorenzen 1998).

### **AIM OF THE STUDY**

The addresses the following questions:

1. Are regional concentrations to be seen in woodworking sectors and have the benefits to be derived from such concentrations been recognised and developed?
2. What is the institutional environment for business in Finland especially in wood working sectors?
3. What kind of business problems are the Finnish woodworking industries facing?

### **MATERIAL**

The survey was made in 1999 by mailed questionnaires and interviews of 65 organisations representing woodworking industrial branches in eight European countries: Austria, Denmark, Finland, Germany, Ireland, Italy, Sweden and the United Kingdom. The questionnaire was developed in conjunction with partners in each country. The two main problems to be solved were a) adjusting the theoretically oriented questions to the reality on the ground in each country, and b) compatibility of the questions after translation into the domestic language. A wide range of organisational structures was represented, ranging from single, centralised organisations, often representing more than one industrial branch, to countries with a plethora of organisations representing every branch or craft, at national, regional or even local levels (Selby & Petäjistö 2002).

The countries were selected subjectively on the basis of prior knowledge of their woodworking industry, their tendency to form industrial districts, and their labour input intensity coefficient (the number of jobs created by 1000 m<sup>3</sup> solid raw wood equivalent of domestic timber). Italy and Austria also have specific legislation for SMEs, while Ireland was included because of the rapid growth of the wooden furniture industry around an incipient industrial agglomeration. Fifty-six usable questionnaires were returned.

Other data concerning forest and woodworking SMEs in Finland were collected by interviews and mailed questionnaires, by sectors, over a period of years (Mäkinen 2002). The study concerning the builders' carpentry and joinery sector that forms the basis of this paper was made in 2000 (Petäjistö et al. 2001).

## RESULTS

### Direction of development

Post-Fordian production regimes, under which production networks based on flexible specialisation become a central feature of production structures, have been identified to a greater or lesser degree throughout the European woodworking sector. Countries in which the woodworking branches are strongly adjusting to this new production regime can be considered to in a more favourable position than those in which adjustments are not seen to be so important. On the basis of the question *In what direction(s) do you think industrial production will develop in your branch during the next five years in order to maintain or improve its competitiveness?* It was possible to construct three principle components: 1 - Component-specialised JIT-networks, 2 - Market-oriented JIT-networks, and 3 - Region concentration of production (Selby & Petäjistö 2002)(JIT=Just in Time). The components support Steiner and Solem (1988) who noted that the success of small manufacturing firms depends upon specialising in products, markets and/or customers.

With respect to the development of *component-specialised JIT-networks*, industry representatives in Austria, Finland, Denmark obtained the highest mean component scores, that is to say, these countries most strongly recognised this direction of development. As the differences in the means scores was statistically significant at  $p=0.07$ , these three countries should gain some competitive advantage by following this development.

Similarly, with respect to *market-oriented JIT-networks* representatives in Finland, Austria, Denmark and Germany obtained the highest mean scores, while in Sweden, UK, Ireland and Italy, such a trend is considered to be less likely (negative mean scores). However, as the differences in the means were not statistically significant. This implies that no country has a distinct advantage or disadvantage in this respect.

*Region concentration of production* is often seen as a major advantage to any SME-based industry. Organisations in Denmark, Germany and Italy considered that regional concentration of production is likely to occur in future. The result is interesting given that Danish and Italian woodworking SMEs already have strong regional concentrations. Finnish, Austrian and Swedish representatives did not consider that regional concentrations were likely to develop. In the Finnish case, the result is supported by studies of the woodworking industry by (Kautonen 1998, Selby & Petäjistö 2002 and Packalén et al. 2003) despite the presence of a distinct potential for regional concentrations of the builders carpentry & joinery and wooden furniture sectors (Figure).

FIGURE about here

These later results are interesting in that studies of forest and woodworking enterprises in various sectors have revealed not only inter-firm co-operation on a number of aspects of business, but also the opinion that such co-operation is beneficial, especially with respect to supplies, but also with respect to information exchange, marketing and some aspects of production (Mäkinen 2002). In the builders' carpentry & joinery sector over a quarter of the self-assessed "successful" firms engaged in regular inter-firm co-operation, where as the moderately or less successful firms engaged in much less inter-firm co-operation (Petäjistö et al. 2001).

## **Institutional environment and national political support**

In the comparative study, representatives were asked: *How does your organisation perceive other organisations'/groups' attitudes with respect to developing the preconditions for SMEs?*

It was assumed that where institutional attitudes towards SMEs are perceived to be favourable (or at least neutral), then a branches' interaction with the institutions of the corporate state should lead to institutional structures which support SMEs, e.g. via policy instruments favourable to SMEs. On the other hand, where institutional attitudes are unfavourable, then it is likely that the institutional position of SMEs will be perceived to be weak. The responses were reduced to basic dimensions using principle component analysis. Two well defined components were obtained: 1 - Local level (practical) organisations, and 2 - National level support, which contained mainly national level interest groups (Selby & Petäjistö 2002).

*Local/practical support* for woodworking SME development was considered to be strongest by Finnish, Italian, Danish and German representatives (highest mean component scores) and less strong amongst Irish, Swedish, Austrian and British representatives. The difference in national means were significant at  $p=0.03$ . Thus, by maintaining or developing its standard of local level (practical) infrastructure, Finnish woodworking SMEs would appear to have an opportunity to obtain a competitive advantage.

In the case of the *National-level support*-component, the differences between national means were not statistically significant, so that there should be no major competitive advantages or disadvantages for the countries in this respect. Where national level support for SMEs to be developed, then clear advantages should be forthcoming.

With respect to public sector incentives for SMEs representatives were presented with a set of likely incentives with the question: *Have the following types of public sector support for small businesses been actively taken up in your industrial branch.* Four principal components were obtained: 1 - Start-up incentives, 2 - Staff-training and development incentives, 3 - Re-location incentives, and 4 - Tax relief (Selby & Petäjistö 2002).

With respect to star-up incentives, Italian and Finnish representatives experienced the most positive situation. The differences between country means were statistically significant at  $p=0.00.$ , and so countries with high mean score should have more favourable conditions for SME formation. The result reflects the fact that, of the countries in the study, Italy and Finland had the greatest number of woodworking enterprises both as a percentage of all industrial enterprises and as the number of enterprise units per 1000 inhabitants. Also, because of a deep economic depression in the 1990s that resulted in high long-term unemployment, Finnish employment policy has sought to increase the creation of small enterprises.

Concerning *industrial re-location incentives*, Swedish, German and Austrian representatives considered their countries' to have the most favourable incentive schemes for assist firms to re-locate. Such schemes support regional development, but they would also be important to assist with the creation of regional industrial networks, industry concentrations or industrial districts. Finland has low priorities in this respect.

*Staff training and development incentives* did not vary significantly between countries. This implies that competitive advantage would be gained by any country that assisted SMEs invest in human resources, e.g. via vocational education.

As vocational education can provide a pool of skilled labour as well as helping to create a new generation of entrepreneurs (Gibb 1993, 2000), representatives were asked: *In your experience, is the vocational education system supportive of small businesses?* A five-point scale from strongly supportive to strongly unsupportive (via "neutral") was employed.

Of the Finnish replies, only 17% considered vocational education to be (at best) mildly supportive of small business, while two-thirds of the Finnish replies considered vocational education to be mildly prohibitive. Italian representatives, too, reported dissatisfaction with vocational education, with 23% reporting a strongly unsupportive situation and the remaining 77% reporting the situation to be mildly unsupportive. Only German and Irish organisations reported strong support for small business from vocational education. These countries also report a mildly supportive system, so that their overall satisfaction was high. The results indicate that corrective actions are required if Finnish woodworking SMEs are to have access by suitably qualified employees.

Finnish woodworking enterprises are only partly aware of the problem. Just over a third of SME entrepreneurs in the builders' carpentry & joinery sector took part in development courses in 1999 (of which 11% were technical courses and 20% management courses) (Petäjistö et al 2001). However, there was a strong correlation between participation in courses and turnover. Over 80% of entrepreneurs of firms with a turnover greater than 1.6 million euros took part in course compared to only 10% of firms with a turnover of less than c.170 000€. A similar result was obtained with respect to the training of employees. In firms that were self-assessed as "successful", 85% trained their staff in-house via apprenticeships or other training schemes, while in firms that self-assessed as "less successful" only 1 firm (10%) had trained staff in-house, nor had this firm employed vocationally trained employees (Petäjistö et al. 2001).

## **Business problems of woodworking SMEs**

### *Problem identification*

To assess the nature of the problems that were perceived to be facing SMEs in the case study countries, representatives of the industrial organisations were asked the question: *To what extent are the following issues seen as problems in small businesses in your industrial branch?* A number of alternatives were presented that were derived from earlier studies and the international SME literature. Representatives could also add their own specific issues, but few felt the need to do so. As the problems facing SMEs are not singular, principal component analysis is again employed to examine the inter-relations between sets of problems. Four dimensions were identified by principle components: 1 - Concern over production substitution and raw material supply, 2 - Concern over factors of production, 3 - Concern over coping with regulations, 4 - Concern over economic performance.

*Concern over product substitution and raw material supply* was greatest amongst Italian, Austrian and German representatives. The least concern as amongst Irish representatives. The Irish result is logical given that forest industries have been developed in close cooperation with the state forest authority (Growing for the Future 1996) and the wooden products are largely based on woodfibre (MDF, etc.).

*Concerns over factors of production* (labour supply and costs, and the maintenance of skills and technology) were greatest amongst Swedish, Italian and Irish representatives, and least amongst German, Austrian and British representatives. The difference between country means was statistically highly significant, suggesting these problems need to be taken seriously in the countries concerned.

*Concerns about coping with regulations, standards and norms* (e.g. ISO 9000 & 14000, and EMAKS) were greatest amongst Austrian, Irish and Italian organisations. Finnish and Swedish firms reported the least problems. It is tempting to conclude that because Finnish and Swedish firms are dominated by LSEs, there has been a better ability to apply resources to adjust to new norms and regulations, and that relevant information has thus been well disseminated throughout the industry (LSE=large scale enterprises, more than 250 employees). The difference in the country means was statistically significant.

*Concerns over economic performances*, notably profitability and competitiveness were strongest amongst Danish, Finnish, German and Swedish representative organisations. Austrian, Italia and especially Irish organisations received scores below the mean, i.e. the problem was perceived to be less important. The result for the Irish case is logical given that the data was collected in the 1998-9 when that country's economy was growing at c. 8% per annum. The Austrian woodworking industry was also expanding at the time of the investigation (Petäjistö et al. 1997, Petäjistö et al. 2002).

In a study of the Finnish builders' joinery & carpentry sector (Petäjistö et al. 2001), a common problem reported by SMEs concerned *product marketing*. A lack of knowledge of the markets was reported by 26% of the self-assessed "successful" enterprises, but this figure rose to 70% of the self-assessed "less successful" enterprises, of which 40% reported this to be a serious problem. Virtually the same figures were repeated for "marketing skills". Forty percent of the "successful" firms nevertheless reported some problems with their marketing skills. When assessed on the basis of firms' turnover, all of the firms with a turnover of over 1.6 million euro reported a lack of knowledge of markets, with 40% considering the problem to be serious. Just over a fifth (23%) of the firms in the 168 000 - 1.6 million euro class reported no problems with knowledge of the market, but 46% considered their lack of knowledge to be a serious problem. Over three quarters of the smallest group (less than 168 000 €) considered lack of knowledge of the markets to be serious.

The profitability and competitiveness of Finnish woodworking firms is a problem not fully recognised at the firm level in the builders' carpentry and joinery sector. Most of the firms studied at the end of the 1990s reported that their profitability and other performance parameters would either remain the same or improve in the future (Petäjistö et al. 2001).

However, a recent report suggests otherwise, with the large number of small firms crating intense inter-firm competition via pricing, and that this is reducing the profitability of the woodworking sector (Pohjois-Pohjanmaa Liitto 2004).

## DISCUSSION

The Finnish woodworking sector is characterised by a relatively large number of woodworking SMEs. Whether calculated as enterprises per 1000 inhabitants, or as a proportion of all enterprises, Finland has almost as many wood working enterprises as Italy,

and more than Denmark - both countries famous for their proliferation of woodworking SMEs. Finland therefore seems to have a basis for the development of SMEs in the woodworking sector. The challenge is how to create growth from this endowment of knowledge and experience.

Finnish woodworking industry organisations recognised that the industry was moving towards a market-oriented-JIT economy. Similarly, they recognised that the market would be increasingly oriented toward component production on a JIT basis. The higher awareness of these trends, in the face of the restructuring of international markets can only be considered as a strength. How the industry responds to these changes, of course, is the main challenge.

In several countries, major benefits to the woodworking sector have been obtained by regional concentrations of SMEs. An analysis of the distribution and location of employment and enterprise in Finland's wood products and furniture SMEs indicated that regional concentrations already occur in certain branches. Despite this, few of the benefits have been obtained (Kautonen 1998, Packalén et al. 2004). Finnish organisations do not consider that increased regional concentration of production is likely to occur, which suggests that they, too, have failed to recognise the benefits of such concentrations. Conversely, in Denmark and Italy, where the woodworking industries have obtained considerable benefits from concentration into industrial districts, representatives consider that regional concentration will continue. Finnish woodworking enterprises are activity engaged in inter-firm co-operation, however, but this has not yet led to widespread external benefits. The institutional environments of some of the Finnish regional agglomerations are currently being developed to further improve the knowledge infrastructure and to encourage networking amongst woodworking SMEs. Even inter-regional links are envisaged to facilitate R&D transfers to SMEs.

There remains a number of entrepreneurs who have negative attitudes towards networking, and attitudes are changing very slowly (some firms refuse to learn). In the Schumpeter tradition, these firms may cease, thereby making way for young innovative firms that can benefit from, and help to create, a constructive knowledge environment.

Of the various types of business problems facing woodworking SMEs, Finnish woodworking organisations' main concern was the general problem of competitiveness and profits. With respect to other problems, such as coping with administration & regulations, product substitution, and human resources (availability, competence and costs), Finnish concerns were below the average of woodworking organisations in other European countries. The results fail to reveal the specifics of different woodworking sectors. For example, the wooden house sector is currently performing rather well, while the wooden furniture industry suffers from severe price competition that is reducing profitability. Both sectors suffer from a large number of small firms that compete with each other, thereby reducing profitability. This problem could be overcome by increased networking, with synergy effects and external economies (Pohjois-Pohjanmaan Liitto 2004).

Many existing firms have growth potential, and a number of woodworking SMEs have demonstrated their ability to succeed in the export market. Such firms have nevertheless had to undergo considerable production and managerial renewal. The healthy regeneration of the woodworking sector also requires new entrants into the sector. Reflecting their concern over competitiveness, Finnish organisations consider that woodworking entrepreneurs required training in business management skills. Previous research has demonstrated that woodworking firms often possess good technical skills, but are weak on management

practises (e.g. Selby 1989, Selby & Petäjistö 1992). Training in the ability to cope with changing standards and regulations that are associated with the development of the Single Market are also required.

Finnish woodworking industry organisations considered that there was rather poor national political support for woodworking SMEs, possibly reflecting the LSE dominance of the forest industry sector. The strong institution position of LSEs have ensured that the institutional environment supports their interests a more national-level political support for their SMEs (Passila 2000). Lobbying is not practiced by Finnish woodworking SME organisations (Selby & Petäjistö 2002); perhaps it should be. On the issue of local-level, practical support, Finnish organisations reported a satisfactory situation (despite a lack of local branches). Finnish organisations should continue to develop this relative strength. There is evidence of a major change in the institutional response to SMEs and wooden construction in Finland. The governmental Entrepreneurship Policy Programme seeks to improve the preconditions for entrepreneurship, while a major six-year programme for the Advancement of Wood Use addresses the development of the wood products industry, the advancement of wooden buildings, and the marketing of wooden products in Europe.

Finnish woodworking organisations are fairly satisfied with the institutional environment for business, although Italian, German and Austrian woodworking are more satisfied with their countries' institutional environments. These latter countries also have specific SME oriented business legislation. The result is contradicts the World Economic Forum's Global Competitiveness Reports that have usually ranked Finnish industry very highly while Italian industry usually gets a poor assessment (the WEF inquiry largely concerns the LSE environment). The result of the present investigation are more in line with the findings of the Global Entrepreneurship Monitor (Arenius et al 2001), even though this does not operate at the sector level. According to GEM, in 2003 Finland ranked fifteenth out of 30 countries with respect to the total level of entrepreneurial activity. Limited to Europe, Finnish enterprises were ranked fifth, ahead of both Danish and Italian enterprises.

To cope with a rapidly changing business environment, both globally and domestically, Finnish woodworking SMEs have to be well endowed with information and skills that concern not only their industry, but also business skills to cope with the changing demands of the institutional environment (new industrial norms, legislation, etc.). They also need to have the skills to negotiate participation in vertical and horizontal production chains. This requires then to find the balance between inter-firm co-operation and competition. The more successful firms, and also firms with larger turnovers, have taken steps to acquire managerial skills, and to train employees. Such activities have features less in smaller and less successful firms, raising issues of cause and effect. Similarly, despite Finnish society being at the forefront of ITC use, woodworking SMEs were still surprisingly limited in their use of ITC at the beginning of the decade. The increasingly close interaction between customers, firms and suppliers envisaged by current trends in both the global and domestic business environment demands that greater competence in the use of ITC is acquired (Petäjistö et al. 2001, Teriö et al. 2005).

The learning and adjustment processes required by Finnish woodworking SMEs should be motivated by the fact that the wooden products industry still faces a number of opportunities. In the builders' carpentry and joinery and wooden house sector, opportunity is being provided by changes in society. The increasing prosperity of society is creating demands for detached houses in areas adjacent to the growing urban centres. In 2002, only 12% of such houses were constructed of bricks or other mineral materials, while 57% were wood-frame houses, and

20% wood-element houses, the remaining 11% being log houses. To expand this sector, however, new planning legislation is required to make suitable land available. Another development is toward wooden apartment buildings, and to encourage this trend, new building regulations are required. In other words, many of the opportunities rest with institutional decision makers rather than in the individual firms. Once these opportunities are made available, the woodworking firms must be ready to respond to the challenge.

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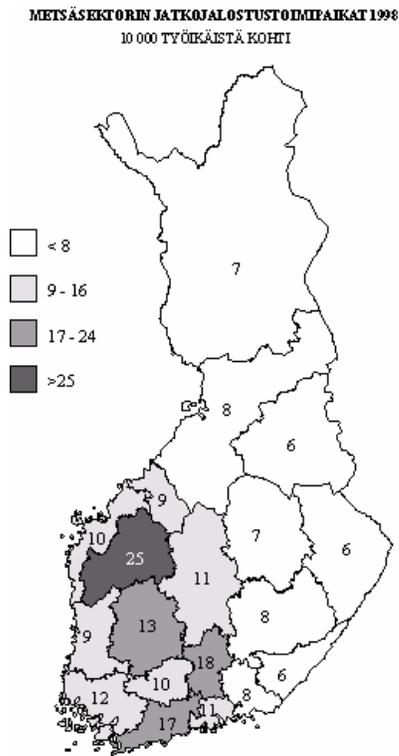
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Figure. Enterprise units in forest industry further manufacturing per 10 000 economically active population, 1998.



**Comparison of Centralization and Delegation Practices in  
Family versus Non-Family SMEs:  
A Rasch Analysis**

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**ABSTRACT**

This study investigates the span of delegation and control of owner/managers in small and medium-sized enterprises (SMEs) and compares the practices of owner/managers in family-businesses to those in non-family businesses. While too much centralization in a firm can lead to unmotivated employees and decision-making bottlenecks, too little management oversight can lead to frustration as employees flounder to make decisions with little guidance or direction. Although small businesses in general have problems delegating and determining an appropriate level of control, research indicates that family-business owners may be even more controlling. In a study of SME owner/managers, the authors use Rasch analysis to examine the concentration of authority in these firms and develop a measurement scale to identify the centralization and delegation practices of the owner/managers. Specifically, this study finds that family-business owner/managers both maintain more centralized decision-making and delegate differently than their non-family counterparts. The paper also shows how an individual owner/manager can use this study's results to compare his/her delegation practices with those of study respondents.

## INTRODUCTION

Past research has shown that one of the key challenges for small business owners is determining an appropriate level of management control (e.g. Daily & Dalton, 1992). When founding owners begin firms, they typically do everything. However, as they add staff members, owners must learn to delegate to other managers and subordinates. Too much centralization in a firm can lead to unmotivated employees and decision-making bottlenecks, resulting in poor firm performance and even firm failure. Conversely, if managers delegate too much, employees can find their jobs frustrating as they flounder to make decisions with little guidance or direction (Schultz & Schultz, 2002). This also leads to poor performance.

While small businesses in general have problems delegating and determining an appropriate level of control, research indicates that family-business owners may be even more controlling (e.g. Dyer, 1986; Daily and Dalton, 1992; Upton and Heck, 1997). Because these owners are concerned about family matters in addition to business matters, they often have problems releasing control to subordinates. Such problems may be worsened by pressures to hire from within the family and/or make decisions that prioritize family control and wealth over enlightened operational and strategic management.

This study investigates the delegation and control practices of owner/managers in small and medium-sized enterprises (SMEs) and compares the practices of owner/managers in family-businesses to those in non-family businesses. In general, we believe that family-businesses are less likely to delegate and more likely to maintain a centralized decision-making process than non-family owner/managers.

## METHODOLOGY

The evaluation of centralization practices among SMEs was conducted as part of a larger study of practices among such firms. Seven hundred forty-five executives from a sample of 321 firms in a large Southwestern market were mailed a nine-page, multiple-construct survey. Responses were received from 167 executives. Of these, 124 were usable for this analysis: 57 from family firms and 67 from non-family firms. The sample consisted primarily of owner/managers (n=111) as well as a small set of non-owner senior managers (n=13). The average number of employees for all of these firms was 69, ranging from 1 to 2000. Ninety percent of the executives (112 firms) reported that their firms had fewer than 100 employees. Because analysis of delegation practices in one and two-person firms is inappropriate, twelve respondents who indicated that their firms had fewer than three employees, were excluded. In addition, the authors removed 26 respondents because Rasch analysis indicated that their response patterns showed unexplainable misfits. "Misfits" are those respondents who seem to misuse the survey instrument by indicating inappropriate response patterns or who limit their responses to the extremes of the instrument's scales (Wright & Masters, 1982). The final sample included 41 family firm respondents and 47 non-family-firm respondents.

Within the larger survey instrument described above, eleven questions were from an Aston studies-based organizational structure scale intended to measure the degree of centralization in a firm (Inkson, Pugh & Hickson, 1970). Factor analysis (principal components, quartimax

rotation) revealed that these eleven questions all loaded on to the same factor, thus indicating that they measured dimensions of the same construct. As will be discussed below, Rasch analysis was used to optimize the scale for use among SME owner/managers.

## ANALYSIS

The authors performed Rasch rating scale analysis using Winsteps 3.21 software. Rasch, named after the method's founder Georg Rasch, is an analysis technique used for developing linear measures (Smith, 1999). Rasch rating scale analysis compares measures on a common logit scale similar to characteristics of conjoint measurement. While researchers often use the technique for developing models in education and in health sciences, Rasch has not been widely used in the business sciences. As an evaluation tool, individuals can compare their results with a model's scale to determine how they compare to their peers or to desired performance levels. In simpler terms, Rasch rating scales perform similarly to standardized test scales used in college placement exams.

### Instrument Evaluation

This section discusses how the authors used Rasch analysis to evaluate the Aston studies scale to determine if the instrument could be used in SMEs. The Aston scale examines task performance practices at six organizational levels: board of directors or owner, chief executive, divisional or functional manager, sub-department head, first-level supervisor, and operative. Because many of these levels may not exist in SMEs, analysis first examined if the levels were appropriate for this study. Analysis revealed that of the six levels in the instrument, "sub-department head" was never the most probable response. Given that 90% of respondent firms had fewer than 100 employees, it seems unlikely that the organizational structures of the SMEs included this job title, especially given the instrument also included the level titled "first level supervisor." Correspondingly, the authors recoded both "sub-department head" and "first level supervisor" into one position. This resulted in a five-level scale that worked well for SMEs with infit (*1.86*) and outfit (*1.63*) measures below the prescribed level of 2 (Smith, 1999).

The authors next used polytomous Rasch analyses to evaluate the functioning of the eleven measures in the Aston scale. In many ways similar to factor analysis, polytomous Rasch analysis checks for item multicollinearity and for each item's contribution to the measurement of the latent construct, managerial centralization. Initial analysis yielded an item reliability of .95. Reliability measures are interpreted similarly to Cronbach's alpha in factor analysis. To determine if scale elements are in their natural sequence and to detect if there is multicollinearity, Rasch analysis generates item fit statistics (Wright and Masters, 1982). Infit/outfit analysis revealed that one item, "methods of personnel selection," did not fit the model. The item's overfit is understandable given that the survey instrument also included the item "whether to employ a worker." It appears that if a business empowers managers with the decision "whether" to employ a worker, they also empower the manager to determine "how" to employ that worker. In this respect the two questions, while appearing to measure separate constructs, are multicollinear. As a result, the authors removed the first question, leaving a scale of ten items.

## FINDINGS

## **Overall delegation patterns of SME owners/managers**

The key form map (Figure 1) shows the differences in delegation practices of the SME managers analyzed. To interpret the map, items from the Aston scale are plotted from bottom to top based on the probability that they will be managed at lower levels of management. In rank order from decentralized to centralized, decisions were:

1. allocation of work among available workers
2. overtime to be worked at shop level
3. delivery dates of priority orders
4. machinery or equipment to be used
5. method of work to be used
6. production plans to be worked on
7. whether to employ workers
8. dismissal of a worker
9. the number of workers required
10. internal labor disputes

[Insert Figure 1 about Here]

The scale's validity can be seen by the relatively normal distribution of the "X's" to the left of the line. (Each X indicates the placement of a single subject.) In the center of the scale, the letter "M" indicates the mean rating and each of the letters "S" represents an additional standard deviation from the mean score. The large spaces without items both at the top and bottom of Figure 1 indicate that the scale's content validity and discriminate ability could be improved by adding more items: more strategic items, which are usually performed by the upper levels of management, and more operational items, which are frequently performed by first line employees.

## **Delegation Practices of Family versus non-Family Business Owner/Managers**

To determine if family-business owner/managers delegate differently than non-family business owner/managers, the authors conducted a Differential Item Functioning (DIF) analysis (Table 1). T-tests between the mean logit scores of the two types of firms indicate significant differences in delegation practices for four of the ten items measured: handling internal labor disputes, approving overtime, determining delivery dates, and dismissing workers ( $p < 0.5$ ).

[Insert Table 1 about Here]

To illustrate the rank order differences of the delegation practices of the two groups, Figure 2 looks at the relative ranking of the different items. A solid line connects those items where business practices of the two types of managers vary by more than one rank-order position. The spider-web pattern formed by the lines illustrates how differently the two groups delegate. While owner/managers for both types of firms tend to delegate the determination of job assignments, they handle all other responsibilities differently. The most significant difference occurred in handling employee terminations. While non-family owner/managers reported handling

terminations themselves, family-business managers tended to place that responsibility at the supervisory level.

The scales also show that family-business managers tended to maintain control over tasks typically delegated. For example, family managers reported that more than any other task, they maintained control over production scheduling. Non-family managers tended to delegate the job.

[Insert Figure 2 about Here]

An analysis of the item separations of the logit measures, indicated by each item in parentheses, reveals that overall family-businesses are more centralized than are non-family businesses. After exclusion of the one commonly ranked item, job assignments, family-businesses show much less separation than non-family businesses. For family-businesses, the absolute distance between the logit scores of the second and the tenth items is only .93 logits, while for non-family owned businesses, the absolute difference is 1.47 logits. The narrower score range indicates that decision making in family firms is much more centralized.

### **Individual Assessment Possibilities**

While the scale presented can be used to compare the centralization practices of different types of business structures, it is also may prove useful for use by SME managers to assess their personal delegation practices versus those of their peer owner/managers. To use the scale as such a tool, an individual manager would complete a pencil and paper assessment of the amended Aston scale (Table 2) and compare his/her summed responses to this study results, as seen in Table 3.

[Insert Tables 2 and 3 about Here]

If an individual manager wishes to identify those specific areas where his/her centralization practices differ from those of his/her peers, he/she can transcribe his/her results from the previous instrument to the self-assessment tool in Figure 3. For any individual task score that falls within the unshaded area, that manager's practices are similar to those of this study's peer group. Any results falling into the lightly shaded areas are between one and two standard deviations of the mean, and therefore are either more centralized (for scores to the left) or more decentralized (for scores to the right) than peer group practices. Scores falling in the darkest area are over two standard deviations from mean results. The practices of managers falling in this area are significantly more centralized than those of the study group. Of note, the current scale does not include enough items to identify overly laissez-faire management practices. As discussed in the previous section, the identification of such items could improve the instrument.

[Insert Figure 3 about Here]

## **DISCUSSION—IMPLICATIONS AND LIMITATIONS**

Delegation practices in small businesses can have an important impact on organizational outcomes. Prior research suggests that family business owner/managers are less inclined to delegate than non-family owner/managers (Dyer, 1986). This research supports that conclusion. While both groups showed high levels of managerial centralization, the study found that non-family owner/managers tended to be more empowering than family-business owner/managers. Logit measures from Differential Item Analysis found that the two types of managers delegate responsibilities differently. Family business owner/managers were more likely to delegate hiring, firing, and labor disputes while managing production planning, work methods, and delivery dates. Conversely, non-family business owner/managers were more likely to delegate overtime approval, delivery dates, and equipment scheduling while managing the handling of labor disputes, firing, and hiring.

This study has implications for both theory and practice. In addition to supporting research that indicates that family businesses are more centralized than non-family businesses, this study also indicates that responsibilities are allocated differently in the two types of firms. Another important practical implication involves the use of the Rasch analysis technique to assess factors such as degrees of delegation and centralization. Using the centralization scale, the 10-item pen and paper test, described in Figure 3, can be used by owner/managers to compare their delegation tendencies to those of their peers. Such an instrument could be a useful tool for small business managers and/or consultants.

Analysis of the ten items shows promise for the development of larger scale to measure the degree of centralization/decentralization in SMEs. When comparing practices between firms, the prescriptive centralization measures will vary based upon a number of factors including the education level of the employees and task requirements. Cross-industry validation of this instrument could be used to develop scores for different industries. Once industry benchmarks are developed, struggling firms could evaluate their scores based on those prescribed for the industry. If firm scores are significantly higher or lower than are those of competitive firms, management would be well advised to re-evaluate the level of centralization and control being utilized in the firm

This scale is not appropriate for owners of very small firms with fewer than four employees. In addition, this analysis was only conducted on SMEs. The results, therefore, are most appropriate for companies with between four and one hundred employees. For such firms, however, this model appears to offer promise to be developed into a usable diagnostic for small business owners to determine the appropriate level of centralization for their firms.

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Figure 1

SME Decentralization Practices Variable Map

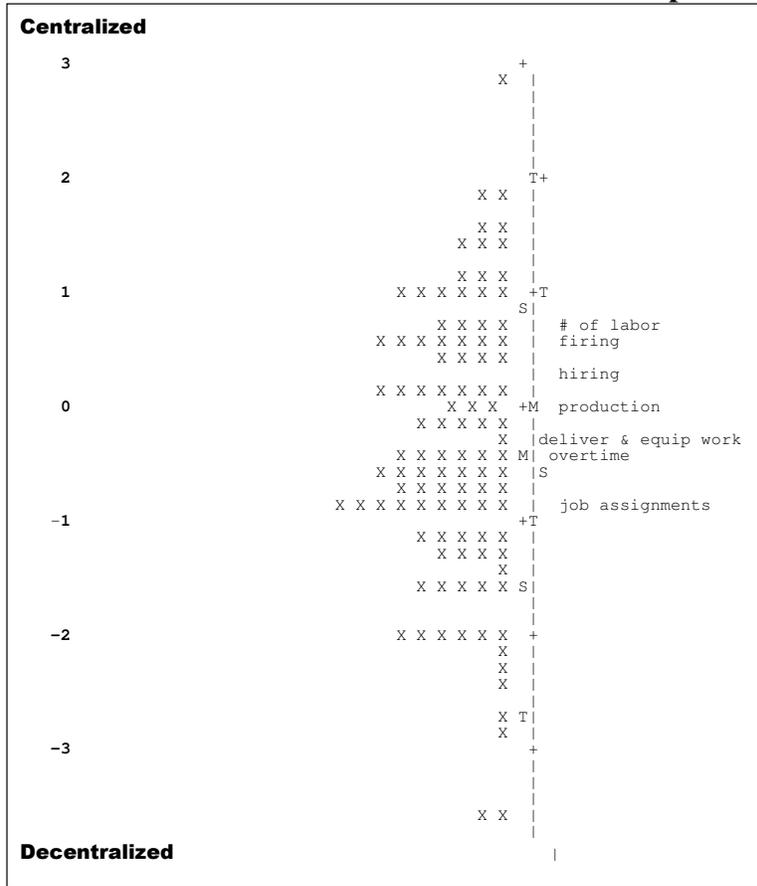


Table 1

| Family Versus Non Family Owner/Managers,<br>Differential Item Functioning Analysis (DIF)<br>Logit Score Comparison |                   |               |   |
|--|-------------------|---------------|---|
|  | <u>Non-Family</u> | <u>Family</u> |   |
| # of workers   | .48               | .32           | - |
| hiring   | .22               | -.37          |   |
| labor disputes   | .79               | .12           | * |
| overtime   | -.68              | .04           | * |
| delivery dates   | -.49              | .27           | * |
| production plans   | .22               | .55           |   |
| firing   | .66               | -.27          | * |
| work method  | -.03              | .26           |   |
| equip/mach used  | -.33              | .15           |   |
| job assignments  | -.84              | -1.06         |   |

*\*misfit, p<.05*

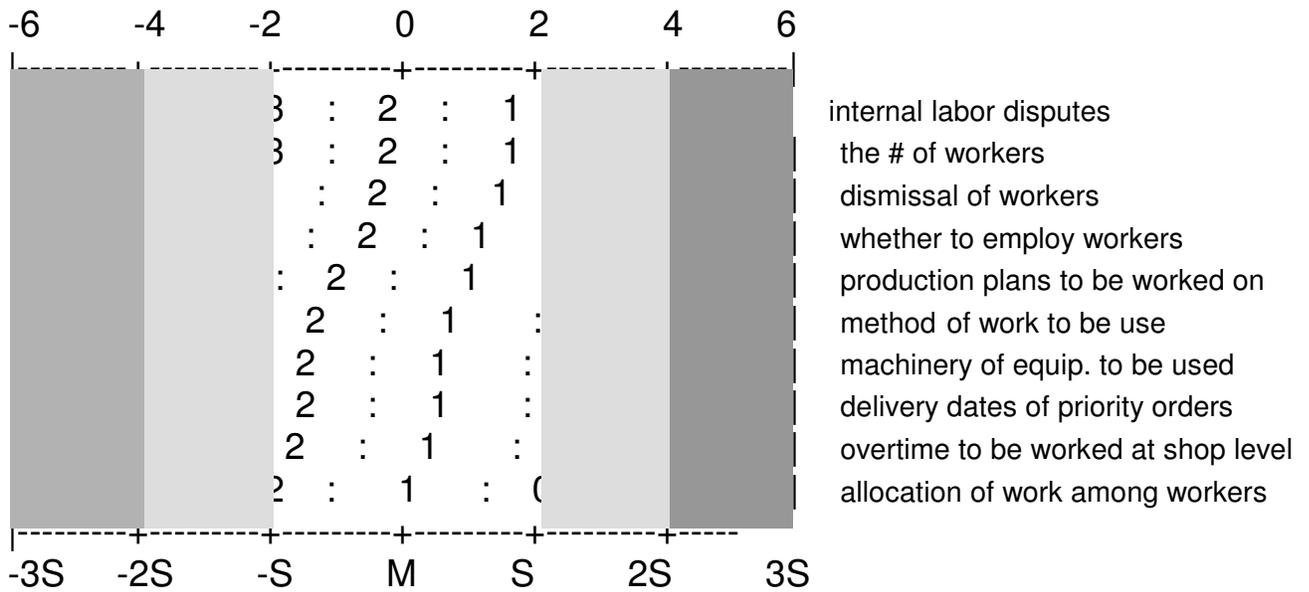


**Table 3**

| <b>Respondent Score</b> | <b>Std Deviations from Mean</b> | <b>Implications</b>                       |
|-------------------------|---------------------------------|---|
| 40                      | -3                              | Much more centralized than peers.         |
| 30-39                   | -2                              | More centralized than peers               |
| 10-29                   | ± 1                             | Similar centralization practices as peers |
| under 10                | +2                              | More decentralized than peers             |

**Figure 3**

**Centralization/Decentralization Self-Assessment Tool**



# SMALL FIRMS' ASSESSMENT OF COMPLEMENTARY ACTORS IN THE DEVELOPMENT OF INNOVATION – SOME PRELIMINARY FINDINGS

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## Abstract

Small firms are frequently the source of many significant innovations and it is common for national governments to focus attention upon smaller entrepreneurial firms when seeking to encourage enhanced innovation. However, the entrepreneur within a small firm is frequently resource poor and requires collaborative partnerships with other organisations in order to bring their innovation to market. The role of complementary actors as a part of the firm's strategic network is well recognised as being important to innovation, particularly in the diffusion of new technologies into established markets. This study examines the findings of a pilot study of small, high innovator firms in Australia and their assessment of the risks and benefits of forming strategic alliances with third party complementors. A linear regression analysis found that the entrepreneurs of these small innovator firms were willing to form strategic alliances where such collaboration would assist in reducing customer perceptions of risk in the adoption of their innovation, while also enhancing the customer's understanding of the innovation. However, the entrepreneur of the small firm also needed to be confident that the alliance would allow him or her to retain control over the quality of the final outcome to their customer. These findings suggest that entrepreneur education in the development and management of strategic networks may be a useful enhancement to the process of innovation in small firms.

## INTRODUCTION

Small to medium sized enterprises (SME) (e.g. those with fewer than 200 employees) operate within a web of stakeholders that typically include customers and suppliers, financial institutions and venture capital providers, employees and government agencies (Jennings & Beaver, 1997). Unlike their larger, vertically integrated counterparts, many

SME lack sufficient resources to fully develop all aspects of a new innovation or bring it to market. Entrepreneurs of small firms find it is often advantageous to form strategic partnerships with customers, suppliers and third-party actors that supply finance or even intellectual property to assist the firm to secure a competitive advantage (Ostgaard & Birley, 1994).

This study examined the strategic decision making of entrepreneurs from small firms who were engaged in the commercialisation of a new innovation. A collaborative study involving Australian and French research groups, the project explored strategic risk assessment frameworks originally developed within France (Santi, et.al. 2003) and applied them to a sample of firms drawn from a government database of small innovator firms in Western Australia. The study examined the strategic decision making of the entrepreneurial owners in relation to their risk-return profile (Mazzarol & Reboud, 2005). Particular attention was given to their decision to proceed with a new product or process innovation, and their willingness to engage third party complementary actors in its development and diffusion. Of interest was the role complementary actors might potentially play in the innovation diffusion process.

### **FACTORS INFLUENCING NETWORKING AMONG SMALL FIRMS**

Alliances within networks for small firms can be both formal and informal and can take place across both the production and resource network layers. Given the importance of the owner-manager in the decision to form an alliance, it is within the social network layer that attention needs to be given in seeking to understand the networking of small firms. A personal network – whether formal or informal in nature – is a valuable source of knowledge and ideas for the owner-manager and can assist them in making strategic decisions (Hogberg and Edvinsson 1998).

Common causes of network failure include the attempt by a large focal firm to appropriate the resources of other network partners, or attempt to interfere too much in the operations of their suppliers or distributors. A lack of trust or poor communication between network members can also lead to fatal damage to the alliance. Finally, if the network actors become overly specialised and narrow in their focus, they can lose their ability to innovate and the alliance may see its competitiveness reduced over the long-term (Miles and Snow 1992).

An examination of the strategic networking behaviour of small firms in Europe suggests that entrepreneurs from such businesses are motivated to forge alliances due to social ties built upon family and friends, but this may widen over time to enable the gathering of useful market intelligence. Such networks are both formal and informal in nature and are related to both the customer-supplier relationships and those associated with industry or trade associations and professional agencies (Donckels & Lanbrecht, 1997). A study of Australian small firms found that entrepreneurs are likely to seek strategic alliances in order to either create new market related opportunities, secure access to resources so as to build up business capacity, or defend market position against competitors (Jarrett, 1998).

For many small business entrepreneurs the prospect of forming strategic alliances with other firms is fraught with problems. A common concern appears to be fear that valuable information or intellectual property will be leaked away via the network. This 'leakage' of information is recognised as a major challenge facing business networks and is only really controlled via the trust and mutual respect held among network members. These entrepreneurs may also avoid entering into strategic alliances out of a desire to retain their independence and a perception that other firms could not be trusted (Dean, Homes and Smith, 1997). Manufacturing firms were found to be more likely to avoid such collaboration than service-based firms and older, more established firms were more likely to seek collaboration than younger, less established ones. Entrepreneurs that did engage in strategic alliances expressed the benefits of doing so to achieve sustainable growth and profitability, as well as enhanced information exchange and the improvement of product quality.

A study of 149 small manufacturing firms in the United States found that social networking by the entrepreneurs running these firms was the principal determinant of how strategic alliances were formed. Entrepreneurs who had a high propensity to network were more likely to be engaged in a wide range of formal and informal professional, trade and social organisations. Of importance was their perception that an association in such circles was likely to enhance their prestige. Also important was the strength of the alliances that comprised the network. It was of more importance that the network was focused on valuable outcomes for the entrepreneur than its overall size. Such a network might be focused on production activities or support activities involving marketing, sales, training or investment agreements (BarNir & Smith, 2002).

### **THE ROLE OF COMPLEMENTARY ACTORS IN INNOVATION DIFFUSION**

Brandenberger and Nalebuff (1995) outline the concept of complementary actors within a firm's strategic network. In addition to customers and suppliers, the firm's "value net" contains both "substitutors" and "complementors". The first of these are essentially the competitors who have the ability to substitute the firm's products or services for their own. The latter are those that offer the firm complementary services or whose products or services can complement those of the firm, enhancing the overall benefits to the customers. An example might be that of hotels and airlines, or software companies and those that manufacture computer hardware.

For small firms seeking to commercialise a new innovation it is useful or even necessary to secure access to complementary technologies or resources that can assist the diffusion process. The brilliance or originality of the innovation is often not sufficient to allow a new idea to find ready acceptance within a selected market (Price, 1996). Innovation must be able to meet a market need and must be configured in such a way as to conform to the customer's existing environmental requirements (Grupp & Maital, 2001). Much may depend on the nature of the innovation itself. For example, an incremental innovation may be relatively easy to bring to market without much external assistance. Market disruption is low and customers can readily adopt the product or process with

minimal effort. By comparison a radical technological product or process innovation is likely to be more disruptive of the market and may be more difficult for the customer to quickly adopt, even if it brings substantial benefits to them (OECD, 2001).

Customer acceptance of an innovation – particularly a technological one – is likely to be contingent on their capacity to determine during the selection process five key things: i) the relative advantage of the innovation; ii) how complex it is to understand and use; iii) whether it is compatible with existing technologies and systems; iv) whether it can be trialled before it is accepted; and v) how observable are the benefits from the innovation (Rogers, 1995). In decision making relating to the acceptance of a new technological innovation, the customer is also likely to consider how useful this new product or process is and how easy it can be to use (Davis, Bagozzi & Warshaw, 1989). In some markets the decision as to whether or not a new innovation is adopted may be impacted by the influence of social pressure groups, the brand image associated with the product, how relevant the new technology is to the adopters core business or work, whether the adopter can demonstrate the benefits of the innovation and also the experience the adopter might have with such technologies (Legris, Ingham & Robertson, 2003). Further, within organisations it is common for the adoption decision making to be a two-stage process that involves initially the adopting firm's management, but then the implementation stage in which the end users are engaged (Zaltman, Duncan & Holbeck, 1973; Leonard-Barton & Deschamps, 1988). This can create additional problems for small firms seeking to get their innovation adopted by larger organisations as the diffusion process can be complex.

Complementors can assist the diffusion process by providing a supportive strategic network where the innovation developed by the originator firm is combined with the existing technologies or business systems of a complementary actor in the firm's network. A case in point is that of Australian firm TCG that possessed expertise in electronic metering. To enable them to bring a new product into the aviation refuelling market TCG formed strategic alliances with two complementary actors; a large oil company supplying fuel to the aviation sector and an existing fuel metering manufacturer that did not have the advanced electronic systems offered by TCG. Together the three firms collaborated in the process of new product development. This strategic collaboration enabled TCG to enter this new market that might have been otherwise impossible to access alone (Matthews, 2001).

Based upon this previous evidence this study sought to test several research propositions:

- P<sup>1</sup> – that small innovator firms will seek to implement an innovation strategy where the customer is perceived to secure a significant benefit from the new innovation;
- P<sup>2</sup> – that small innovator firms will seek to implement an innovation strategy where the new innovation is perceived to be compatible with the customers existing technologies or systems;

P<sup>3</sup> – that small innovator firms will seek to establish strategic alliances with complementor networks when the market diffusion may be impeded by above average levels of perceived risk by customers due to the innovation's complexity.

## **SAMPLING & METHODOLOGY**

In 2002 a small scale qualitative study was undertaken in France with 15 entrepreneurs from small firms based in the Dijon region and Paris. The study identified a risk-return evaluation framework for entrepreneurs seeking to invest in a new innovation (Santi et. Al, 2003). This study sought to follow up the earlier French research. In 2004 a pilot survey was conducted with a sample of entrepreneurs from high innovator small firms in Perth, Western Australia. A questionnaire, developed from the original French qualitative study, was distributed to around 550 SME (less than 100 employees, with  $\frac{3}{4}$  of them having under 20 employees, over 80 percent had turnover less than AUD\$5 million, with the average around AUD\$1 million) identified as highly innovative and registered with the WA State Government Department of Industry and Resources (DOIR). A total of 57 usable responses was returned (10% response rate). The majority of respondents was executive managers and owners.

The questionnaire was targeted at persons within the firms who could report on behalf of the entire organisation. Within the final sample 42 percent were owner-managers, 23 percent were executive managers and principal shareholders, 25 percent were executive manager shareholders and 10 percent were executive managers without shareholdings. Thus the majority of correspondents was both executive managers and owners. The questionnaire asked respondents to indicate whether they had an innovation that they were planning to invest in over the next three years, and 96.5 percent indicated that they did so and were planning to introduce a new innovation into the market during this time frame. All firms had introduced a new product or process innovation in the past three years with the average number of new product or service innovations being 4 over the previous three years. The average proportion of annual turn over that these firms invested in new product R&D was 24 percent, reflecting their high innovator status. This should be compared with the Australian industry average of only 0.6 percent (ABS, 2005).

Other questions in the survey were structured around their risk-return assessment of the innovation, as well as the strategic decision making associated with the investment. A particular focus was placed on the role of complementors in the market diffusion process, examining the size of the complementor network, the impact this network was felt to have on the firm's success and the relative importance of the complementors to the innovation.

A step-wise linear regression analysis was employed to test the strength of this complementor network with the dependent variable being the relative importance of complementary actors to the proposed innovation. There were 28 independent variables tested in the regression analysis that related to customer perceptions of the benefits and

risk of the innovation, customer ease of understanding the innovation, their ability to measure the innovation’s benefits, as well as customer and supplier power issues. These variables are shown Table 1.

**Table 1: Independent Variables used in Regression Models**

|  |   |
|--|---|
| <b>Q22</b> value offer to customer                 | <b>Q39</b> supplier power over cost control             |
| <b>Q23</b> price offer to customer                 | <b>Q40</b> customer power over quality                  |
| <b>Q24</b> customer ease of understanding          | <b>Q41</b> customer power over cost control             |
| <b>Q25</b> customer prior test evaluation          | <b>Q42</b> firm power over quality                      |
| <b>Q26</b> customer post test evaluation           | <b>Q43</b> firm power over cost control                 |
| <b>Q27</b> customer compatibility of technology    | <b>Q44</b> customer power over switching costs          |
| <b>Q30</b> customer views of risk                  | <b>Q45</b> supplier power over switching costs          |
| <b>Q31</b> customer views of transfer costs        | <b>Q46</b> firm power over switching costs              |
| <b>Q32</b> customer views of time saving           | <b>Q47</b> supplier power to integrate forward/backward |
| <b>Q33</b> customer views of complexity            | <b>Q48</b> customer power to integrate forward/backward |
| <b>Q34</b> customer views of opportunities         | <b>Q49</b> firm power to integrate forward/backward     |
| <b>Q35</b> customer views of ease of understanding | <b>Q50</b> importance of sales turnover to suppliers    |
| <b>Q36</b> customer views of ease of measurement   | <b>Q51</b> importance of sales turnover to customers    |
| <b>Q38</b> supplier power over quality             | <b>Q52</b> importance of sales turnover to firm         |

## FINDINGS

Within the sample, 51 percent indicated that they had entered into some form of joint venture with leading customers, but only 25 percent had entered into any formal joint ventures with key suppliers. Almost half the sample (47%) indicated that they had entered into a joint venture with other companies. This suggests an above average level of strategic alliance building within these firms, which is consistent with highly innovative small companies (Mazzarol 2003). In terms of the number of potential complementary actors that might be involved in the diffusion of the innovation: 69.6 percent of the firms could identify 1-2 partners; 21.4 percent of the firms could identify 3-5 partners; and 8.9 percent of the firms could identify over 6 partners. With respect to the value such complementary actors might offer, 60 percent considered that their value would be high and 40 percent low. Further, 51 percent of the firms considered that these complementary actors would be larger and stronger firms, while 49 percent identified their complementary actors as smaller and more dispersed.

The regression analysis used a stepwise methodology in the SPSS statistics package that produced a model after five steps. It can be seen from Table 2 that this model had an adjusted R-square of 0.42 suggesting that the model explains around 42 percent of the variation in the data. This model suggests that the predictors of the importance of complementary actors to the innovation were:

- The customer’s perception of the level of risk they were likely to face when adopting the new innovation;
- The level of power the innovator firm had over quality within its industry;
- The customer’s perception of the opportunities the innovation would create for them if adopted;
- The compatibility of the innovation to the existing technologies operated by customers; and
- The customer’s ability to easily understand the innovation.

**Table 2: Model Summary**

| Model | R    | R Square | Adjusted R Square | Std Error of the Estimate |
|-------|------|----------|-------------------|---------------------------|
| 5     | .695 | .483     | .420              | 1.512                     |

**Predictors:** (Constant), Q30 customers views of risk, Q42 firm power over quality, Q34 customers views of opportunities, Q27 customer compatibility of technology, Q24 customer ease of understanding

**Dependent Variable:** Overall the relative importance of complementary actors to my proposed innovation is.

**Coefficients**

| Model |  | B      | Std Error | Beta  | t      | Sig. |
|-------|--|--------|-----------|-------|--------|------|
| 5     | (Constant)                               | -3.224 | 1.582     |       | -2.038 | .048 |
|       | Q30 customer views of risk               | .571   | .171      | .391  | 3.341  | .002 |
|       | Q42 firm power over quality              | .504   | .123      | .494  | 4.079  | .000 |
|       | Q34 customer views of opportunities      | .479   | .139      | .412  | 3.452  | .001 |
|       | Q27 customer compatibility of technology | .397   | .150      | .312  | 2.652  | .011 |
|       | Q24 customer ease of understanding       | -.447  | .181      | -.288 | -2.470 | .018 |

## DISCUSSION OF THE FINDINGS

The regression model outlined above suggests that the respondent's assessment of the importance of complementary actors to their proposed innovation is determined by how easily the customer can understand it and the customer's assessment of the risk and potential opportunities offered by the innovation, as well as how easily it can be integrated into their existing technologies. Finally the model suggests that the small innovator firm's own ability to influence the level of quality in the industry plays an important role.

The findings provide support for the research propositions outlined at the commencement of the study, particularly the third proposition. They are consistent with the evidence from innovation diffusion theory that highlights the importance of customers being able to overcome the issues of complexity, compatibility, trial ability and observability in an innovation prior to its adoption (Rogers, 1995). However, where these issues become too difficult to address alone, the innovator firm is likely to seek collaborative partners.

As noted above, previous research into the strategic networking behaviour of small firms in Australia suggests that many find the formation of alliances with complementary actors both confusing and somewhat threatening (Dean, Holmes and Smith 1997). However, such alliance building can provide significant benefits to small firms in terms of enhancing their competitiveness (Ostgaard and Birley 1994).

As previously explained small firms benefit from forming alliances with complementary actors in order to secure access to new markets or product opportunities, to access resources otherwise unavailable to them and to defend established market positions (Jarrett 1998). In markets where the small firm may lack suitable access to key resources, or requires additional enabling technologies to facilitate the adoption of an innovation, collaboration becomes essential. This has been described as a 'triangular' process of new product development, in which the innovator firm collaborates with a third party to secure the adoption and diffusion of their innovation by a potential customer (Matthews 2001).

The findings from this analysis suggest that the small innovator firms in the sample are considering such a process. Where customer's perception of risk is high and their understanding of the innovation is low collaboration is likely. However, the small innovator firm must also be confident that it has an innovation that can offer customers good opportunities and one that will integrate readily into the existing technology base. Finally, the small innovator firm should feel that it could control the quality of the product or innovation within the industry. This last point is likely to be important, because this is likely to provide the small innovator firm with a degree of control over the end result. Should they feel that they couldn't control the quality, they are likely to be vulnerable when engaging complementary actors who might adversely influence the final outcome. The beta score of Q24 "firm power over quality" is not surprisingly the largest within the model.

## CONCLUSIONS

Although tentative, these findings suggest that entrepreneur education in the development and management of strategic networks may be a useful enhancement to the process of innovation in small firms. Small firms benefit from forming alliances with complementary actors but the management of such relationships can be taxing on the entrepreneur and is fraught with potential risks. Teaching entrepreneurs the benefits of strategic partnering and assisting them to find and forge useful strategic alliances should be placed among other management skills in future entrepreneurial education programs.

While only a small scale study, the findings suggest that future research to explore the benefits and impediments to strategic networking among small firms is relevant and useful. Lessons learnt from this research can inform policy makers and entrepreneurs as to the most effective ways to encourage and build alliances. Entrepreneurs need to recognise that the commercialisation of a new – particularly radical – technological innovation is unlikely to be undertaken successfully without the involvement of third party complementary actors. The formation of strategic partnerships with such actors is therefore a strategic management issue that should be addressed early within the business planning process. Policy makers and management educators also need to recognise that the formation and management of strategic alliances is often crucial to the process of successful commercialisation. However, it is frequently viewed as a risky process and assistance processes such as facilitation services that assist entrepreneurs to network in a secure environment can be most helpful. Teaching entrepreneurs the value of strategic alliances and how to manage these from both a legal and social perspective is also important.

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**LEARNING NETWORKS AS AN AID TO DEVELOPING STRATEGIC  
CAPABILITY AMONG SMEs: A CASE STUDY FROM THE IRISH  
POLYMER INDUSTRY**

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**ABSTRACT**

Strategic decision making within small manufacturing firms is a high risk and necessary element for business growth. Small manufacturing firms are more vulnerable when choosing new business paths compared with larger competitors, with superior resources, know-how and finance. Smaller firms must adapt and become more efficient within their current business path and more dynamic in their approach towards finding new paths. Traditional improvement philosophies adopted by many manufacturing firms are widely appreciated as having led to enhanced product quality and reliability. These philosophies, although useful, are not focused on delivering new capabilities or developing new business paths. Learning networks are co-operative associations of partner firms that share knowledge, physical resources and expertise to improve current performance within existing business domains and advance new business paths. Learning networks are advancing the capability of small firms in the polymer industry in Ireland. Ireland has emerged as a significant net contributor of plastics to the global medical device, telecommunications and ophthalmic products sectors. The role of the learning network as a catalyst for both new business development and increased technological enhancement is advanced in this study of an Irish polymer manufacturing firm. The firm is a participant within a learning network called First Polymer Network. The name of the firm has been altered to Mould-Tech for the purpose of this presentation. Adaptation of dynamic learning networks as expounded in this study present participant firms with new opportunities to both '*learn and earn*', i.e. enhance and acquire new capabilities and grow their businesses.

## INTRODUCTION

Strategic change has increasingly been appreciated as a process in which the ability to learn faster than a competitor - is key to competitive success (Eisenhardt, 1999). Over the past two decades, the principal developments in strategic analysis focused upon the link between strategy and the external environment. Prominent examples of this focus are Porter's (1985) analysis of industry structure and competitive positioning. By contrast, the link between strategy and the firm's resources and skills has suffered comparative neglect (Grant, 2002). With the development and maturity of strategic management approaches, it seems clear that a new organisational capability is emerging that is critical to success i.e. the ability to understand and learn from organisational performance (Ulrich & Smallwood, 2004). The ability of an organisation to recognise these capabilities and exploit them through the vision of its leaders will be an essential requirement in a bid to sustain competitiveness.

Traditionally, capabilities-based competition has focused on the development of narrow capabilities based on prior experience, but failed to address how firms cope when existing capabilities become obsolete, or how firms acquire new capabilities (Teece & Pisano, 1994). Much of the work on capabilities has attempted to identify and measure internal components, such as employee skills, know-how and intellectual property. In contrast, there has been relatively little research on capabilities based on linkages with other firms and the position of a firm within a network of organisations. Firms compete in a sector but they can also create a context within which they can co-evolve, especially in areas of capability acquisition (Eisenhardt & Galunic, 2000). As the business environment becomes more complex there is likely to be an increased focus on organisational learning networks as a source of complementary assets and other resources for capability building. With growing complexity in the business environment, the focus on capability building in small firms shifts from capabilities based on internal assets such as R&D activities and intellectual property, to the position of a firm within a network, capabilities based on its relationship with other organisations and the complementary assets of those organisations.

The primary focus of this research study is capability building through knowledge transfer within a Learning Network, entitled 'First Polymer Network' (FPN). Learning has become increasingly important to the survival of firms. The need for learning has yielded a wide variety of alternatives to formal training methods, in contributing to individual and organisational learning.

Firms can no longer be good at everything they must do to meet their customers' needs; they must specialise and learn to combine their capabilities with other firms. Through inter-firm collaboration, networks may allow firms develop solutions to common problems, combine resources to gain knowledge, achieve economies of scale, acquire technologies/resources and enter markets that would otherwise be beyond their reach (McNaughton & Bell, 2001). Learning Networks act as a source of competitive advantage for small firms and help them overcome the disadvantages of size. Cook (1996) found that 'learning through networking' has proven to be an important factor in the economic development of some of Europe's more dynamic regional economies.

## **First Polymer Network (FPN)**

The Polymer industry has become increasingly important in Ireland's industrial structure, employing 11,000 and exporting an estimated €500m annually. The sector is under competitive pressure from low-cost economies including Eastern European countries - some of them new EU entrants. It is also dependent on the fortunes of the industries - electrical, electronics and medical devices - of which it is a supplier.

FPN arose from a government supported initiative to encourage different industry sectors to group together voluntarily to develop their own *enterprise-led* learning (Department of Enterprise, Trade and Employment, 1997). This was a deliberate contrast to learning driven by State development agencies, hitherto seen as abstract and not meeting the real needs of the industry.

Prior to the establishment of FPN in 2000, skill development initiatives were somewhat haphazard and not systematically applied. Acting on their own, individual firms engaged the services of specialist trainers. The growth of FPN allows firms to combine resources to gain knowledge, achieve economies of scale, acquire technologies and resources and enter new markets. Firms in the learning network gain by increasing their ability to access external expertise thus developing their internal resources and capabilities.

FPN aims to build an *industry-led* sustainable learning network provision for the polymer industry through the development of training programmes leading to Further Education Training and Awards Council (FETAC) certification. (FETAC is a State sponsored accreditation agency ensuring education and training standards).

FPN gives real expression to the principle of partnership at all levels. The requirement for new mechanisms and structures for decision making allows multiple stakeholders to come together in a network-centered learning environment, to co-ordinate and integrate efforts (Baron & Markman, 2000; Blundell & Smith, 2001). Partnerships between key stakeholders widen participation, increase demand for learning and link together measures designed to strengthen local capacity and participation, stimulate innovation, pool resources and develop more flexible and varied provision for learners. Some of the key features of the partnership challenge include:

- Collaboration of employees/firms and collaboration among firms' employees
- Integration of ideas and information
- Capacity to deliver - move fast, take risks, make and learn from mistakes, not afraid of the concept of failure - 'learning by doing'
- Recognition of the workplace as an important opportunity for the achievement of lifelong learning

## **Mould-Tech**

Mould-Tech was established in 1991 as a family business, employing seventy people and specialising in printing of telecommunications components using pad printing/screen printing techniques. In the late 1990's Mould-Tech added injection moulding to its bundle of resources,

enabling it to supply moulded lenses for the mobile phone sector. Four common factors highlight the characteristics of Mould-Tech's path creation strategy as illustrated in Fig. 1.

**Fig. 1. about here**

1. *Displays a single-minded commitment to clearly recognised objectives* - To be at the leading edge of technologies such as in-mould decoration and in-label decoration and continue to improve these existing technologies through modern measurement equipment.
2. *Possesses a focused understanding of the competitive environment* - recognised that it had too great a dependence on the mobile phone sector - in hindsight this was deemed risky. Senior Management saw winning a stake in Ireland's growing medical devices sector as a strategic path for Mould-Tech's future. Significant investment rendered it well positioned to penetrate the attractive medical devices sector, where clean room techniques and moulding precision was already the norm.
3. *Conducts an objective appraisal of resources* - Fulfilling this goal was a challenging task and a key element in Mould-Tech's plan was to bring on board a consultant in moulding technology to develop turnkey cost effective solutions for the medical devices sector.
4. *Affects strategic path solutions* - this is due largely to continuous investment in staff, processes and new technologies. FPN was pivotal in the implementation process by providing *enterprise-led* initiatives in Robotic expertise, Single Minute Exchange of Die (SMED), Design of Experiments (DOE) training and First Line Management skills - all incorporating FETAC qualifications to staff within Mould-Tech. The main motivator for joining FPN has been, inter-organisational collaboration, reducing cycle times, decreasing transaction costs and managing uncertainty through lobbying (Heracleous and Murray, 2001).

**LITERATURE REVIEW**

Following Penrose's (1959) contribution, it is well understood that capabilities are critical to a firm's ability to mobilise and use its resources to grow and compete successfully in rapidly changing technologies and markets (Chandler, 1990; Grant, 2002). In exploring the growth of a firm, Penrose, (1995) was very clear: 'In planning expansion, a firm considers two groups of resources - its own previously acquired or 'inherited' resources, and those it must obtain from the market (in this case FPN) in order to carry out its production and expansion programme'. The implication is that resource configurations develop over time, are constrained by what has gone before and require investment if they are to continue. Penrose asserted that what happened *inside* the firm was just as important as the market place *outside* the firm.

The resource-based analysis (RBA) school of thought attempts to link superior firm performance to capabilities possessed by firms (Teece, 1980; Rumelt, 1984; Wernerfelt, 1984; Barney, 1986; Peteraf, 1993). Although it might at first appear that the RBA is particularly suited to large firms with vast resources, it is also relevant for small and medium-size enterprises (SMEs). Such firms tend to have a smaller number of resources but they can also be more flexible and

entrepreneurial. RBA has been the subject of fundamental criticisms, the most noteworthy of which, relates to the operationalisation of capabilities. For instance, Porter (1994) criticises existing conceptualisations of capabilities for being tautological. The Amit and Schoemaker conception is static, in that it looks at capabilities of a firm at one point in time. As numerous authors have pointed out (Foss, 1997; Teece, Pisano and Shuen, 1997), it is important to go beyond static measures of capabilities and focus on how a firm's superior capabilities might help it in resource creation for the future. This acknowledges the role of path dependencies in the acquisition of capabilities. In the management literature, it is widely acknowledged that leveraging of knowledge throughout firms is important. However, there appears little evidence of what knowledge is transferred between firms and how this occurs. The literature also tends to neglect how firms use knowledge transfer to cultivate appropriate capabilities. Specifically, the author is interested in the following research questions:

- How do learning networks contribute to capability building in small firms?
- How does the learning process take place - including individual and organisational learning, inside the firm and within the learning network?

## **METHODOLOGY**

This research consisted of a single in-depth case study (Hamel, 1993) incorporating a three year observation period, whose purpose was to explore the impact of a Learning Network on path development within Mould-Tech. The study was explanatory in nature. There were many 'how' and 'why' questions to be answered with regard to this issue. It is believed that through direct observation and systematic interviewing, case study methodology was the most valuable for understanding the relationship between a learning network and the capability building process within Mould-Tech. The case study method was deemed appropriate in this context as it sanctioned the investigation of contemporary phenomena within a real life context (Aaker and Day, 1990; Bell, 1993; Yin, 2003) and particularly appropriate to small business research (Hill and McGowan, 1999). This research mode's application is reinforced by Brown and Duguid (1991), who suggest, 'understanding and impacting learning and innovation requires one to study and understand the situation in which practice occurs'. While case research may be criticised for its lack of rigour, the author has followed suggestions from previous studies (e.g. Eisenhardt, 1989; Miles and Huberman, 1994; Yin, 1994) to ensure the validity of the study.

### **Data collection**

Data collection for this study utilised semi-structured interviews in a field setting to ensure standardisation. A case study protocol was designed and used to guide the structured interview and data collection (Yin, 1994). The protocol included multi-diagnostic questions. On site interviews and observations were conducted. While most of the data collection was qualitative in nature, quantitative data was also collected to verify the findings. The use of multiple sources of evidence enhanced both the reliability and validity of the study (Voss et al., 2002; Yin, 1994).

To ensure the quality of the research design several validity tests were conducted as indicated necessary by previous studies (Yin, 1994). Table 1 reviews the tactics applied to ensure the

quality of this case-study method. The rest of this section reviews the information collected in relation to the background of the firm studied and analyses the effects of a Learning Network involvement in its strategic path development.

### **Table 1 about here**

## **FINDINGS**

In a fast-moving, technologically complex and innovative industry Mould-Tech's ability to keep pace with innovation in manufacturing processes forced it to rethink its strategy. Technology within the industry continued to develop incrementally until quite radical changes impacted on the Telecommunications sector - Mould-Tech's key customer base. Argote (1999) observed that any distinct business-specific knowledge or skill may be quickly out-dated or bypassed by shifts in market or stakeholder relationships. While Mould-Tech continually held on to the past, trying to modify its own production techniques with little success, its market share slipped away. What seemed to be a small incremental development in technology required Mould-Tech to totally rethink the way it did business, from its production processes to its sales and marketing strategies! It was unique in its effort to translate its technological understanding of the need for change by re-adapting the routinised processes in the firm. A central challenge facing Mould-Tech is what Volberda (1998) calls the 'paradox of flexibility': 'Organisations need to be able to adapt while remaining stable enough to exploit any changes made'.

Mould-Tech provides technology solutions which involves partnerships with customers, offering services principally centred on component design. This means that Mould-Tech could manage the whole process from initial concept to volume manufacture. Technology road maps provide Mould-Tech with a means of depicting a link between current and emerging technologies that it chose to exploit (Probert & Shehabuddeen, 1999). It outlined the design process, such as sourcing the best components, materials management and final distribution. It involves utilising their global expertise in procurement so that customers can maximise the availability, reliability and flexibility of materials. The emphasis is on lowering cost without losing any quality or speed of operation. Their Materials Resource Planning (MRP) programme provides accurate stock forecasts which facilitates capacity planning and minimises incidences of idle stock.

The firm decided to abandon its traditional functional structure in favour of a more flexible team-based structure and a more business-process-oriented way of doing business. A New Product team was formed offering a wide range of pre-production services. Prototyping is carried out, so that the customer could access the products' suitability for volume production – this has significant savings for the customer in terms of time and money. Before these changes the firm was organized into functions - Production, Administration, Purchasing and Marketing/Sales. This structure created problems with cross-functional co-ordination. In the new structure teams reported directly to the senior management team. The responsibility for co-ordination of any project was shared between the business team (commercial responsibility) and delivery team (production planning).

The paths traveled give Mould-Tech significant advantages:

- *First-mover advantage* – by being the first to make a strategic move in the market they have the capability to launch a new product ahead of the competition. On the face of it,

this gives considerable benefits. It takes time for competitors to catch up, allowing Mould-Tech to gain economies of scale, experience curve effects, build customer loyalty and therefore enjoy switching costs. Their strategic path initiatives enable them to use technical know-how and build a market stronghold in the medical devices sector as resource-based competitive advantages.

- *Core capabilities that it deems robust in nature* – are embedded in the way the firm works and not explicit. For example, higher levels of personal service, specialist expertise, design skills and bespoke solutions. This may be regarded as organizational knowledge, based on intuition and experience i.e. shared knowledge based on interactions across many parts of the firm - ‘ways of doing things’

## CONCLUSION

There is much anecdotal evidence that a scarcity of resources encourages learning. Unlimited resources breed waste and inefficiency. Innovation, invention and adaptation are encouraged in an environment of shortage, competition and the struggle for survival. Using the SWOT model, the absence of *threat* removes the stimulus to exploit all the firm’s *strengths*.

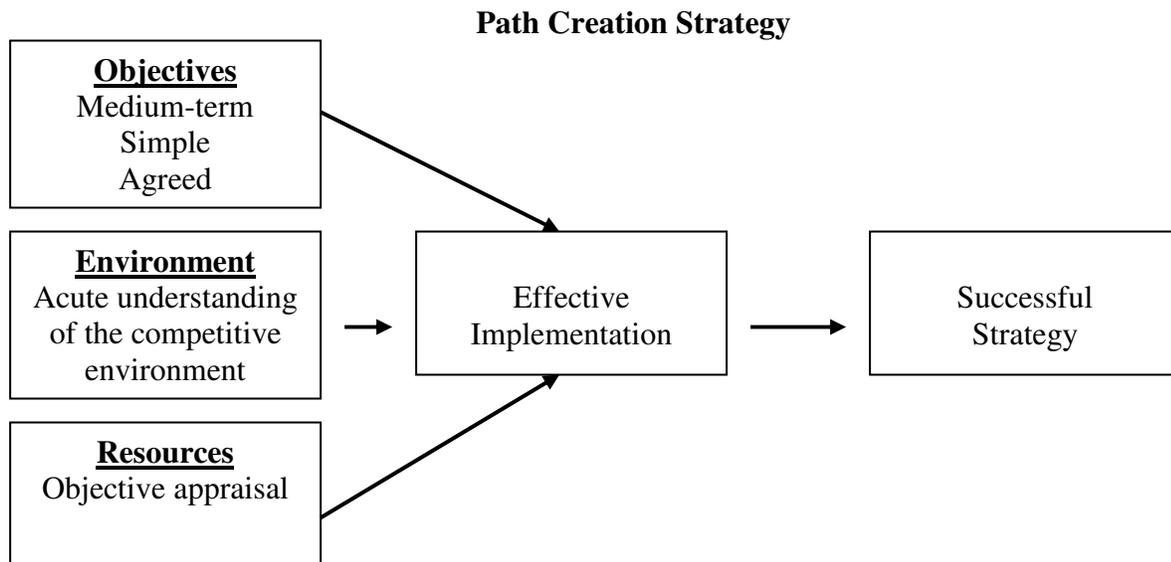
Small firms such as Mould-Tech are only too aware of the external environment in which they operate (Threats and Opportunities). They know that complaining about what is a globalised marketplace is a waste of time. So they work on developing their strengths (capabilities) - speed of adaptation etc., recognising their weaknesses - high wage costs etc. and reacting to the external environment.

In the context of this paper, it is clear that Mould-Tech knows that it must meet increasingly arduous production standards to remain in business. The industry standard approach is to purchase modern equipment designed for these tight tolerances. However, Mould-Tech can not justify the expenditure and must seek other means of meeting standards. As a consequence, it modifies its processes and procedures to meet exacting standards. This has led to discovering new ways of setting up existing machines, preparing feed materials and monitoring performance. These skills have become available across a range of its activities and produce an improved all round performance. It has developed a new set of capabilities which enhance its ability to compete and more importantly, its ability to learn how to compete. None of this would be possible if it had not participated in the learning network - FPN.

Capability building through participation in FPN is deemed more likely to be successful in Mould-Tech as it builds on the strengths already available to it, rather than starting from scratch in a totally new area. Building on this prior knowledge confers an ability to recognise the value of new knowledge and assimilate it. Cohen and Levinthal (1990) refer to this ability as absorptive capacity. Management recognises that this does not guarantee that the strategy will be successful but it is a contributing factor. Building on existing strengths, exploits uniqueness that has been built as a result of the firm’s history and investment over the years - path dependency. New capabilities do not mystically appear within the firm - they are the outcome of deliberate learning processes, as Winter (2000) has stressed: ‘To create a significant new capability, an organisation must typically make a set of specific and highly complementary investments in tangible assets, in

process development and in the establishment of relationships that cross the boundaries of the organisational unit in which the process is deemed to reside’.

Mould-Tech is an example of a small manufacturing firm that has realised new capabilities through the shared expertise of partner organisations in FPN. This study has highlighted the movement of an Irish SME in the polymer industry towards a new business paradigm involving the exploitation of shared expertise in a learning network. The ‘*learn and earn*’ paradigm of strategic partnership as exemplified in this study is serving to foster a newly strengthened industrial sector in Ireland.



**Fig. 1 Source : Adapted from Grant, 2002**

**Table 1. Research Validity Tests**

| <b>Test</b>   | <b>Approach/Tactic Used</b>   |
|---|---|
| <p>(1) <b>Construct Validity</b><br/>Develop sufficient set of operational measures to reduce subjective judgement</p>              | <p>(a) Revised multiple sources of evidence so that the findings were based on convergence of both qualitative and quantitative information</p> <p>(b) Established a chain of evidence with sufficient citations to relevant portions of the case study transcripts</p> <p>(c) Asked participants to review draft case interviews</p> |
| <p>(2) <b>External validity</b><br/>Ensure generalisation of findings</p>   | <p>In this case, the researcher strived to generalise a particular set of results on to a broader theory</p>  |
| <p>(3) <b>Reliability</b><br/>Demonstrate that repetition of the data collection procedures will result in the same conclusions</p> | <p>(a) Interviewed multiple subjects within Mould-Tech and responses were cross-referenced</p> <p>(b) Created case study notes and narratives for future reviews and analysis</p>   |

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## THE ROLE OF THE RESEARCHER IN CREATING CORPORATE NARRATIVE

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## ABSTRACT

Corporate narrative is a term describing the use of narrative in organizations. Interest in corporate narrative has grown out of the increasing acceptance of interpretivism as a research tool, the growing use of case studies in management research and growing understanding of the importance of narrative in field studies. As management researchers begin to utilize the study of corporate narrative as a research tool, it behooves us to begin a discussion of the role that the researcher plays in actually developing these narratives.

This paper examines the role that the researcher played in the creation of corporate narrative in a three year old service company in the natural gas industry between 2003 and 2004. The primary role of the researcher in field study was found to be the role of sounding board for the interviewed. An important secondary role for the researcher was found to be the role of mediator who draws societal meaning out of the narrative.

This study points out both the power and the limitations of active researcher involvement in qualitative research. The power of active researcher involvement in qualitative research comes from the ability of the researcher to experiment with the implementation of theoretical speculation in the fieldwork setting. The limitation of active researcher involvement in qualitative research comes from the bias that the researcher introduces into the fieldwork setting.

## INTRODUCTION

While there is not general agreement as to what the term *narrative* means, it is generally conceded that the term refers to a thematic, sequenced account that conveys meaning from an author to an audience (Barry & Elmes, 1997, p.431). Scholes has described narrative as: "...the symbolic presentation of a sequence of events connected by subject matter and related by time" (Scholes, 1981, p.205). Ricoeur has defined narrative as "the discourse of a narrator recounting the discourse of the characters" (Ricoeur, 1984). Implied in both definitions is the attempt by individuals to create meaning of both past actions and new sequences of events. Currie suggests that narrative is an essential part of the human condition; we define ourselves as the tellers and interpreters of narrative (Currie, 1998, p.2).

Corporate narrative (Fleming, 2001), or organizational narrative (Boyce, 1996), are terms describing the use of narrative in organizations. Corporate narrative can take the form of a performance (the act of narration) or the form of text (the written account of a narrative) (Boje, 1991, p.110). Corporate narrative can be fiction or non-fiction. Boje has described how the Walt Disney Company used fictional narrative to craft an official history that ignored the darker side of Walt Disney and the Disney corporate culture (Boje, 1995). Alvarez and Merchan have described the common use of narrative non-fiction in management education, in the form of case studies (Alvarez & Merchan, 1992, p.29).

Gabriel suggests that corporate narrative is a growing field of study (Gabriel, 2000, pp.17-18). Interest in corporate narrative has grown out of the increasing acceptance of interpretivism as a research tool (Hiley *et al.*, 1991), the growing use of case studies in management research (Gummeson, 2000, p.3; Remenyi *et al.*, 1998, p.165) and growing understanding of the importance of narrative in field studies (Bruner, 1986; Pentland, 1999). Qualitative researchers are discovering that open-ended interviews allow them insight into many areas of management, which are not ordinarily on view. Corporate narratives can expose interpersonal issues, such as racism or sexism in the workplace, can shed new light on old

problems, such as the working of corporate culture and can help researchers understand working situations such as job-related stress and trust (Rubin & Rubin, 2005, pp.2-4).

As management researchers begin to utilize the study of corporate narrative as a research tool, it behooves us to begin a discussion of the role that the researcher plays in actually developing these narratives. This paper examines the role that the researcher played in the creation of corporate narrative in a three year old service company in the natural gas industry between 2003 and 2004. The analysis is structured around two axes: the role of the researcher as an agent of the creation of the corporate narrative and the role of the researcher in the institutionalization of the meaning of the corporate narrative.

## LITERATURE REVIEW

Becker and Geer were early qualitative researchers who realized that a specific advantage of participant observation is the completeness of information provided to the researcher (Becker & Geer, 1970, p.133). However, as Ruben and Ruben have pointed out, the researcher must recognize the part that he or she plays in creating the construction of this information (Rubin & Rubin, 2005, p.30).

Kvale has conceptualized the role of the researcher in narrative study through two metaphors: the metaphor of the researcher as a traveler and the metaphor of the researcher as a miner (Kvale, 1996, p.3). The metaphor of the researcher as traveler depicts the researcher as a reporter, who constructs meaning through the agency of conversation. The metaphor of the researcher as miner depicts the researcher as a discoverer who mines precious facts and meaning as the agent of institutionalism of knowledge. These two roles mirror two important forms of qualitative discovery: action research and institutional ethnography.

Action research traces its origins to Aristotle's definition of *praxis* or practical knowledge (Eikeland, 2001, pp.146-149). Recent pioneering of action research is credited to Kurt Lewin (Lewin, 1946) and Chris Argyris (Argyris *et al.*, 1985). Reason and Bradbury define action research as:

A participatory, democratic process concerned with developing practical knowing in the pursuit of worthwhile human purposes, grounded in a participatory worldview...It seeks to bring together action and reflection, theory and practice in participation with others, in the pursuit of practical solutions to issues of pressing concern to people, and more generally the flourishing of individual persons and their communities. (Reason & Bradbury, 2001, p.1)

In action research, the researcher acts as a reporter, who through the agency of conversation constructs meaning. Gummesson has noted that action research affords scholars the opportunity to couple the demands of consultancy work with the demands of academic research (Gummesson, 2000, pp.210-218). A common goal of the action researcher is to assist stakeholders in describing their work or organization in detail (Stringer, 1999, p.65). In moving towards this goal, the researcher often utilizes and develops corporate narrative. However, it has been pointed out that is important for the researcher to be aware of his or her intervention in the research situation and in the development of the resulting narrative (Remenyi *et al.*, 1998, p.49). Wadsworth also notes that action research involves all parties in actively examining their current actions (Wadsworth, 1998, p.13).

Institutional ethnography traces its origins to the development of ethnomethodology as a tool of social inquiry by Harold Garfinkel (Garfinkel, 1967). Smith, through her work as a feminist sociologist, has defined institutional ethnography as:

...an insistence on discovering and writing the social as the everyday and every night coordinating of people's actual activities...as participants in discourse entering into and contributing to forces that stand over against us and overpower our lives (Smith, 1999, p.228)

In institutional ethnography, the researcher acts as the agent of institutionalism, pointing out the linkages amongst the narratives of everyday life and the implications for organization, administration and governance (DeVault & McCoy, 2003, p.369). A common goal of the institutional ethnographer is turning narrative into text. Through the development of a case study, many of the social relations embedded in narrative are explicitly recognized. Smith has noted that part of this process involves creating a sense of accountability between what members of an organization actually do and what these members interpret their actions to be (Smith, 1987, p.161).

## FIELDWORK

This study draws upon field research conducted in 2003 and 2004. This field research captured seven hours of oral narrative performed by the senior management of a three year old service company in the natural gas industry, CJB Ventures Ltd. The recordings were made in two sessions, May 7<sup>th</sup>, 2003 and July 17, 2004 and involve the researcher in dialogue with the company principals: Cam McKenzie, Jim Fjeldsted and Bruce Henderson. Each of the company's principals has spent years working in the harsh conditions of Canada's Western Sedimentary Basin and each is an accomplished story-teller.

The first recording session, May 7<sup>th</sup>, 2003 was intended as a strategic planning retreat. The narratives recount the start-up and rapid growth of the business and describe a number of issues that the company has had to face in its early years. As a result of this discussion with the researcher, the principals of the company made a decision to abandon their efforts to establish a reclamation venture, CJB Reclamations Ltd. and to concentrate their effort on the more profitable inspection and supervision of gas pipeline installations.

The researcher interpreted key elements of the narratives recorded in this session into a written case study: Harvesting CJB (McKenzie, 2004b). This case study summarizes the narratives of the principals of the company and describes the impressive financial results of their decision to concentrate their efforts in the inspection and supervision of gas pipeline installations. The company grew from a profit of approximately \$10,000 in 2003 to a profit of \$300,000 in 2004. The case study, Harvesting CJB ends with a description of the next problem facing Cam, Jim and Bruce: how should they harvest the value from their venture?

The researcher created a second interpretation of the narratives in a formal evaluation of the value of the venture (McKenzie, 2004a). This valuation was presented to the management team at the beginning of the second recording session. The narratives of second recording session, July 17, 2004, revolved around each of the principal's vision of the future of CJB Ventures as well as an exchange of stories of recent fieldwork experiences.

Four weeks after the second recording session, one of the principals had a disagreement with a major client. This disagreement led to a serious dispute amongst the three principals of

the company over the way that the client had been treated. The dispute was resolved by two of the partners buying out the third partner.

## DISCUSSION

The primary role of the researcher in field study is to act as a sounding board for the interviewed. In this position, the researcher must acknowledge his or her role as an agent of the creation of a corporate narrative. In this study, the researcher set the stage for the development of corporate narrative by bringing the principals of CJB Ventures together to discuss the past and future direction of the company. The researcher acted as the author of this corporate narrative both in scripting the pattern of individual narratives and in developing these narratives into a cohesive text. This role would appear to embody the principles of institutional ethnography.

An important secondary role for the researcher is to act as the mediator who draws societal meaning out of the narrative. Thus, while the narrator claims authorship of his or her story, the interviewer claims authorship of what Edward Bruner describes as “the three tellings of fieldwork” (Bruner, 1986, p.147). The first of these tellings is the direction of the memoirist’s recollection by telling what information the interviewer is seeking. The second telling is the part the interviewer plays in the creation of the narrative: both as a listener and as a questioner. The third telling is the summary and analysis the interviewer creates for the audience of his or her scholarly work. This role would appear to embody the principles of action research.

It would appear that the disagreement between the one partner and the major client was recognized by the other partners as being dissonant to the corporate narrative generated during the two recording sessions. This partner had engaged in similar disagreements previously and none of these disagreements had led to dispute amongst the partners. It would appear that the development of institutional norms through the evolution of corporate narrative allowed the other two partners to recognize the transgression of these norms.

## IMPLICATIONS

This study has important implications for both researchers and practitioners in the field of entrepreneurship. The study points out both the power and the limitations of active researcher involvement in qualitative research. The power of active researcher involvement in qualitative research comes from the ability of the researcher to experiment with the implementation of theoretical speculation in the fieldwork setting. The limitation of active researcher involvement in qualitative research comes from the bias that the researcher introduces into the fieldwork setting.

As pointed out in the discussion, the mere presence of the researcher changes the direction of corporate narrative by creating an audience for the performance of the narrative. The researcher further influences the creation of corporate narrative by controlling the agenda of the discourse that creates the narrative. This effect is compounded, when the development of the corporate narrative creates a new institutional framework which is used by the actors of the narrative to measure the relationship between their own and each other’s personal narratives and the corporate narrative.

Researchers will be able to use this study to assist in the determination of the effects of researcher bias in qualitative studies. The subtle nature of the influence of the researcher in the development of corporate narrative requires sensitivity to this influence. Action researchers

should be aware that there is often a conflict between their role as consultant and their role as researcher. Institutional ethnographers should be aware of the recursive nature of the development of social relationships embedded in corporate narrative.

Consultants will be able to use this study as a guideline for the effective collection and analysis of corporate narrative. Techniques described in this paper outline the powerful role that corporate narrative can play both as a normative and a prescriptive tool.

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**SMALL BUSINESS BENEFITS, AS BLACK ECONOMIC EMPOWERMENT DRIVES THE SOUTH AFRICAN ECONOMIC MIRACLE**

**SMALL/BIG BUSINESS PARTNERSHIPS - LESSONS FOR BUSINESSES EVERYWHERE ARE BEING LEARNT IN THE ECONOMIC REVOLUTION CURRENTLY UNDERWAY IN SOUTH AFRICA.**

Ivan van der Merwe

SAESBA, South Africa

South Africa is intent on producing an economic miracle comparable to its political miracle of 1994. That process is now underway, although still in its early stages. The main method for fast-tracking the empowerment of previously disadvantaged persons is through employing established businesses to share their existing business knowledge, risks, assets and opportunities - and transferring skills. In the South African model this transfer process is between larger (white) businesses and smaller (black) businesses, but in any country similar programmes can be developed between larger and smaller businesses, irrespective of race. The challenge is to motivate larger businesses to see this as being in their own interest.

**Introduction**

The South African political miracle happened 11 years ago, in 1994. That event transformed the political scene in the country. The economic transformation that needed to follow could, however, not be achieved on one election day and hesitant steps were taken during the first 10 years of the new democracy, mainly by big businesses, to bring black persons in as participants in ownership and management.

The slow pace of economic transformation is evident in the 2003 earnings estimate which shows that 95% of all persons earning executive level incomes of US\$60,000 or more per annum – are white persons. In the absence of hard statistics it can be extrapolated that business ownership proportions would be similar.

This led to the introduction, during 1998 to 2003, of strong encouragement measures, mainly through preferential procurement systems, inducing many businesses to start changing their ownership profiles as well as employment policies, procurement policies, etc.

**NEW SYNERGIES BETWEEN “EMERGING” AND “ESTABLISHED” BUSINESSES**

While working as a small business strategy consultant, I noticed the potential for synergies between black and white businesses. On the one hand a typical small, black-owned, business finds itself with a growing potential to capture certain markets, yet often lacking the capacity to deliver to required standards or quantities. These markets mostly consist of government and corporate procurement opportunities, but also export and local consumer markets.

On the other hand, many white owned businesses have excess capacity and need to expand their markets or recapture lost markets.

This presents a unique opportunity for the creation of synergies through matching and joining the interests of these two business types. The benefits for the promotion of the policy of black economic empowerment are obvious.

For historical and cultural reasons black and white small business owners do not tend to meet each other very often, and this means that promoting these synergistic partnerships needed a catalyst.

The City of Cape Town provided funding in 2003 for an internet based database system to find and link potential partners countrywide for such joint venture businesses. Businesses that are not yet linked to the internet can join the system by telephone or personally. Once a link is made, further services are provided to assist the dealmaking process.

Benefits of these new joint ventures have become clear, and these include:

- The expected synergies often do take place, benefiting both partners, in some cases quite spectacularly. One example is that of a factory owned by a black family that experienced severe difficulties with working capital and management despite having access to scarce raw materials. A white business was introduced and took a minority shareholding. New technology was introduced and a finance provider then agreed to provide working capital. Management training followed, and the business was turned around and ready for strong growth;
- Real empowerment takes place through ownership of business assets, senior management roles for black persons, and the development of latent entrepreneurial and business leadership talent;
- The willingness of both racial groups to do business together is exceeding expectations and bodes well for the future growth and stability of the South African economy.

So far, this is just a short overview of some aspects of the Black Economic Empowerment (BEE) process as it applies to small businesses. As can be expected in any transformation process, it is not all smooth sailing. All the difficulties, inequities and abuses of the process as well as the formal process itself are certainly worthy of debate and criticism and one is tempted to get into that debate right now.

But I have another debate to propose to you. One that is more relevant to this forum as a whole, although some of the thinking behind this proposal derives from the black empowerment process in South Africa.

## **ENTERPRISE DEVELOPMENT AS BUSINESS POLICY**

In terms of the BEE process, industry-wide black economic empowerment policies have been adopted by major industries in South Africa providing, inter alia, for expenditure on “enterprise development”, i.e. larger companies contributing to the development of smaller businesses. In world terms, this could well be a unique business policy item. Never before have the bigger and medium sized businesses adopted policies and budgets intended to support and develop other businesses. This new practice is certain to have far reaching effects for small business development.

Many of these larger companies are likely to focus on developing their own suppliers. A new skill set now needs to be developed or contracted by the larger companies – that of small business development advisors and mentors.

### **APPLICATION IN OTHER COUNTRIES**

The question now is: Would larger companies in other countries be prepared to adopt similar policies? This of course depends on whether they see it as being in their own best interests.

There are three possible approaches towards providing motivation for this process:

- Long range macro planning;
- Government incentives; and
- Corporate supplier relationships (CSR)

### **Long range macro planning**

The strength of the economy of a country is usually measured in terms of the flow of money, goods and services, but the underlying basis of that strength is the human entrepreneurial effort that produces business growth. Stated more specifically, the number of competent business and entrepreneurial leaders in a country, relative to its population, is a major determinant of its economic growth.

In the previous political era South Africa was drawing its business leaders & entrepreneurs mainly from a section comprising about 12% of the population. This suggests that South Africa should, over time, be able to multiply its pool of competent business leaders. My own target would be for at least a four-fold growth. This is bound to lead to a substantial increase in the performance of the economy.

South Africa aims to develop these new business leaders through a process of *sharing* existing business knowledge, risks, assets and opportunities - and transferring skills. In the South African model this transfer process is between larger (white) businesses and smaller (black) businesses, but in any country similar programmes can be developed between larger and smaller businesses, irrespective of race. The challenge is to motivate larger businesses to see this as being in their own interest.

### **Government incentives**

Most governments understand very well the crucial contributions made by small business enterprises to the economies of countries and especially to job creation.

In most countries access to academic institutions for small business owners to develop their skills as entrepreneurs and business managers is woefully inadequate. Even in countries where such access can be regarded as adequate, there remains the need for development of practical skills.

The knowledge and skills base contained within the more substantial and established corporations is vast, and if that resource can be employed in the development of small enterprises, it can lead to strong growth for the small business sector.

Governments could therefore provide tax incentives or other inducements to corporations in exchange for the provision of training, mentoring and support to smaller businesses.

### **Corporate supplier relationships (CSR)**

Business corporations have two groups of people participating in the production of their market offerings, i.e. their full time staff and their suppliers. Staff and suppliers have several things in common: Both groups consist of people; both provide services to the employer; both have an interest in the success of the employer; and, the services of both require integration into the final offering of the employer. Yet, employer companies treat these two groups very differently.

The Business Link Service in the UK runs a "Benchmark Index" service. It is essentially a best practice benchmarking service. Their criteria for staff include 20 best practice standards while only four criteria refer to suppliers.

In the Malaysian MITI Annual Report on Small Enterprises in 1984, it was stated that "the Japanese manufacturing industry owes its competitive advantage and strength to its subcontracting structure".

Professor John Carlisle of the Centre for Integral Excellence at Sheffield Hallam University in the UK quotes these further examples:

British Leyland had a terrible relationship with their suppliers even as late as the early 1980s. One of the results was that in one month they had to return over 22,000 defective parts to their suppliers - a real lose/lose.

The tragedy of the tenth Challenger mission: a direct consequence of the buyer (NASA) riding rough-shod over its supplier.

The Xerox and Honda stories are becoming legendary, as is Motorola because buyer/supplier partnerships have been an integral part of their Total Quality drives from the beginning.

Chrysler, with its annual savings of \$1.5 billion from its suppliers, is probably the success story of the west.

We have benchmarks that corporations aim at, such as “to have an employee satisfaction ratio of 73%”. Do any of these corporations have a benchmark for a “supplier satisfaction ratio”? We even have ratings for “Best company to work for” – BUT only for employees. What about doing the same for suppliers?

Most manufacturers spend around 60% of their money on the supplies that are necessary to keep the business running. This is an indication of the relative importance of supplier relationships.

Here are some ideas towards building a best practice model for corporate supplier relationship (CSR) management:

1. Establish a formal CSR programme and produce an annual written CSR report that includes a review of support provided to suppliers.
2. Identify key suppliers with whom you form a closer working relationship, which involves some joint working. Establish formal ‘partnerships’ with them and share knowledge with them to improve the way each of you works and adds value to your customers.
3. Involve your suppliers in developing new products and services.
4. Build a relationship of trust with suppliers.
5. Recognise individuals or teams of suppliers for loyalty or contributions to the business.
6. Commit at least 3 percent of total procurement spend for investing in CSR. (This percentage is an attempt to align with international best practice for skills development expenditure on staff at 6% to 8% of payroll in appropriate industries.)
7. Carefully evaluate potential suppliers and their backgrounds in order to select the suppliers that will best fit the needs of the business.
8. Engage suppliers in forward planning. This is critical in establishing the stability in the supplier relationship that is necessary for both parties to feel comfortable. Furthermore, the future planning makes it more likely that the supplier will have the resources and qualified staff available when the buying company requires them.
9. In addition to focusing on the direct service provided by the supplier, provide deliberate contributions to the general development of the supplier business.
10. Assign day-to-day management responsibility for CSR to a position that is no more than one executive away from the CEO or COO.

**PROPOSED INTERNATIONAL COLLABORATIVE TEAM**

I want to end with a proposal for this conference, namely that the ICSB put together an international collaborative team on Corporate Supplier Relationships (CSR) with the following objectives:

1. To formulate an international best practice model for CSR.
2. To find (or establish) and promote a CSR information/training programme for employer companies.
3. To research existing and proposed effects of effective CSR practices on small business development and employer company benefits.
4. To research and lobby governments to provide incentives and/or assistance to employer companies towards improved CSR practices.

I would like to invite all delegates and others who may be interested in participating in this proposed team to contact me and I will take it up with the ICSB board.

# **BUILDING MECHANISMS FOR NURTURING INNOVATIVE SMEs: *Lessons from the North American Science Parks and Incubators***

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## **Introduction**

It is now widely accepted that knowledge and innovation are engines of economic growth and that innovative small and medium sized enterprises (SMEs) are key contributors to that growth. Like the other vibrant regions of the world, countries of the North American Free Trade Agreement (NAFTA) region (US, Canada, and Mexico) are focusing on the development of their knowledge-based economies. This requires policies that are placing an ever-increasing emphasis on the successful development of new technologies and their commercialization through SMEs. As the NAFTA embarks on its second decade and we build on the accomplishments of its first ten years (1994-2004), it is an opportune moment to assess the effectiveness of the mechanisms employed to support the development of innovative SMEs in the North American region.

As policy makers at various levels of government grapple with strategies to stimulate the development of innovative SMEs in their regions, they consider various enterprise development tools available in the form of direct incubation mechanisms, to realize their future economic development objectives. In North America, science parks and incubators are the main mechanisms that have been employed over the past 25 years for providing enabling “incubation spaces” for the creation and growth of SMEs. The technology business incubation concept holds

out the possibility of linking technology, know-how, entrepreneurial talent and capital (Mian 1996, Smilor, and Gill 1986). Science parks and incubators are generally established through collaboration among university, industry and government, and are aimed at promoting technology diffusion into the local economy (Etzkowitz 2002). Most North American technology incubation facilities are directly or indirectly associated with universities — the primary source of trained human and intellectual capital — or with public or private research laboratories, and share common objectives such as providing a training ground for entrepreneurs and supporting technology-led entrepreneurship based on university or laboratory research results. Many of these incubation mechanisms are sponsored in full or in part by universities, colleges or research laboratories. Other sponsoring organizations include state and local economic development agencies as well as private parties (Doutriaux 2001).

After providing an overview of the evolution of technology business incubation industry, this paper examines 12 regional cases from across North America<sup>2</sup>. For each of the three NAFTA nations four regional cases with science park and incubator mechanisms were selected for in-depth study. Unlike in the US and Canada where both science park and incubator industries have taken roots, the Mexican cases emphasize more on incubators due to the limited science park experience of the nation. Background information is provided for each case. It is followed by an assessment of the performance of these mechanisms. The article concludes with a synthesis of the case studies, and a list of the “best practices” and lessons that seem to be most appropriate for various types of regions along with policy implications.

## **Mechanisms for nurturing SMEs:**

### **Science parks, incubators and their evolution**

The modern organizational mechanisms employed for supporting the creation and growth of technology-based firms (TBFs) are known under various names – science/research/technology parks, technology incubators, innovation centres, and technology centres. The underlying common function of these mechanisms is the provision of a tangible physical space for TBFs in proximity with other public and private support organizations that allows networking opportunities and facilitates the acquisition of value added services. However, in recent years (late 1980s) the popularization of the concept of virtual incubators in which networked regions act as “incubation spaces” and “distributed parks” has made the provision of physical space somewhat optional, making the intangible component of the value-added support services for TBF as key characteristic of some of today’s incubation programs.

The main differences between traditional science parks (generally called research parks or technology parks in North America) and technology incubators (often called innovation centers in Europe) are that<sup>3</sup>:

The parks are property-based ventures consisting of research and development facilities for technology- and science-based companies. They often promote community economic development and technology transfer. They tend to be larger-scale projects than business incubators, often spanning many acres or miles. The parks house everything from corporate, government, and university labs to big and small companies. Unlike business

incubators, the parks (particularly in North America) do not generally offer comprehensive programs of business assistance. However, an important component of some university parks is a technology incubator focused on early-stage companies. On the other hand, technology incubators have main objective of nurturing the development of entrepreneurial companies, helping them survive and grow during the start-up period, when they are most vulnerable. These programs provide their client companies with technology and business support services and resources tailored to young firms.

According to the Association of University Research Parks (AURP)<sup>4</sup> there were more than four hundred (411) science and technology parks worldwide in 2002 out of which 41 percent (167) were in North America – with roughly 86 percent (144) in the US and the rest in Canada and Mexico. Another end of 2002 survey by Association Research Inc. identified 179 park facilities in the US and Canada<sup>5</sup>. According to the survey, these North American parks (49 percent response rate) revealed that a majority of them (70 percent) were established with the help of public funds and most (83 percent) were incorporated as non-profit entities. Average size of the parks surveyed was 532 acres (3 to 7000 acres range) housing 41 firms and related-organizations and employing 3400 persons per park. The average capital investment was US\$186 million per park. The report revealed that 62 percent of the responding parks have incubators. The dominant technologies (many parks reported more than one technology) were medical biotechnology followed by information technology. A 2004 estimate put the number of North American parks to 194, reporting park facilities in 40 US states<sup>6</sup>. A Coopers and Lybrand study had found a growing trend towards establishing incubators in both existing and new parks<sup>7</sup>. Another survey of park managers had revealed that in the US, 88 percent of the parks have access to university

resources, more than half of these parks are estimated to be growing in terms of buildings and tenant facilities and another less than one third are thought to be stagnant<sup>8</sup>. Figure 1 graphically displays the growth of the North American science parks industry since the 1960's. The graph demonstrates the drastic increase in the establishment of parks in the mid-1980s to the early 1990s.

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Figure 1 about here

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According to NBIA<sup>9</sup>, as of 2004 there were more than 4000 incubators worldwide out of which 1000 business incubators were spread all across North America (including 5 to 6 percent in Canada and Mexico combined). In 2002, around 950 North American incubators were occupying an average of 47,000 square feet of space and had 22 client firms per facility. They were serving more than 35,000 startup companies and providing full-time employment for 82,000 people<sup>10</sup>. Approximately 37 percent of these incubators (around 350) are technology-related, up from 25 percent in 1998; a quarter of which are university or college affiliated<sup>11</sup>.

Statistics on the number of incubator facilities over time shows a trend similar to that of science parks (Figure 2). However, the science parks were around a bit longer than the incubators. The

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Figure 2 about here

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literature on this industry follows also a similar trend, most of the literature having been generated in the 1980's. Recent studies do show that both science parks and incubators continue to be developed, however cautiously<sup>12</sup>. The industry temporarily paused in the early 1990's as researchers, policy makers, and park & incubator managers focused on improving the effectiveness of existing facilities rather than on establishing new ones. In the early 2000's, growth has resumed as shown by the large recent increases in the number of incubators.

In the late 1990s, a large numbers of experienced investors/company builders started engaging in formal business incubation through the creation of new models of incubation – internet incubators, accelerators, eggubators, virtual (portal) /hub incubators, networked incubators, internet Keiretsus/ Zaibatsus, captive (corporate) incubators, business and technology accelerators. This interest in for-profit business incubation occurred so rapidly that within a matter of months the percentage of North American incubators represented by this category exploded from only 10 to 12 percent in 1998 to more than 35 percent by the late 1999/early 2000. When the NASDAQ market for technology and internet stocks plummeted in April 2000, a large number of these internet incubators and their clients firms started to fail. It is estimated that by 2002, they had fallen back to their 1998 levels. Some facilities have survived until 2004-05 the volatility of the stock market, but it remains to be seen whether this new type of incubation mechanisms will be sustainable over the long-term (Lavrow, Sample 2000). However, as evidenced by their continued popularity and growth, the impact of the market volatility on the traditional brick and mortar not-for-profit incubators has thus far been limited.

In summary, within the past quarter of a century since the concept of business incubation through science parks and incubators first began to take root in the United States, the industry has grown rapidly and matured considerably. The hey-day of this industry came into being during the last two decades of the past century in which it survived growth spurts so explosive that both public and private entities often engaged in a great deal of ill considered and poorly planned incubation development initiatives. The industry also survived economic down turns, and the sometime unrealistic expectations of government funding agencies and economic developers. Given the complexity of developing such business and technology support programs for new innovative ventures, business incubators needed time — the time to test, to experiment and adapt, and to fail or succeed. Years ago it was often said that it would take 10 to 20 years for the true value of incubation industry to make itself known. Luckily, in the US, that time was afforded. In future, given the generally positive experience of the last two and a half decades as a guide, it may well be that every community that aspires to follow suit will learn from this unique experience.

## **Benchmarking the Incubation Mechanisms:**

### **Learning from the Best Practices**

Dedicated incubation spaces, generally science parks and technology incubators, are used as basic enterprise development mechanisms in many technology innovation poles. It is therefore essential to evaluate the efficiency and effectiveness of those spaces and related programs (the incubation system) as elements of any regional technology incubation strategy. Despite the steady increase in the number of these relatively new technology innovation mechanisms since

the early 1980's, especially in North America<sup>13</sup>, there has been no single framework available to assess how they are working and thereby improve their effectiveness. As noted by Autio and Klofsten (1998), "in spite of the rapid increase in the number of evaluations, the available material is largely dominated by documents of the so called "success story" type." This has placed economic development leaders in a difficult position. On the one hand the regions that see a wave of activity sweeping the world feel some pressure to follow suit. On the other hand, experts caution that the jury is still out due to the lack of pertinent experience and hence evidence about their usefulness (Mian 1997). This is particularly true in light of the numerous questions regarding their impact and organizational self-sustainability. In the case of business incubation, the challenges confronting researchers developing such a framework include (Doutriaux 2001):

- Lack of understanding of the technology business incubation process;
- Lack of consensus on the type of evaluation criteria to be used (OECD, 1997, page 24);
- High heterogeneity of the population of science parks and technology incubators, with a high variety of sponsors, objectives, science orientation and business models;
- Lack of proper experimental design with an appropriate control group to correct for pre-incubation firm characteristics and external effects (Sherman and Chappel, 1998); and
- Short times series of data for analysis because of the emerging nature and relatively short history of these mechanisms.

Success is relative and depends on expected outcomes. As noted by Bearse (1998), "The definition of a business incubator in terms of its goals and objectives provides the essential

starting point for an evaluation”. However, not all incubation programs have the same goals and objectives. Whereas an economic development agency may be interested mainly in job creation, a university may look for dynamic research linkages and research funding, whereas a for-profit incubator may insist on profitability and return on investment. Success criteria will therefore generally differ from case to case, making for difficult comparisons and generalizations.

Sherman, Hugh and David Chappell (1998), have proposed four domains of potential incubator impact, each needing their own sets of measurements: “incubator-level impacts, firm-level impacts, community-level impacts, and ancillary community impacts”. Studies on “best practices” often use the following criteria: number of jobs created (by tenants and by graduates, locally and globally), number of graduates and survival rate, sales of tenant firms and of graduates (locally and globally), growth in sales and profitability of tenant firms, number of clients served and their geographic distribution, incubator revenue (profitability, sustainability), new technologies brought to market, taxes paid by the incubator and its tenants, local economic impact (direct and indirect impact, in terms of business activity, jobs, regional exports and imports, property values).<sup>14</sup>

The most important weakness of most assessment schemes is the difficulty to find an acceptable control group to evaluate the impact of the incubation program (incubator, science park) itself and control for the new firms’ individual dynamics (start-up characteristics, management team, business proposition), technology life cycle, sector of activity, external economic and technological factors: how different would have those firms’ development be if they had not joined the incubation program?

Typical key success factors reported in the literature and by practitioners include:

- a well researched business plan/feasibility analysis with focus on financial feasibility, sustainability
- a business management approach, with enough financial resources to hire an experienced incubation program manager and to offer competitive staff salaries.
- local business community support, local businesses having recognized the need to broaden/diversify the local economy
- local government ready to champion the concept and acting as stimulator, strategic partner
- partnerships with local universities or colleges
- strategic partnership between all levels of governments
- proactive board of directors with vision and good business/social networks

To benchmark the performance of an incubation mechanism — technology incubator or science park — a comprehensive assessment framework is proposed, which is based on the following three key sets of variables<sup>15</sup>:

(1) *Performance Outcomes* - the incubation system's performance outcomes are assessed using four elements: (a) program sustainability and growth; (b) tenant firms' survival and growth; (c) contribution to the sponsors' mission; (d) community-related impacts.

(2) *Management Policies and Their Effectiveness* - an assessment of the incubators and science parks' management practices and operational policies in light of the program objectives provides a review of the effective utilization of resources resulting in the success of the program. The key elements assessed include: (a) goals, organizational structure and governance; (b) financing and capitalization; (c) operational policies; (d) target markets.

(3) *Services and Their Value-Added* - a review of the actual provision and their perceived value-added to the client firms in the form of: (a) the typical shared office services including rental space and other business assistance services; (b) the sponsor institution -related inputs, such as, in the case of a university, student employees, faculty consultants, and other institutional support and provision of networking for the TBF.

## **North American Case Studies**

This section will present twelve case studies from emerging technology regions in North America in which science park and incubator mechanisms have played varying roles. The purpose is to identify “best practices” in various environments that could eventually be considered, after some adjustments, for building such mechanisms to help develop regional innovation capacity through appropriate public policy measures.

## *The US Cases*

The US is a leader among NAFTA nations in terms of experience with science parks and incubators. The following paragraphs highlight the role these incubation mechanisms have played in the transformation of four US regions into emerging technology innovation poles. The park and incubator facilities analyzed in these regions are: Rensselaer Technology Park and its Incubator Program in the New York Capital Region; Northwestern University Evanston Research Park and its Innovation Center in the Chicago Metro Area of Illinois; Virginia Tech Corporate Research Center with its Business and Technology Center in the New River Valley region of Virginia; and the University Research Park and its MGE Innovation Center in the Madison Metro Area of Wisconsin. These cases were selected out of a sampling frame of 15 regional cases where science parks and incubators have played significant roles in the development of their surrounding regions into viable innovation poles<sup>16</sup>. The selected sample includes diverse cases of rural/urban settings, public/private university sponsorship, technology focused/mixed use type, and with/without formal incubator facilities; and they all have a sustained operational record of more than one and a half decade. Table 1 provides a comparative overview of the benchmarking characteristics of these four US cases described below:

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Table 1 about here

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Situated in the New York Capital Region, Rensselaer Technology Park (RTP) is an internationally prominent science park that provides a successful model of a private university

led regional economic development. The RTP is a suburban facility established by the Rensselaer Polytechnic Institute (RPI) and is equipped with a highly successful incubator program. Besides RPI, the presence of SUNY-Albany, several technical colleges, and private R&D institutions including GE's R&D Laboratory offer a knowledge-laden environment. The area has experienced a downturn in smokestack industries during 1970s and 1980s triggering layoffs. To cope with this challenge, RPI with its visionary leadership took lead in setting up the innovation infrastructure — incubator (1980), science park (1982), and a number of interdisciplinary research centers. Several GE spin-offs by former employees along with local university alumni and students were the main sources of TBFs. Since the region possesses a broad knowledge base with strong information system and manufacturing industry, and a fairly developed seed and venture funding programs, it emphasizes diversity of technology sectors. However, software, biotech firms are dominating. This comprehensive technology development infrastructure with active private sector and supportive government policies offer a well-developed innovation milieu. A survey of RPT shows that the facility has experienced sustained growth over the more than two decades of its existence. The Park and incubator firms have experienced high survival rates with substantial innovations leveraging university technology, involvements of student interns, and alumni entrepreneurs. Both Park and its Incubator are well established award winning facilities that are considered successful science park and incubator models.

The Northwestern University/Evanston Research Park is another reputable science park situated in Evanston, a northwestern suburb of the Chicago Metropolitan Area. The park is equipped with a successful incubator. The facility is a salient example of public-private partnership where

a private research university's interest in technology commercialization prompted its leadership to team up with the host city government to offer a broader tax base with technology-oriented economy. After 15 years of sustained growth the park has recently transformed into a mixed-use business and technology park facility. The incubator portion of the park is successful in maintaining a high tenant firm survival rate, providing a sectoral focus on software, biotechnology and material sciences firms in which university has considerable strength. The facility has provided an entrepreneurial training ground for the university's students, alumni and faculty. The park is a for-profit corporation governed jointly by the university and the city of Evanston<sup>17</sup>. The incubator part is not-for-profit with strict entry and flexible exit policies that aim to support technology transfer and area's economic development through the creation and development of TBFs . With the new mixed use emphasis the park is endeavoring to maintain its technology emphasis. However, the incubator facility maintains its technology focus and is an award winning model program. As a novel experiment of university-industry-government partnership for technology development the park's Park has emphasized its role as the promoter of technology-based high value-added businesses in this economically challenged region of the industrial 'rust belt'. However, over the past several years, the park has partially been successful in attracting and retaining large R&D organizations and more recently has been relying more heavily on its incubator component in search of its coveted science park identity. The efforts are underway to transform the ambient region of the park into a fully networked modern technopole.

The Virginia Tech Corporate Research Center is a state university led science park situated in Virginia's rural New River Valley Region. Established by the Virginia Technological Institute and State University, this rapidly developing modern innovation pole offers multitude of highly

developed infrastructure located next to the University campus and offers trained manpower and university R&D results. Not only new firms based on university technology are being nurtured, but outside firms are also being solicited through generous relocation packages. The Park has experienced steady growth in physical facilities and number of tenants since inception providing technology transfer and entrepreneurial training generating substantial innovations. The park is a not-for-profit subsidiary of the Virginia Tech Foundation, which is governed by a board with broad regional representation and serves as a focal point in economic development by incubating and capturing technology-oriented firms in this rural region of the state of Virginia. Due to its technology emphasis, the entry policy is restricted toward those firms, which can benefit from regional technology resources and the exit policy is kept flexible. With its numerous value-added services the facility is making sustained efforts to tap university technology by modernizing the area's technology infrastructure through broad band connectivity and leveraging university resources. The VC and seed capital availability is limited and there are conscious efforts to improve this service by co-locating financial institutions on the park facility. The park provides a virtual incubation support to new and fledgling firms from throughout the state. A new brick and mortar technology incubator facility is being established to overcome the need for formal incubation support. New technology clusters are being developed in biotechnology and transportation and research base of the university continues to grow at about 20% per year. The CRC is becoming recognized as the center of technology development in the state and beyond.

The University Research Park in Wisconsin-Madison is a suburban park equipped with a maturing incubator facility. The focus is on university-developed technologies managed by its Wisconsin Alumni Research Foundation (WARF), specifically in the biotechnology area. The

Park is another state university led initiative that has been successful in incubating several new firms in partnership with the local private sector that is also funding the incubator operation. The facility is organized as two not-for-profit corporations, one for real estate operation and the other to run its science center. It provides shared space and office services to its client firms. Most business development services including VC and financial referrals and technology support services from university resources are available to the clients. A survey of the client firms showed that they were generally satisfied with the provision of these services<sup>18</sup>. URP is a state-of-the-art award winning park with a relatively new incubator—the Madison Electric and Gas (MGE) Innovation Center. As a unique public-private partnership for technology development, the MGE Innovation Center houses a number of new start-up firms some of which are experiencing growth and have moved to the Science Center building of the Park which provides a flexible space for expansion. The UW-Madison itself has benefited in multiple ways. Its students and faculty have enjoyed collaborations with Research Park companies through student internship programs and part-time jobs, faculty company creation and research partnerships. University's drive in technology commercialization and the promotion of its image as a partner in regional economic development has been well served.

Several lessons can be learned from these US cases:

(a) The presence of a knowledge base in the form of research universities and or major R&D institutions will serve as engine (s) of new knowledge and trained manpower. In all of the four cases the respective universities and their R&D centers played this crucial role.

(b) Successful partnerships of the university and/or R&D institution with public and private sector institutions will allow the necessary mobilization of the resources for the pursuit of entrepreneurial ventures such as access to information, shared governance, tapping university resources, availability of private venture capital. The above four cases offer salient examples of university-industry-government partnerships in most cases allowing ample sharing of resources.

(c) Presence of champions that provide the necessary motivation to initiate and impetus to persistently pursue the development of projects such as the establishments of science parks and incubators. The existence of individual and organizational champions at various levels is evidenced in all of the four cases.

(d) Once established, securing necessary funding and professional management to run these facilities that include devising entry policy to target certain technologies and allow flexible exit policy in line with the facility objectives. The provision of a comprehensive level of shared space and office services along with business and technology support are essential ingredients that add value to the tenants survival and growth needs. All four facilities have endeavored to secure necessary funding and professional management to run their facilities. Only the Virginia Tech-CRC does not have a formal incubator and lacks the shared tenet space availability, the rest of the cases provide all of the services.

(e) The performance of the science park and incubator mechanisms needs to be assessed through their program sustainability and growth, tenant firms success, overall contribution to the sponsor's mission, and the regional impacts. In all of the four cases the science parks and

incubators reported carrying out performance assessment activities through benchmarking with their peers.

### *Canadian Cases*

Four Canadian regions, Ottawa, Quebec City, Saskatoon, and Calgary Metro areas are included in the study. Each of these regions has a science park. All except Saskatoon also had one or more incubators in the 1980's or 1990's. Since 2000, additional incubators have been established in the Ottawa and Calgary regions. These regions and parks were selected from about a dozen technology intensive poles in Canada to provide examples of high-tech development in different regional environments. Lessons learned are derived from a comparison of the successful and not so successful cases.

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Table 2 about here

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Developed in the 1980's, the Quebec, Saskatoon and Calgary science parks had technologically-based local economic development as primary objective. No specific sectoral focus was indicated but their goal was to leverage local research activities (university, public laboratories, and local industry) and facilitate its commercialization (Table 2). The result are that parks with activities reflecting quite well with each region's research base are: optics and information technology in Quebec, agricultural biotechnology and information technology in Saskatoon,

telecommunications, wireless, geomatics and oil research in Calgary. The situation in Ottawa is different; its research park having been created in 1992 to support the development of a nascent life science sector, a new sector in an R&D intensive region active in the telecommunication, photonics and microelectronic sectors. The region has developed as a very active technology pole since the mid-1970, thanks to the presence of an industry leader (Nortel), without the help of any formal technology incubator or research park. Even if the local universities (all research-oriented) were involved in the creation of the science park and have representatives on their Board of Directors, they are only indirectly linked to park operations.

Overall, the Quebec, Saskatoon and Calgary science parks are quite successful, having been able to attract several public and private research laboratories in their early years, followed by high-tech firms, high-tech start-ups, and service organizations, to reach reasonable levels of development within a decade of their creation. The Ottawa Life Science Park, on the other hand, barely moved for ten years with a single multi-tenant building but is seeing significant development in 2003-04. The following paragraphs briefly describe each of the four science parks and their incubators:

The Innovation Place in Saskatoon has been one of the key factors in the region's success at attracting specialized federal and provincial research laboratories, quickly followed by private technology intensive firms and technology and business service firms, and helping the region become a world-class knowledge pole in agricultural-biotechnology (ag-biotech). Its success comes from the excellent collaboration between the federal and provincial governments and their decision to concentrate federal and provincial ag-biotech research activities in the park to create

a highly focused knowledge pole with the critical mass needed to become attractive to external organizations. This is an excellent example of a science park driven regional development in an isolated medium-sized community with a solid research university. With its mix of research institutes, private high-tech firms, and private technology and business service firms, the park has become a dynamic organic environment supportive of research and innovation, of public-private-university partnerships and networking, the centre of such activities in town, the place to be for science-based activities. There is no formal brick-and-mortar incubator in Saskatoon, the park itself being a solid incubation space. In 1990, Innovation Place was considered to be one of the 20 most successful University-Related Research Park in the world

One of the biggest advantages of the University of Calgary Research Park has probably been its real estate, the provision of leasable serviced land in a nice location next to the University and not too far from the center of town. As such, it has been a very useful addition to the local technology infrastructure and has contributed to the successful diversification of Calgary's economic base from its original exclusively oil-based orientation (including related research activities) into telecommunications, wireless, geomatics. The park does not have a specific sectoral focus. In addition to Discovery Place, a large multi-tenant/incubator building, it houses the research centers of several large corporations (oil and non-oil firms). Except possibly within Discovery Place, the park does not seem to have been able to develop the organic culture that facilitates and encourages informal networking between its tenant research organizations, possibly because of its urban location. In spite of its proximity to the University of Calgary, one of its founders, few university spin-offs are located in the Park. The University of Calgary Research Park is certainly a nice place to be for research-based organizations, but it is not the

only place in town for this type of activities. Starting in 1985 and during the 1990s, the Technology Enterprise Centre operated two small incubators in town, one providing support and guidance to firms renting space in Discovery Place in the park. Discovery Place is primarily an upscale multi-tenant building for technology-based firms, with common spaces, some networking activities and no exit policy. Occasional business counseling is now provided by its manager on an as-needed basis.

The Quebec Metro High-Tech Park started well, under the leadership of a university, industry, government consortium created to develop a solid high-tech base in the region.<sup>19</sup> Quebec City was (and still is) a relatively isolated medium sized government town with a good quality of life, a good research university, and a limited industrial base. The Park was supposed to be the focal point for the development of a local technology base. The Park had no official sectoral focus. It was quite successful initially, attracting early-on several public research laboratories, rapidly followed by high-tech firms, spin-offs from university and research labs, and service organizations. Those early years were facilitated by generous funding from the federal and provincial governments covering the Park's operating costs (a significant subsidy to tenants) and were made successful by solid cooperation between the various levels of government, the business community and the university. In the mid-1990, Park development stalled with the phasing-out of subsidies, reduced leadership and reduced cooperation between local stakeholders. The Park has now been privatized and its operations are financed by the sale of land to technology-based firms and research organizations. The Quebec Metro High Tech Park is still considered a prestigious address in the Quebec City region. It is however only partially developed as the availability of low cost serviced land in the area reduces its appeal. Its name

and the benefits of collocation with other technology-based organizations do not seem to be sufficient to justify the price difference. In the late 1980s, early 1990s, the Centre Régional de Développement d'Entreprises de Québec (CREDEQ) was leasing space in one of the park's buildings to incubate small technology-based firms. CREDEQ, created in 1988 by a consortium of the municipal government, the university and a job creation public organization, was financed until the late 1990s by the provincial and federal governments as well as local businesses. It was offering subsidized space and services to tech-based start-ups in the park or in its other building in town. It started well with good graduation and survival rates. It stopped leasing space in the park in the mid-1990s to save money and quickly lost its appeal for tech-based start-ups, its building in town being not close enough from the places where research and technology development were taking place.

As noted previously, the Ottawa region, a research-intensive government town, developed a solid telecommunication, photonics and software base in the 1980s and 1990s, without the use of science parks and formal incubation mechanisms, with the region acting as a "distributed incubation space". The Ottawa Life Science Technology Park was created in 1992 by the regional government and the university to be a focal point for the development of a life sciences/biotech sector close to the region's research hospitals and government laboratories. After an early change of governance<sup>20</sup> and about ten years of slow operations (with only one multi-tenant building), in 2003, the park was finally starting to develop, with the transformation of the multi-tenant building into a biotech incubator, the construction of other buildings, and the opening of another biotech incubator on land belonging to the federal experimental farm a few miles away. After a long gestation period, the life science-biotech sector in the region is starting

to grow, under the leadership of the Ottawa Life Science Council (OLSC), a public-private partnership representing local life-science interests including government research laboratories, local hospitals, the University of Ottawa and private firms. OLSC is a key driver in the development of a life-science sector in the region, and the Park, located next to the area hospitals and the University Of Ottawa Faculties of Medicine and of Health Sciences, has proved to be a focal point for the envisioned technology development.

Generalizations based on the observation of only four science parks and their incubators with different objectives located in different environments may have a low level of validity. Still, it may be useful to note that our analysis of those four Canadian cases seems to show that successful parks:

- (a) Require the solid cooperation of local and other levels of governments, local industry, and universities
- (b) Need a solid research base (research universities, public and private research laboratories) to create the critical mass needed to become attractive to other research organizations and high-tech firms and services
- (c) Benefit from the leadership of a champion, generally a local consortium of public and private organizations, firms, universities (OLSC in Ottawa, CR&DA (now CTI) in Calgary)

(d) Provide value based on the intensity of knowledge activities, networking opportunities, proximity to research laboratories or a university, availability of services, rather than monetary incentives (low rent or low fees).

### *Mexican Cases*

The Mexican regional cases included in this paper are: Queretaro-Bajío, Cuernavaca-Ensenada, Guadalajara-Monterrey, and Mexico City. Each of these four regions have technology incubators, but only two (Queretaro-Bajío, and Guadalajara) also had science parks, one of which closed in 1995. In general these incubators and science parks have encountered financial difficulties that forced a number of them to close down after some time of operation (Table 3).

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Table 3 about here

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In the Querétaro–Bajío region, there are two incubators: Programa Incubador de Empresas de Queretaro (PIEQ, firm incubator program of Queretaro) and Centro de Negocios e Incubacion Tecnologica (CENIT, business and technology incubation center). The PIEQ, enterprises incubator program founded in 1992 was in operation in Queretaro until 1999. CENIT, the technology incubation business center, founded in Bajío in 1996, was subsequently moved from Leon, Guanajuato to the Entrepreneurship Program in Silao, Guanajuato, which is co-sponsored by the University of Guanajuato. The San Fandila Technology Park which was developed in Queretaro went into bankruptcy by the end of 1990s.

In the mid-sized cities of Cuernavaca and Ensenada, there are also a number of technology incubation centers. The Centro de Empresas para la innovacion Tecnologica (CEMIT, technology incubator enterprises center) was established in 1991 in Guernavaca City. The Incubadora de Empresas de Innovacion Tecnologica y Admonistrativa (IETEC, incubator of management and technology innovation firms) was created in 1994, also in Cuernavaca City. The Incubadora de Empresas de Base Tecnologica (IEBT, incubator of technology based firms) in Ensenada City was also founded in 1991. These three incubators operated with some success until 1998.

In the large city of Guadalajara, the Technology Park “Los Belenes” is located at the Industrial Complex belonging to Guadalajara University. The Centro Universitario de Emprendedores Tecnologicos (CUNITEC, Entrepreneurial Center of Guadalajara University) is located inside Los Belenes Park and was established in 1992. In another large city of Monterrey, the Instituto Tecnologico de Estudios Superiores de Monterrey (ITESM, the Monterrey Higher Studies Institute) began its Entrepreneurship Program in 1985, creating a positive environment for creativity and entrepreneurial culture. By 2000s additional incubators were built such as San Pedro Garza Garcia business incubator in 2001, ITESM’s and UANL’s (Universidad Autonoma de Nuevo Leon) incubators in 2002. Other universities began entrepreneurial programs such as the UANL’s university courses which started in 1991.

In the big metropolitan area of Mexico City which includes the Federal District and 36 Mexico State’s municipalities, three innovation areas are identified. One the southern area around Universidad Autonoma de Mexico City (UNAM, National University of Mexico), the second to the north of Mexico City linking Intituto Politecnico Nacional (IPN, National Polytechnic

Institute) and, the third area, in agricultural research located in Texcoco, State of Mexico, towards the east. The fourth western area in Santa Fe is oriented toward modern corporative financial services. Two technology incubators, Sistema de Incubacion de Empresas Cientificas y Tecnologicas (SIECYT, scientific and technological firms' incubator system) established in 1991 and the Torre de Ingenieria (Engineer Tower) by the Engineering Research Institute in 1993 both at UNAM are located in the southern area. In Northern Mexico City the INCUBASK, a technology based incubator center that began its operations in 1995 at Tecamac, State of Mexico. In 2001 the Ferrerìa High Technology Park project sponsored by the Federal District Government was proposed. In East Mexico City, the Centro Empresarial Tecnológico Agropecuario Forestal (CETAF, agriculture and forestry technologies firms center) at Chapingo's University was established in 1993, but soon closed down due to management problems.

Technology incubation in Mexico has gone through several phases over the past twenty years, with periods of expansion due in part to government programs followed by periods of stagnation or of decline due to lack of continued support:

(a) The first period with high expectations took place in the early nineties. It saw the creation of CEMIT in 1990 at Cuernavaca City, of IEBT in 1991 at Ensenada, and of the SIECYT in Mexico City, the PIEQ in Queretaro and the CUNITEC in Guadalajara in 1992. After 1995 most of the incubators were shut down partly because of the lack of funds during the December 1994 national economic crisis. Only the Guadalajara incubator is still in operation. More important causes for their failure has been the lack of seed and risk capital, the rigid structures for decision making and the weak linkages with universities and research laboratories. During

this first period the Mexican Association of technological parks and incubators (AMIEPAT) was providing the orientation and promotion of technology incubators.<sup>21</sup>

(b) This period of high incubation activity was followed by a period of stagnation (1995 – 2000). This period began with the melt down of the pioneers technology incubators and ended with the creation of general purpose incubators. Even though during this period not all incubators disappeared, their number did decrease. Some isolated efforts were observed with the creation in 1995 of IPN's technology enterprises incubator centre, and in 1998 of INCUBASK incubator.

(c) After a period of stagnation, in 2001 a second period of interest in incubation started. During the second period incubators for all types of businesses in any sector including technology based firms were encouraged. **Several new** incubator projects were launched during this period in the metropolitan area of Monterrey: the San Pedro Garza García incubator (2002), the UANL incubator (2002) and the incubation system of ITESM on several of their campuses all over the country (31 incubators). The Ferreria high technology park project in Mexico City was also started at that time. A new Mexican Association of Management Incubation (AMIRE) was created in August 2003 which replaced AMIEPAT. This new association is focused on growth, creation and business consolidation to generate employment and economic development by supporting the creation, establishment and operations of high value added and technology based firms as well as commercial, industrial, services, and agribusiness firms. It also works at building knowledge-management networks, scientific and technologic parks, private capital investments firms, industrial clusters and strategic alliances. This period of renewed interest for incubation coincides with the introduction of new financing programs for small high-tech firms. Until 2003, the main source of funds for technology-based firms had been the Fondo de Inversion y

Desarrollo Tecnológico (FIDETEC, investment and development fund), a joint Consejo Nacional de Ciencia y Tecnología (CONACYT, national science and technology council) and Nacional Financiera (NAFIN, national financial institution) partnership. In 2002, the government launched the AVANCE (a high value added CONACYT) programs<sup>22</sup> for new business creation through technologic and scientific development. It includes sectoral funds, a joint creation of CONACYT's and of institutes and federal public management branch offices, to provide funds for science and technology in their sectors of competence. It also includes use of mixed funds, a partnership program started in 2001, between CONACYT and each State to provide financial backing to science and technology oriented research projects. Both programs target information technology, electronics and telecommunications, health (diagnostic systems, material equipment and drugs), land and cattle, fishing and foodstuffs, advanced materials, environment, energy, design and manufacture, dwelling and building.

(d) In 2004, the Federal Government (through the Ministry of Economics) launched a program for incubating small and medium sized firms (SMEs), with incubators associated with municipal governments, and plans to install at least one in every state. This is a joint project involving several federal authorities including Ministry of Industry and Tourism, Public Education Department, National Association of Mexican Universities and National Financial Institution (CRECE-SEP-ANUIES-NAFIN). The goal is to service 4,000 entrepreneurs during 18 months to create 2,800 SMEs.

There are several reasons for the limited success of technology incubators in Mexico, the most important of which is the shortage of funds both for incubator programs and seed and venture capital for the TBFs incubated through these programs. As mentioned earlier, rigid management

practices instead of flexible decision making processes and lack of networking are also causes for the apparent lack of performance. Though there seems to be a relationship between most local industries and the technology orientation of the incubation initiatives, yet due to the short duration of the government support for such programs did not provide enough time for incubators and parks to approach self-sustainability.

Until 2004 the regional impact of the incubation programs in Mexico has been marginal, resulting in a low visibility for such programs in general, however, incubation efforts have more visibility in regions such as Monterrey and Guadalajara where entrepreneurial culture is relatively more prevalent.

## **Synthesis and Learning**

Twelve cases from selected NAFTA regions have been presented in the previous section. Those cases illustrate the use of science parks and technology incubator as mechanisms to nurture innovative firms. The comparative analysis of these twelve cases (Tables, 1, 2, 3) shows how variable the success of science parks and of incubators is and how dependant it is on local contextual factors and on national economic and technology policies.

That variability and that dependence had been observed by Luger and Goldstein in a landmark study where they questioned the role of research/science parks as a technology innovation pole development mechanism<sup>23</sup>. They found that about a quarter of the US parks observed did achieve their goals of attracting and encouraging research and development activities and

contributing to job creation and economic growth. However, another quarter of the parks analyzed had become pure real estate ventures with little effect on local socio-economic conditions, and the rest of the parks (50 percent) failed. They argued that in many regions, science parks may not be a wise investment<sup>24</sup>. Their theory was that science parks were likely to be most successful in large metropolitan areas but that they would probably not function as growth poles there. Indeed, those areas tend to be naturally attractive to high-technology investments and to engineers and scientists because of their research intensive universities, their well developed research and development base, their business infrastructure, provided industrial development space (land, buildings) is available (thus the attraction of real estate-type business/research parks). Their assessment was that by attracting research and development activities, science parks could eventually contribute significantly to economic development in smaller metropolitan areas lacking a well-recognized university if the right investments in long-term employment were made, but that it would take more time. Their results are supported by research findings in Canada.<sup>25</sup> They are also corroborated by Donnelly<sup>26</sup> who, after observing that the most successful US research parks were associated with the nation's most research intensive universities, hypothesized that "the most privileged class of parks would appear to be those associated with large research universities located in metropolitan areas that are large enough to enjoy a critical mass of corporations, personnel, local entrepreneurs, and capital."<sup>27</sup> The success of parks associated with other types of universities would however be highly dependant on the size of their metropolitan areas, on the "energy coming from outside the institution", and on "special community assets".

In line with the lessons from these studies and given the importance of local factors on park and incubator success observed in the twelve NAFTA cases, it is appropriate to segment our analysis by type of local environment:

- Regions with well diversified economy, a broad and established industrial base and rich sources of knowledge and research activity;
- Regions with relatively diversified economy, a focused industrial base and solid research capacity;
- Isolated regions with a limited industrial base and solid research capacity
- Regions with a small research base.

*Regions with well diversified economy, a broad and established industrial base and rich sources of knowledge and research activity*

The science parks and technology incubators established in the medium to large size cities with broad and established industrial base and good research universities such as New York Capital Region (Troy), Chicago Metro Area (Evanston), Madison, Monterrey and Guadalajara, Mexico City are quite successful on the average. All the US cases have excellent parks and incubators. Guadalajara has a successful park and a good incubator, and Monterrey and Mexico City have good incubators. These parks and incubators were created to enhance a local comparative advantage (well established industrial sector or sector under transformation, field of research with solid expertise at a local university and/or research laboratory). They benefited from well

established local business cultures, local entrepreneurial spirits, infrastructures and resources (business services, financing and communications). Those science parks and incubators tended to result from solid partnerships between the local business sector, local universities and local governments. Their success is certainly due in part to good management, but also to a supportive local environment encouraging networking and cooperation for the common good. Their size (number of firms, total employment) reflects their national environment, national technology and business policies, the availability of seed and growth capital and of other business resources.

*Regions with relatively diversified economy, a focused industrial base and solid research capacity*

The science parks in Calgary, Quebec City and Ottawa, and Queretaro-Bajio were developed by local university-government-business consortia to support the economic diversification of the areas into new domains, building on local research expertise. The Calgary and Quebec parks have grown rapidly and have been great assets for the development of high-technology in their regions. They seem now to have become upscale real estate developments for technology-based firms rather than an effective incubation space facilitating networking between researchers, engineers and business persons, and promoting innovation and entrepreneurship. The Ottawa park has been slow in developing. A little over ten years after its creation, it seems that its role as focal point for a nascent health science sector has been successful and that growth is coming. The Queretaro's San Fandila Park went into bankruptcy primarily due to a lack of commitment in funding and the provision of professional management needed to acquire sustainability in due course of time. Owing to the absence of a critical mass of tangible and intangible inputs

plentifully available in the first type of regional environments (above) success in such regions require relatively more concerted efforts on the part of champion entities that may also warrant some degree of patience as was afforded in case of Ottawa but not in Queretaro.

*Isolated regions with a limited industrial base and solid research capacity*

The science parks in Saskatoon and Virginia's New River Valley (Blacksburg) have been very successful at growing a quality innovation pole around a solid research base of a major university in their isolated smaller communities. Their success comes from a close cooperation of stakeholders (university, business, and governments) and on site availability of all the business resources and services needed by TBFs. Both parks behaved as solid incubation spaces and did not see the need for formal incubators until recently. Their challenge is now to attract venture capital to continue to grow their high-tech firms.

*Regions with a small research base*

Technology incubators in Cuernavaca and Ensenada have been unsuccessful, even if those regions have reasonable research bases and good universities. Those incubators facilities were mostly government supported research center or university driven in regions that seem to lack the culture of networking and entrepreneurship found in more successful places. Lack of government support for research, for high-tech start-ups and for the incubation program

compounded the negative impact of the absence of linkages between researchers and the business sector.

*The lessons from those case studies show clearly that:*

- The regional environment and local business culture are major determinants of the success of incubation mechanisms. Science parks and incubators can contribute very significantly to the transformation and growth of a region into a successful knowledge pole, but they are not sufficient to bring change. The parks provide an enabling milieu by leveraging regional resources to successfully nurture TBF's. They contribute to the critical mass of services and other support mechanisms offered in the region, facilitate networking and exchanges between the local research university, researchers and engineers, and entrepreneurs, and are therefore an important asset in local development.
- The full cooperation and active support of the local research university, local and other levels of government is needed for science parks and incubators to be successful. In terms of governance, most of the U.S. parks have boards with representations from the key stakeholders, which provide policy guidance. Typically, a director heads the park management team and the incubator manager generally reports to the park director as is the case of the four parks studied. However, in a number of other U.S. facilities incubators operate independently of the parks. In Canada, universities, federal, provincial and local levels of government, and the private sector are represented on the boards of all

science parks, but the parks are generally managed by independent non-profit organizations. In Mexico a typical incubator management board is based on partnership of government, university (or a research center), and some private institutes, which help them to be classified according to the lead agent. Government incubator leadership may be federal, state or municipal. There also may be a mix, such as PIEQ's management board, as CONACYT (federal government) is participating with the Queretaro's State government. But, in general the universities have been the dominant institution in half of the incubators

- Key to park success is the provision of a non-monetary value proposition related to R&D (geographic and sectoral concentration of R&D activities, proximity to a university or a large research laboratories, presence of large anchor organizations) and to the availability of business services (often through independent private firms located in the park or in the incubator). Below market prices or other monetary incentives are better avoided as they attract organizations that may not be as solid as needed to ensure fit necessary for providing survival and growth environment.
- Most technology incubators in this study tend to operate independently from the parks and from the universities, although this is not the case for all technology incubators especially in Canada.<sup>28</sup>

In summary, the successful development of an innovation pole depends on a number of players (university, business, government), and on local entrepreneurial and innovative culture. Science

parks and incubators can contribute significantly to stimulate the development of innovative SMEs in their regions. Their success for the creation and growth of SMEs as enabling incubation spaces depends on local culture and on the level of cooperation between the key players

Table 1: Comparative Overview of the US Cases

| Surrounding Region                                 | Medium Size City Urban Area (Troy, NY)  | Large City Region Suburban Area (Evanston, IL)  | Small Size City Rural Area (Blacksburg, VA)   | Medium Size City Semi-Urban Area (Madison, WI)  |
|--|---|---|---|---|
| <i>Science Park/ Incubator</i>                     | <i>RPI Technology Park</i>  | <i>Northwestern University/ Evanston Research Park</i>  | <i>Virginia Tech Corporate Research Center</i>  | <i>University Research Park, Wisconsin</i>  |
| <i>Facility Background</i>                         | A suburban park with a solid incubator facility, established in 1982 by RPI. About 80 firms and 2000 employees. Broad range of university and area technology focus.  | A suburban mixed-use facility with incubator, established in 1985 by NU with city's participation. About 62 firms, 1000 employees. Software, biotech, materials focus   | A rural park with a virtual but developing incubator facility. Established in 1985 by VT. About 104 firms and 1800 employees. Broad range of university technology  | A suburban park with maturing incubator. Established in 1984 by UW. About 110 firms and 2300 employees. Focus on biotech and other areas of university technology   |
| <i>Performance Outcome</i>                         | Sustained growth over the past 2+ decades. High firm survival rate with substantial innovations and involvement of university technology, entrepreneurs and alumni.   | After 15 yrs of sustained growth, park transformed into mixed use. High firm survival rate at incubator with successful firms. Entrepreneurship training for students/faculty   | Experienced fast growth in facilities and tenants since inception. Salient efforts in university tech tr. and enterer. training. Steady tenants generating substantial innovations                                  | Sustained growth in park over the past 2 decades. Significant efforts in university tech. tr. though WARF. Created successful firms and partnered with private sector to help incubate new firms                                  |
| <i>Management Policies and Their Effectiveness</i> | Governed by RPI board of trustees. Funded by RPI, state funds. Strict entry and flexible exit criteria. University training & tech trans., regional. economic development objectives achieved.                | Park is for profit corp. governed jointly by university and city, though recently the city has pulled out. Incubator not-for profit with strict entry and flexible exit criteria. Tech trans, training, area econ. development objects achieved | Park is not-for-profit subs. of VT foundation. Governed by board with regional reps. Strict entry and flexible exit criteria. Serves as a focal point in econ. dev. of the region                                   | Park is organized as 2 not-for-profit corps. under university trustees. Strict entry and flexible exit criteria. Serves as a focal point in mobilizing university developed technology for regional development                   |
| <i>Services and their Value Added</i>              | All shared services. Business and technology development services, seed cap and VC access, info databases, tech tran., access to university resources. Tenant satisfied with support & avail of RPI resources | Most shared services, bus and tech dev services, easy seed cap and VC access, info databases, tech tran., access to university resources. Tenant generally satisfied with support & avail of NU resources                                       | Limited shared park services, including and tech dev services, efforts to provide seed cap and VC access, info databases, tech tran., access to university resources. Formal incubator facility is being developed. | Increasingly developed park and incubator shared services, bus and tech dev services, easy seed cap and VC access, info databases, tech tran., access to university resources. Tenant satisfied with support & avail of resources |
| <i>Overall Assessment:</i>                         | Award winning successful facility serving as a model. Continued efforts to involve stakeholders, and attract talent & technology.   | The facility has an award winning successful incubator. With the mixed use approach for the park, efforts are underway to maintain university tech trans. focus.  | A modern and growing park facility with virtual incubation component. Sustained efforts to capitalize on university tech and developing area innovation infrastructure.   | A state of the art park with a private sector supported incubation operation. Developing a model tech entrepreneurship infrastructure based on university's R&D strengths.  |

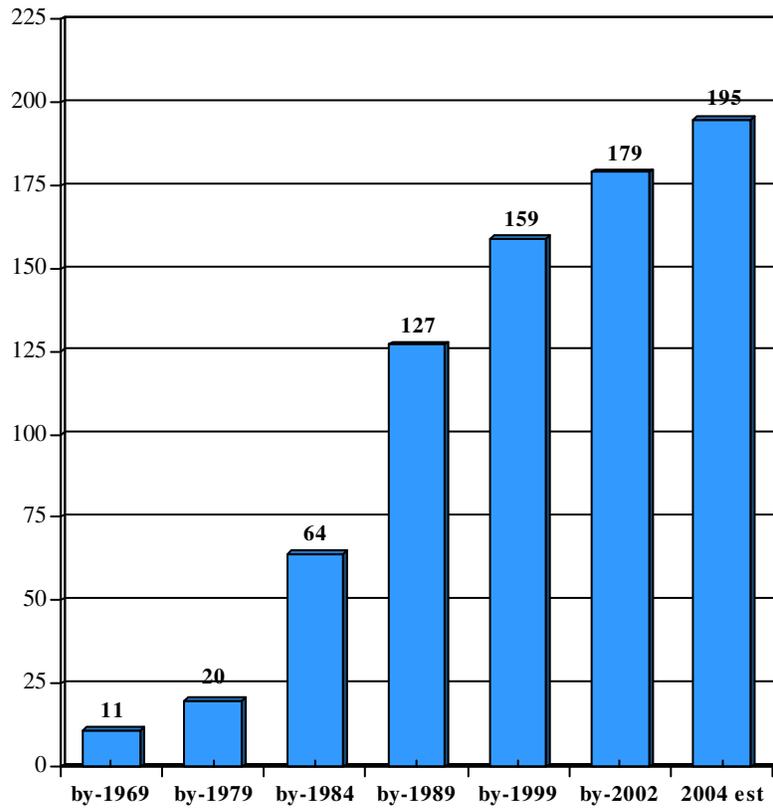
Table 2: Comparative Overview of Canadian Cases

| Surrounding Region                                 | Medium Size City Urban Area   | Medium Size City Urban Area   | Small Size City Rural Area   | Medium Size City Urban Area   |
|--|---|---|--|---|
| <i>Science Park/ Incubator</i>                     | <i>Ottawa Life Science Technology Park</i>  | <i>Quebec Metro High-Tech Park</i>  | <i>Innovation Place</i>  | <i>University of Calgary Research Park</i>  |
| <i>Facility Background</i>                         | Urban park created in 1992. A biotech incubator built 2002; until then mostly multi-tenant building (8 tenants, 40 employees in 2001. Strictly focused on health sciences and biotech.  | Suburban park created in 1983 for regional econ. diversification by local, provincial, fed govts. CREDEQ incubator until the late 1980's. Research on IT, telecom, opto-electronics, new materials, nordicity, forestry. In 2001, 100 orgs (14 buildings), 2500 employees.                      | Urban park created by Province and Univ of Saskatchewan in 1977 on university land. No formal incubator. Main focus on Ag-biotech, but also IT, electronics and related support services. Around 115 organizations, 2200 persons in 23 buildings   | Urban park created in 1983 by city, Chamber of Commerce and university on government land. Technology incubator in multi-tenant building in Park (now named Alastair Ross Tech Centre). No sectoral orientation; mainly IT, telecom, software. Over 3000 persons in 7 buildings.  |
| <i>Performance Outcomes</i>                        | After ten years of slow development, the biotech/health sector in Ottawa seems to be picking-up steam; two biotech incubators have been built in 2002. The Park seems to finally start growing. Was probably one of the catalysts for the growing biotech cluster in Ottawa | Successful at first with govt. Funding. Difficult times in mid-late 1990's with phasing-out of government support. Privatized, not-for-profit, to continue to develop/sell land for high-tech activities. Contributed to the dev. of Quebec's small high-tech base                              | Very successful, due to Province's full commitment and management team's clear focus and commitment First 5 tenants were provincial organizations. Considered one the 20 best "University-Related Parks" in the world in 1990. Key factor in the development of the region as a world class ag-biotech centre. | Excellent location for R&D activities, with an up-scale multi-tenant building. Multi-tenant building worked well as incubation space; rest of park mostly high-tech real estate. Has definitely contributed to the high-tech development of the region by providing well located quality space for R&D activities.                |
| <i>Management Policies and their Effectiveness</i> | City, local universities, provincial government, federal government, and local industry on governing board. Managed by OLSC, not-for-profit consortium dedicated to development of health science in region. Funded by Ottawa city, industry, other levels of government.   | Large 26 person board of directors with university, business, government. Was offering subsidized business services and networking opportunities until government funding stopped. Now mainly private non-profit high-tech real estate service.   | Nine members board, 3 from the University, others named by Innovation Place, subject to University approval. Managed by provincially-funded public entity. More university involvement expected as provinces reduces its involvement/funding. (2003-04)  | Twenty six persons board with representation from the Univ. of Calgary, Alberta Research Council, Govt. of Alberta, and private industry. Managed by non-profit entity. CTI financed about 50% by local, provincial, federal governments, 40% own revenues from services.   |
| <i>Services and their Value Added</i>              | Usual services offered in a multi-tenant building, including reception and conference space. Networking opportunities, workshops. Prime urban location for health research activities, next to hospitals and medical school; focal point for nascent health science cluster | Business services to SMEs provided by park administration: technology assessment, business planning, export promotion, marketing, etc.; networking activities and workshops, seminars. High concentration of research; regional pole in optics; excellent location; offers prestigious address. | Most business services offered by to park tenants, business, accounting, legal, IP issues, networking activities, workshops, seminars; access to fully equipped laboratories, etc. High concentration of research; availability of all business services; a very good address; high-tech nucleus of region     | Some business services available in Discovery Place (now Alastair Ross Tech Centre), large multi-tenant and incubation building in Park. Access to University facilities. High concentration of research, in domains representative of local high-tech-base; closeness to university, good support services, a very good address. |
| <i>Overall Assessment</i>                          | First 10 years very slow; with the opening of the Ottawa Biotech Incubation Centre (OBIC) in 2002, the park seems to finally start growing; it has been the catalyst for the growing biotech cluster in Ottawa.   | Started well with govt. funding; went through difficult time in mid-late 1990's with the phasing-out of public funding; has been a focal point for local high-tech businesses; now in danger of losing its science orientation and becoming only a nice industrial real-estate park.            | Overall, highly successful, current challenge is to attract venture capital to sustain the growth of its small firms; may suffer from current questioning on genetically modified plants.  | Quite successful as an up-scale high-tech real-estate development, with well located land for R&D activities; has definitely contributed to the high-tech development of the region; unclear if it has contributed to the creation of many high-tech spin-offs (except at Discovery Place)  |

**Table 3: Comparative Overview of Mexican Cases**

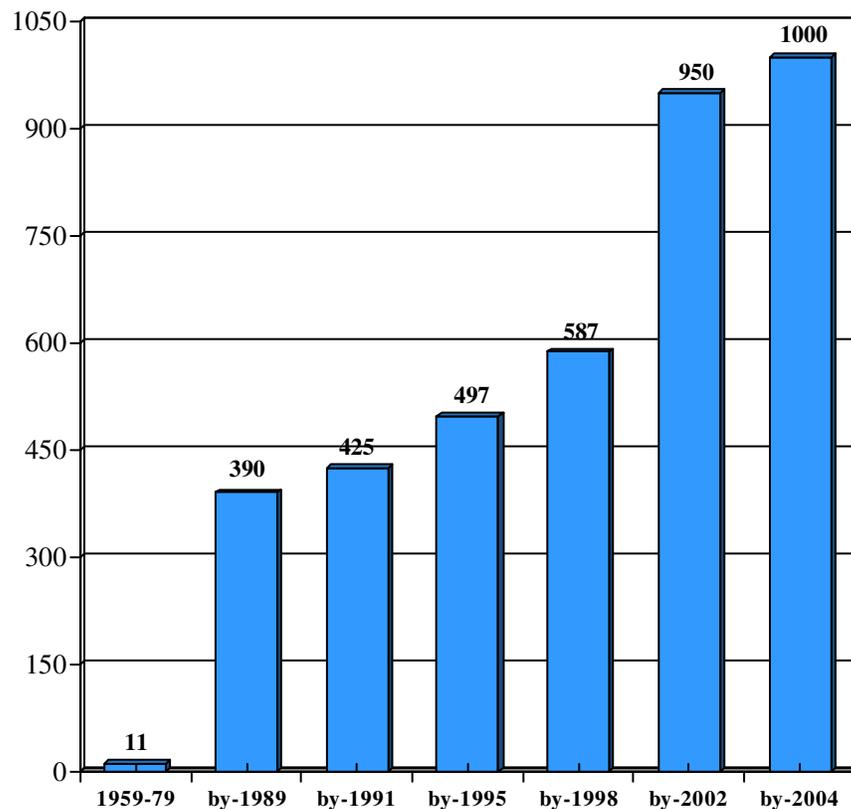
| Surrounding Region                                 | Small Size Cities  |   | Medium Size Cities  |  | Large Cities   |   | Mexico City  |
|--|--|---|---|--|--|---|--|
|  | Queretaro - Bajio  |   | Cuernavaca  | Ensenada   | Guadalajara  | Monterrey   |  |
| <i>Science Park/ Incubator</i>                     | <i>PIEQ/San Fandila</i>  | <i>CENIT</i>  | <i>CEMIT, IETEC</i>   | <i>IEBT</i>  | <i>CUNITEC/Tech Park Belenes.</i>  | <i>ITESM Incubator program</i>  | <i>Siicyt-UNAM, "Torre de Ingeniería"-UNAM, CETAF-UACH, CIEBT-IPN e INCUBASK- UAEM.</i>  |
| <i>Facility Background</i>                         | Operated during 1992-1999. It had 3 graduated firms out of 25 tenants. PIEQ is located in the San Fandila Park which did not take off.   | Established in 1994 at Delta Industrial Park (Leon, Gto). In 1996 changed to an Ind-Univ Collaboration Program (VEN, Silao, Gto).   | CEMIT founded in 1991. IETEC was established by ITESM in 1994. Both were in operation until 1998 after which they were closed down.   | Started operations in 1991 and closed down in 1998 after seven years of operation.   | Created in 1992 at "Los Belenes" Tech Park. There are 23 tenants, out of which 8 graduated. The Park, has 13 firms.  | ITESM incubator program started in 1985. There are 3 incubators operating: San Pedro Garza García (2001), ITESM incubator (2001), and UANL incubator (2002).                              | There are 5 Incubators. The first 3 which are pioneers went into bankruptcy. IPN's and INCUBASK are operating. INCBASK has 10 tenants and one grad. Second generation incubators have diverse all types of firms |
| <i>Performance Outcomes</i>                        | Poor performance and failure primarily due to lack of financial resources to operate the facility and support TBFs activities. Replaced by a Research Center   | Now the incubation of tech firms is only one of its multi entrepreneur functions at VEN. The firms' creation has lower priority. Hence no significant regional impacts                | No funding was available for continued operation. The Cuernavaca area has developed a strong R&D infrastructure and benefits from its location close to Mexico City.                                    | Causes of closing are due to lack of risk capital. Incubator is more a result of technology push than a pull of the local demand, which is limited for this type of project. | There is no seed and risk capital available. The regional impact is low. But due to the sustainability of both incubator and tech park the symbolic impact is there. | There are no funds for risk and/or seed capital. Teaching entrepreneurship is an important activity of ITESM. The second generation mixed use incubators are the outcome of this program. | Lack of seed and capital risk are the main causes of first generation incubators closing. The impact of incubators is marginal. It is more a push idea to reality.   |
| <i>Management Policies and their Effectiveness</i> | Queretaro State Govt leads PIEQ's activities, jointly with CONACYT. CONACYT and NAFIN provided financial backing for 3 years.  | CENIT had a Leon City hall and a research Center governance. But now VEN is under Guanajuato University. The main funding was provided by CONACYT, NAFIN and State government of Gto. | CEMIT has a large cumbersome board of governance with a research center (IIE) in the leadership position. NAFIN, backs its activities. IETEC has been an ITESM local campus incubator.                  | A large board led by a Research Center (CISECE). Incubator set up was made possible by Cicese financial support. Additional risk capital came from Conacyt-Nafinsa fund.     | There is a large board and Guadalajara university is the lead institution. However management decision making need to be more flexible and efficient.                | Universities are the main agents to settle incubation spaces (ITESM and UANL). It is a case of local municipal government led incubator as the San Pedro Garza Garcia.                    | Universities (UNAM, IPN) are the main leaders in Mexico City incubators. But university culture does not generally match with the firms needed business environment.   |
| <i>Services and their Value Added</i>              | Incubators help in sharing information, to create a positive tenants association to attend outside demands. Due to cash shortages often have problem to cover incubator rent and common services.    |   | Cuernavaca has a better R&D knowledge infrastructure and keeps a good knowledge networking.   | Incubator has a good support from Cicese in knowledge networking.  | An anchor machine tool firm helps the incubation of other firms. There is strong networking support.   | The second generation incubators have less risk tenants as most of them are not TBF. So the incubators services are mainly sharing common costs by tenants.                               |  |
| <i>Overall Assessment</i>                          | The lack of funds and risk capital has a general effect on tenant's success. Potential tenant firms networking with the large research infrastructure is not fully used for technological innovation |   | Incubator bankruptcy due to: 1) lack of seed and risk capital; 2) rigid and slow decision making due to overloaded institutional governance 3) too strict breakeven for money self sufficiency (IETEC). |  | Sustainability of the incubator and Park is due to flexible decision making and networking support   | Better chances of success due to a tenants mix of TBF with traditional firms. Availability of public funds for spin offs (AVANCE), as well as State Gov support.                          |  |

Figure 1: Growth of North American Science/Research/Technology Parks



(Source: AURP, 2005)

Figure 2: Growth of North American Incubator Programs



(Source: NBIA, 2005)

## ENDNOTES

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<sup>2</sup> The authors are thankful to El Colegio de Mexico's Inter-American Research Program for funding the study. For a detailed comparative analysis of those regions, see Corona, Doutriaux, Mian (to appear, fall 2005).

<sup>3</sup> National Business Incubation Association (NBIA), Athens, Ohio 45701, USA, visited on March 14 2005  
<http://www.nbia.org>

<sup>4</sup> Association of University Research Parks (AURP), Reston, VA, USA, <http://www.aurp.net>

<sup>5</sup> *University Research Park Profile 2003*, Association Research Inc, AURP Publication, January 2003

<sup>6</sup> [http://www.aurp.net/about/critical\\_role.ppt](http://www.aurp.net/about/critical_role.ppt)

<sup>7</sup> Coopers and Lybrand (1996) Survey of University Parks, AURRP

<sup>8</sup> The Research Park *Forum*, May 1998, AURRP

<sup>9</sup> NBIA, Op. Cit.

<sup>10</sup> 2002 State of the Business Incubation Industry, NBIA Publications, 2003

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- <sup>11</sup> NBIA, Op. Cit.
- <sup>12</sup> see Mian 2003 for details.
- <sup>13</sup> For details see OECD, 1997
- <sup>14</sup> Inferred from presentations made at the 2001 National Business Incubation Association conference, San Jose, CA, May 2001, and also from OECD, 1999.
- <sup>15</sup> For an in-depth coverage of the assessment framework, see Mian (1997).
- <sup>16</sup> For details see Corona, L. Doutriaux, J. and Mian, S. (2005, forthcoming).
- <sup>17</sup> In 1999 when it was decided to transform the park into a mixed use facility to stimulate real estate development, the city of Evanston did not renew its equal partnership contract and the technology component of the park facility is now the sole responsibility of the University.
- <sup>18</sup> Op. cit.
- <sup>19</sup> <http://www.parctechno.qc.ca/english/histo.htm> (URL in March 2004)
- <sup>20</sup> This Park was created in 1992 as a University of Ottawa initiative backed by the Province of Ontario and the City of Ottawa. It failed quickly because of lack of financial support and is now owned by the Ontario Development corporation and managed since 1994 by the Ottawa Life Science Council (OLSC), a public/private partnership representing local life-science interests including local hospitals and the University of Ottawa
- <sup>21</sup> [www.cfyge-prifepci.ipn.mx](http://www.cfyge-prifepci.ipn.mx), consulted on January 5, 2004.
- <sup>22</sup> CONACYT web page. [www.conacyt.mx/dat/avance](http://www.conacyt.mx/dat/avance) visited on November 26, 2003.
- <sup>23</sup> Luger and Goldstein (1991), pp.74, 75. .
- <sup>24</sup> Ibid., pages 183-84.
- <sup>25</sup> Doutriaux J. (1998)
- <sup>26</sup> Donnelly, Brian (1996), page 3.
- <sup>27</sup> Ibid., page 9
- <sup>28</sup> QBIC, the Québec Biotechnology Innovation Centre (<http://www.cqib.org/indexAnglais.htm>), is an excellent example of a prize-winning incubator operating in a park with solid indirect links to several universities.

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## **GENDER DIFFERENCES OF SMALL COMMUNITY BUSINESS OWNERS IN NETWORK MEMBERSHIP PERCEPTIONS**

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### **ABSTRACT**

This research examined concepts inherent in social capital and strategic network theory. Data was collected from 277 men and 100 women, who in addition to operating a small business in a small community, were members of one of twenty-nine business networks. The variables of shared vision, resource sharing, business activities, and advantages to networking, were regressed on owners' desire to continue network membership. Gender differences in owners' personal and business characteristics in relation to continued network membership were also explored and found significant, thus requiring the use of control variables in the subsequent analysis. In a hierarchical order of entry, gender, years of ownership, gross sales, and numbers of employees were first entered for statistical control. Results of hierarchical multiple regression suggested that advantages from networking and a shared vision significantly explained owners' desire to continue their network membership, with control and network variables also included in the equation. Examination of the interaction effects of gender on each of the four network-based variables suggested that gender with resource sharing also significantly explained the owners' desire to continue network membership. The total  $R^2$  for the seven steps in variable entry equaled .505. On the basis of these findings, we suggest there are descriptive differences among male and female small business owners, such as in business size and age, that should be further explored. Variables central to social capital and strategic network theory held a positive effect on members' future network membership plans thus furthering the likelihood of the networks' future existence.

# **A COMPARATIVE STUDY OF THE UTILISATION OF SOCIAL CAPITAL AMONG THREE ETHNIC ENTREPRENEUR COMMUNITIES**

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## **ABSTRACT**

This empirical study aims to understand how entrepreneurs mobilise social capital. A survey of 325 entrepreneurs from the KwaZulu-Natal province of South Africa was conducted. Analysis of variance, factor analysis and discriminant analysis was performed on a 20-item scale on social capital variables. Results indicate that among the three ethnic groups of entrepreneurs studied, Europeans mobilised social capital better than their Indian and African counterparts. Europeans tend to favour more formal avenues of accessing social capital while Indian respondents tend to prefer informal means. The discriminant analysis findings show that the social capital scale can accurately distinguish between the three ethnic groups.

## **INTRODUCTION**

The concept of social capital has been recognised by sociologists and economists as an alternative to traditional forms of capital, such as financial, physical, and human (Marger, 2001). Social capital may be defined as those resources inherent in social relations that facilitate collective action. The critical issue is that norms of trust, obligation and reciprocity are established through membership in these social networks (Coleman, 1988; Putnam, 1993; Light and Gold, 2000, Portes and Sensenbrenner, 1993; Onyx and Bullen, 2000; Fukuyama, 1995). In addition, social capital is an entity, consisting of all expected future benefits derived not from one's own labour, but from linking with other persons. It is from this membership of a network that individuals are able to obtain scarce resources. Social capital does not constitute the resources themselves, but rather the individuals' ability to mobilise these resources on demand (Portes, 1995).

## **KEY LITERATURE**

### **Social capital**

Portes (1998) argues that the concept refers to dense interlocking networks of relationships between individuals and groups. People engage with others through a variety of lateral

associations, which must be both voluntary and equal (Onyx and Bullen, 2000). Social capital cannot be generated by individuals acting on their own in isolation. It depends on a proclivity for sociability, but a spontaneous sociability, a capacity to form new associations and to co-operate within the terms of reference they establish (Fukuyama, 1995).

Nahapiet and Ghoshal (1998) state that the crucial issue of social capital theory is that networks of relationships constitute a valuable resource for the conduct of social affairs, providing their members with “the collectivity-owned capital, a ‘credential’ which entitles them to credit, in the various senses of the word” (Bourdieu, 1986: 249). Much of this capital is embedded within networks of mutual acquaintance and recognition. Bourdieu (1986), for example, identifies the durable obligations arising from feelings of gratitude, respect, and friendship or from the institutionally guaranteed rights derived from membership in a family, a class, or a school. Other resources are available through the contacts or connections networks bring. For example, through “weak ties” (Granovetter, 1973) and “friends of friends” (Boissevain, 1974), network members can gain privileged access to information and to opportunities. Finally, significant social capital in the form of social status or reputation can be derived from membership in specific networks, particularly those in which such membership is relatively restricted (Bourdieu, 1986; Burt, 1992; Nahapiet & Ghoshal, 1998).

### **Ethnicity and social capital**

Ethnic groups are capable of providing members with social capital. Denoting the web of connections, loyalties, and mutual obligations (shared fate, solidarity, and communal membership) that develop among people as part of their regular interaction, social capital refers to the sense of commitment that induces people to extend favours, expect preferential treatment, and look out for one another’s interests (Light and Gold, 2000). The ethnic base of social capital becomes apparent when co-operation and mutual aid develop among group members of disparate class origins, who would often provide co-ethnics with higher wages and better benefits than out-group consideration and respect. Ethnic resources may yield benefits to an entire group. However, financial, human, cultural, and social capital are often more extensively amassed and shared among subcollectivities wherein control is greater and malfeasance less likely. Granovetter (1985) demonstrates that the value of social capital is often enhanced when it is confined within specific boundaries or, in other words, constrained by both “coupling and decoupling”. In order to optimise their economic position, group members benefit not only by co-operating among themselves, but also by minimising obligations to others, such that gainful action will be unfettered (Light and Gold, 2000: 112).

Portes and Sensenbrenner (1993) redefine social capital as “those expectations for action within a collectivity that affect the economic goals and goal – seeking behaviour of its members, even if these expectations are not oriented towards the economic sphere (Portes and Sensenbrenner, 1993: 1323). Relating to immigrants and their adaptation to the host society, social capital essentially refers to participation within social networks of kin and especially co-ethnics. Such networks may influence immigration decisions, settlement pattern, and social incorporation (Marger, 2001; Massey et al, 1993). In brief, ethnic networks provide immigrants with a support system that assists in the securing of housing and other initial settlement issues, yields crucial information regarding job opportunities, and boosts psychological security in a shortage in a strange environment. These networks can take the form of ethnic voluntary associations, community ties to the origin society, and local ethnic communities and neighbourhoods that emerge in the host society (Marger, 2001).

### **The African Context**

Kinunda-Rutashobya (1999: 24) calls for more empirical work especially in the African context and contends that reasons for success of one ethnic group over another can be further understood by network theory. This perspective is supported by the research of Godsell (1991), in her study of four ethnic groups in South Africa. She found that although both Indian and African entrepreneurs were victims of discriminatory legislation, the Indian entrepreneurs were able to use resources provided by family and the community, which included the local, national and international community. Among the African entrepreneurs, very few networks were found, which was attributed to the low status of small business in the African community. A further explanation for this lack of networks was the perception that traditionally African entrepreneurs have had very few entrepreneurial role models. In trying to explain the lack of entrepreneurship among African entrepreneurs in the UK (Basu & Goswami, 1999; Ram, 1994, 1997), and in the US, (Light & Gold, 2000; Yoo, 2000), it is argued that one feasible explanation was that there was a shortage of entrepreneurial role models in their community.

Ram (1997: 149) and Basu and Goswami (1999: 251) argue that ethnic minority businesses often arise out of a context of disadvantage, and that the adverse “opportunity structure” carries greater explanatory power than speculations on “culture” and so-called “ethnic” resources. Sanders and Nee (1996: 233) accept the importance of social capital in explaining interethnic variations in self-employment, but locate the relevant social unit as the immediate family rather than the immigrant community. As a social organization of production, the family’s chief advantages are not simply tangible products, such as unpaid labor, but also involve the mutual obligation and trust characteristic of solidaristic small groups.

In a study in Africa, Brown and Butler (1993) claimed that strong ethnic and cultural ties can act as barriers to those entrepreneurs who are not members of the ethnic group. For example, in Zambia, a large proportion of the business sector is run by Asian immigrants, who are not bound by the cultural factors in the country, and the production and trade of indigenous goods, as well as trade in imported goods were discouraged among “natives” by colonial economic policies (Kobonyo, 1999). Based on research in Kenya, Africans found it very difficult to penetrate business sectors dominated by Asians. This is largely due to social networks among the Asian business operations, which excludes non-Asians.

## **RESEARCH METHODOLOGY**

Data for the analysis was collected from 325 entrepreneurs in Durban, the largest city in the province of KwaZulu-Natal, South Africa. Entrepreneurs were requested to fill in a structured survey instrument to ensure reliability and validity in responses obtained. The sample was selected from entrepreneurs from the three dominant ethnic groups in the region: African, Indian and European. The three ethnic groups chosen for this study will contribute more to our understanding of how social capital is mobilised by entrepreneurs within a developing country. The African entrepreneur group is an example of a marginalised group, but in South Africa, they are a majority, and not a minority group. Therefore by studying this group will add to our understanding of entrepreneurship in this context. Also this group is not an immigrant group, but an indigenous group, and it is important when comparing ethnic groups to have a “native” group. The Indian ethnic group is an example of a group filling the “middleman minority” group. However, in South Africa, they were also marginalised by institutional factors, and will therefore make for an fascinating study. The European ethnic

group also have a long history in South Africa, but their position in South Africa has always been one of privilege, and was originally one of being the colonial power. However, with change, firstly with the Afrikaner-led government and then the Black-led government in 1994, their position has changed dramatically.

The sample was selected largely by personal contacts and referrals and introductions by those interviewed. Given that a large amount of ethnic businesses are still operated in areas dominated by specific ethnic groups, research assistants from the same ethnic group as the respondents' were used. This methodology was utilised by Ram (1994) and Basu and Goswami (1999) in studies conducted in England, and Light and Bonacich (1988) in studies in the US, whereby having interviewers with the same ethnic background led to more access and acceptance by the entrepreneurs. The data analyses consisted of an ANOVA to determine whether there were any significant differences between the mean scores of the three ethnic entrepreneur groups in the social capital variables. Furthermore, a factor analysis was performed to determine the underlying social capital factors. In addition, the scale was subjected to discriminant analysis to ascertain whether the scale could significantly distinguish between the three ethnic groups.

## RESULTS AND DISCUSSION

This section presents a profile of some of the characteristics of the entrepreneur in addition to the results of the analysis of variance, factor analysis and discriminant analysis on the social capital variables.

To determine whether there were significant differences in the various social capital variables among the three ethnic groups, an analysis of variance (ANOVA) was performed. The results are shown in table 1. Of the 20 items included in the questionnaire, at  $p \leq .001$ , 12 were found to be statistically significant when ethnic groups was used as a differentiating factor. The results of table 1 indicate that African respondents have two of the highest means and nine of the lowest means in the 12 significant items. They scored the highest in joining a local community action to deal with an emergency and thinking that multiculturalism makes life better. They scored the lowest in feeling valued by society, satisfaction with the meaning of one's life, believing that by helping others one helps oneself, attending a local community event, feeling that the local community is like home, going outside the community to visit family, running into friends and acquaintances when shopping, knowing where to find information to make a life decision, and feeling free to speak out when one disagrees with everyone else.

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Table 1 Here  
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As for the Indian respondents, the results indicate that they scored the highest in five items and lowest in three items. They scored the highest in the following items: feeling valued by society, satisfaction with the meaning of one's life, attending a local community event, going outside the community to visit one's family, and running into friends and acquaintances when shopping. They scored the lowest on being in a management or organising committee for any local group or organisation, joining local community action to deal with an emergency, and thinking that multiculturalism makes life better.

The results of the European entrepreneurs indicate that they scored highest in five items and none lowest. The five highest scoring items were – believing that helping others helps oneself, feeling that the local community is like home, knowing where to find information, being in a management or organising committee for a local group or organisation, and feeling free to speak out when one disagrees with everyone else.

A factor analysis was also performed on the social capital questions. Findings from the factor analysis illustrated in table 2 show the emergence of a six-factor solution that accounts for 63.078 percent of the variance.

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Table 2 Here  
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**Factor 1: Participation in community activities**

This factor had six item loadings and included the following items: joining local community action to deal with emergency, participating in community project, being in a management/organizing committee of local group, helping organize new service in the area, being an active member of local organization or club, and helping out a local group as a volunteer. This factor deals with the entrepreneurs' level of participation in community activities. The component loadings ranged from 0.488 to 0.756.

**Factor 2: Proximity of network members**

This factor had four item loadings ranging from 0.484 to 0.715, and included items such as: attending local community events, running into friends and acquaintances when shopping, going outside the community to visit family, and feeling that the local community is like home. This factor related to the proximity of entrepreneurs' network members.

**Factor 3: Perceptions of contribution to society**

This factor had three item loadings ranging from 0.544 to 0.825 and included the following items: feeling valued by society, feeling satisfaction with what life meant, and believing that helping others helps yourself. This factor deals with the entrepreneurs' perceptions on his/her contribution to society.

**Factor 4: Attitude towards multiculturalism**

This factor had two item loadings ranging from 0.862 and 0.864 and included items such as enjoying living with people of different lifestyles, and thinking that multiculturalism makes life better.

**Factor 5: Perceptions of safety and trust**

This factor had three item loadings and included items such as: feeling safe walking down one's street after dark, having a reputation of one's area being a safe place, and agreeing that most people can be trusted. This factor deals with the respondents' perceptions of how safe one's area is as well as how trustworthy people generally are. The component loadings range from 0.542 to 0.783.

**Factor 6: Access to and freedom to provide information**

This factor had two item loadings ranging from 0.525 and 0.766, and included the following

items: knowing where to find information when making life decision, and feeling free to speak out when one disagree with everyone else.

The initial-components factor analysis method was used to determine the number of possible factors present. From the eigenvalues greater than one (refer to table 3), it was decided to have six factors because the eigenvalues of the seventh factor onwards was less than one. In order to determine a finer selection of factors, an orthogonal varimax rotation was completed. The factor loadings for each of the six factors are greater than 0,35. All the eigenvalues for the respective factors are greater than 1,0 which fulfills the Kaiser criterion.

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Table 3 Here  
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The six factors and their relative contribution to variance are presented in table 3. It can be seen that all the six factors have an eigenvalue of above 1, ranging from 1.008 to 4.100. Factor 1, participation in community activities, contributes a variance of 20.499 percent, followed by factor 2, proximity of network members, which contributes 14.654 percent. Perceptions of contribution to society, factor 3, contributes 9.678 percent of the variance, while factor 4, attitude towards multiculturalism, explains 7.182 percent of the variance. Factor 5, perceptions of safety and trust, contributes 6.025 percent in explaining the variance while factor 6, access to and freedom to provide information contribute 5.040 percent. The total cumulative variance explained by the six factors is 63.078 percent.

The data collected were also subjected to item analysis. The Cronbach's alpha coefficient ( $\alpha$ ) was calculated to determine the internal consistency of the items on the scale. The alpha value for the entire social capital scale was found to be 0.7757, which indicated that the internal consistency was quite high. Cronbach's alpha coefficient for each factor of the scale were as follows: factor 1 = 0.7746; factor 2 = 0.6823; factor 3 = 0.7255; factor 4 = 0.7975; factor 5 = 0.5226; and factor 6 = 0.5035.

Discriminant analysis was also performed on the data to determine whether the social capital scale can accurately classify the respondents according to their ethnic groupings. The results of this analysis is presented in table 4.

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Table 4 Here  
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The results indicate that using the social capital scale, the overall classification accuracy (hit ratio) is 63.04 percent. Of the 111 African entrepreneurs, 65 were correctly classified, accounting for 58.56 percent. Among the 121 Indian respondents, 84 were correctly classified, corresponding to 69.42 percent. As for the Europeans, of the 90 respondents, 54 were correctly classified, equivalent to 60 percent.

A measure of classification accuracy is the maximum chance criterion which is simply the hit ratio obtained if we assign all the observations to the group with the highest probability of occurrence. In the computation, this results to 37.58 percent. Compare this figure to the overall percentage correctly classified. Based on the maximum chance criterion therefore, the

model is very good. Another measure of classification accuracy is the proportional chance criterion which is calculated by squaring the proportions of each group, with the calculated value of 34.16 percent which is lower than the overall percentage correctly calculated as well as the individual group's percentage correctly classified. Hence, based on the proportional chance criterion, the model is very good.

## CONCLUSION

As the literature indicates (Portes, 1995) social capital refers to the individual's ability to mobilise resources. For entrepreneurs to be successful they need to be able to obtain scarce resources through various sources. It is important for them to establish relationships with others in order to access these resources. The findings indicate that among the respondents from the three ethnic groups, the Africans scored the lowest and the Europeans scored the highest in the social capital variables. This shows that the African entrepreneurs do not mobilise social capital as well as their Indian and European counterparts. These results support Godsell (1991)'s findings that Indian entrepreneurs access social capital better than Africans.

The way social capital is accessed also differs according to the respondent's ethnic grouping. European entrepreneurs tend to access social capital in more formal avenues such as participation in management or organising committees for local groups. Indians tend to rely on more informal means of gathering social capital such as through family, friends and acquaintances. It is quite interesting to note that for the African respondents, they scored the highest in the item related to joining a local community action to deal with an emergency. This could indicate that Africans only mobilise social capital when there is no choice and do not make a conscious effort to cultivate and maintain relationships that would help in this aspect.

To conclude, this paper has attempted to add to our understanding of ethnic entrepreneurs in South Africa. It is widely accepted that entrepreneurship is a social activity, embedded in a social context. Therefore, in line with the mixed embeddedness perspective, there is a need to examine the influence of the wider socio-economic and politico-institutional environments on entrepreneurship.

**Table 1: Mean Scores from Questions on Social Capital**

| <b>Question</b>  | <b>African</b> | <b>Indian</b> | <b>European</b> | <b>F-value</b> |
|--|----------------|---------------|-----------------|----------------|
| Do you feel valued by society?   | 2.66           | 3.56          | 3.11            | 14.934*        |
| If you were to die tomorrow, would you be satisfied with what your life has meant?                 | 2.38           | 3.49          | 3.04            | 19.846*        |
| Do you believe that by helping others you help yourself?   | 3.02           | 3.60          | 3.80            | 14.383*        |
| Do you help put a local group as a volunteer?  | 2.32           | 2.60          | 2.35            | 1.138          |
| Do you feel safe walking down your street after dark?  | 2.07           | 1.78          | 1.56            | 4.555          |
| Do you agree that most people can be trusted?  | 2.15           | 1.77          | 2.07            | 3.505          |
| Does your area have a reputation for being a safe place?   | 2.31           | 1.95          | 2.44            | 5.198          |
| Have you attended a local community event in the past 6 months (e.g. church fete, school concert)? | 2.31           | 3.45          | 2.98            | 18.719*        |
| Are you an active member of a local organization or club (e.g. craft, sport, social club)?         | 2.21           | 1.88          | 2.32            | 3.460          |
| Does your local community feel like home?  | 2.40           | 2.73          | 3.27            | 9.625*         |
| Do you go outside your community to visit your family?   | 2.53           | 3.79          | 3.69            | 48.957*        |
| When you go shopping in your local area are you likely to run into friends and acquaintances?      | 2.62           | 3.78          | 3.69            | 44.883*        |
| If you need information to make a life decision, do you know where to find that information?       | 2.67           | 3.29          | 3.62            | 17.188*        |
| Are you on a management committee or organizing committee for any local group or organization?     | 2.10           | 1.57          | 2.22            | 6.905*         |
| In the past 3 years, have you ever joined a local community action to deal with an emergency?      | 2.35           | 1.65          | 1.89            | 7.936*         |
| Have you taken part in a community project?  | 2.38           | 2.08          | 2.31            | 1.209          |
| Have you helped organize new service in your area?   | 2.34           | 2.02          | 1.89            | 2.557          |
| If you disagree with what everyone else agreed on, would you feel free to speak out?               | 2.83           | 3.40          | 3.61            | 11.916*        |
| Do you think that multiculturalism makes life better?  | 2.87           | 2.22          | 2.81            | 8.923*         |
| Do you enjoy living among people of different lifestyles?  | 2.96           | 2.62          | 2.84            | 3.361          |

\*  $\rho \leq .001$

**Table 2: Rotated Factor Structure for Social Capital**

| <b>Factors</b>   | <b>Factor Loading</b> |
|--|-----------------------|
| <b><u>Factor 1. Participation in community activities</u></b>        |                       |
| Joining local community action to deal with emergency                | 0.756                 |
| Participating in community project                                   | 0.746                 |
| Being in a management/organizing committee of local group            | 0.711                 |
| Helping organize new service in the area                             | 0.699                 |
| Being an active member of local organization or club                 | 0.623                 |
| Helping out a local group as a volunteer                             | 0.488                 |
| <b><u>Factor 2. Proximity of network members</u></b>                 |                       |
| Attending local community events                                     | 0.715                 |
| Running into friends and acquaintances when shopping                 | 0.704                 |
| Going outside community to visit family                              | 0.649                 |
| Feeling that the local community is like home                        | 0.484                 |
| <b><u>Factor 3. Perceptions of contribution to society</u></b>       |                       |
| Feeling valued by society  | 0.825                 |
| Feeling satisfaction with what life meant                            | 0.799                 |
| Believing that helping others helps yourself                         | 0.544                 |
| <b><u>Factor 4. Attitude towards multiculturalism</u></b>            |                       |
| Enjoying living with people of different lifestyles                  | 0.864                 |
| Thinking that multiculturalism makes life better                     | 0.862                 |
| <b><u>Factor 5. Perceptions of safety and trust</u></b>              |                       |
| Feeling safe walking down ones street after dark                     | 0.783                 |
| Having a reputation of ones area being a safe place                  | 0.740                 |
| Agreeing that most people can be trusted                             | 0.542                 |
| <b><u>Factor 6. Access to and freedom to provide information</u></b> |                       |
| Knowing where to find information when making life decision          | 0.766                 |
| Feeling free to speak out when disagree with everyone else           | 0.525                 |

Extraction Method: Principal Components Analysis

This table is based on Varimax Factor Rotation

6 factors extracted/only items that loaded with absolute values greater than 0,35 are shown

**Table 3: Factors, Eigenvalues, Percent of Variance, Cumulative Percent of Variance and Alpha Coefficients**

| <b>Factor</b>                                | <b>Eigenvalue</b> | <b>Percent of Variance</b> | <b>Cumulative Percent of Variance</b> | <b>Alpha Coefficient</b> |
|--|-------------------|----------------------------|---------------------------------------|--------------------------|
| Participation in community activities        | 4.100             | 20.499                     | 20.499                                | 0.7746                   |
| Proximity of network members                 | 2.931             | 14.654                     | 35.154                                | 0.6823                   |
| Perceptions of contribution to society       | 1.936             | 9.678                      | 44.831                                | 0.7255                   |
| Attitude towards multiculturalism            | 1.436             | 7.182                      | 52.013                                | 0.7975                   |
| Perceptions of safety and trust              | 1.205             | 6.025                      | 58.037                                | 0.5226                   |
| Access to and freedom to provide information | 1.008             | 5.040                      | 63.078                                | 0.5035                   |

**Table 4 : Classification Matrix for Discriminant Analysis**

| <b>Actual Group</b>  | <b>Predicted Group</b> |               |                 | <b>Actual Group Size</b> | <b>Percentage Correctly Classified</b> |
|----------------------|------------------------|---------------|-----------------|--------------------------|--|
|                      | <b>African</b>         | <b>Indian</b> | <b>European</b> |                          |  |
| African              | 65                     | 3             | 6               | 111                      | 58.56                                  |
| Indian               | 8                      | 84            | 26              | 121                      | 69.42                                  |
| European             | 15                     | 25            | 54              | 90                       | 60.00                                  |
| Predicted Group Size | 88                     | 112           | 86              | 322                      | 63.04                                  |

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# **THE SIGNIFICANCE OF ENTREPRENEURIAL NETWORKS: FINDINGS FROM A COMPARATIVE STUDY OF THREE ETHNIC GROUPS**

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## **ABSTRACT**

The purpose of this empirical study is to present results from a study of how entrepreneurs use networks, as well as describe the characteristics of these networks. A survey of 325 entrepreneurs from the KwaZulu-Natal province of South Africa was conducted.

Results from the ANOVA and t-tests reveal that there are significant differences between the ethnic groups on the following network variables: number of people the entrepreneur discussed the business with, how well the contacts are known, number of years contacts are known and how well contacts know each other. The results of the regression analysis showed that more than 30 percent of the variation of how well network of contacts are known (avecon) can be explained by ethnic group. Furthermore, more than 16 percent of the variation of number of years contacts are known (aveknow) can be explained by age and ethnic group variables.

## **INTRODUCTION**

The crucial importance of Small and Medium Enterprises (SME's) to the economic development of South Africa has been indicated by Lekota (1995: 11), and in searching for possible strategies to develop SME's, special focus needs to be given to ethnic groups that have been marginalised from active and meaningful participation in the South African economy. There is however, a lack of research on entrepreneurship in the South African context. Existing studies look into psychological traits (Van Vuuren & Boshoff, 1994; De Klerk, 1998) and demographic differences (Boshoff, Scholtz & Roodt, 1995). In recent enquiries, networking theory has been used as a mechanism for exploring the creation and development of new ventures. Looking at current investigations there have been no studies that looked into the characteristics of South African entrepreneurial networks as well as how these networks are used.

Researching entrepreneurship using the social networks perspective is imperative, as studying entrepreneurs' participation in networks highlights the importance of the social structure.

Social networks are crucial assets for business owners struggling to survive in competitive markets (Aldrich and Zimmer, 1986: 12-3; Aldrich, Elam & Reese, 1997). That entrepreneurship is largely a social activity and that entrepreneurs are largely social creatures suggests not only that academics need to continue research on the social networks of new ventures, but that aspiring entrepreneurs would benefit from learning the rudimentary tools of social network analysis (Burt, 1992).

### **KEY LITERATURE**

Ahwireng-Obeng and Piaray (1999: 78) assert that formal institutional factors exert a powerful negative influence on entrepreneurship in South Africa, and the historical and political system has served to promote an anti-entrepreneurial culture due to the dependency on, or control of, the population by the state which decreased the propensity for entrepreneurship (Allie & Human, 1998; Olomi, 1999: 164). In addition, Mbaku (2000) believes that the South African government failed to maintain an enabling environment for the development of indigenous entrepreneurship and the participation of Africans in national development (Iheduru, 1998).

Entrepreneurial activity does not occur in a vacuum. Instead, it is embedded in cultural and social contexts, and within webs of human networks that are both social and economic (Johannisson, 1990). In addition, Johannisson (1990: 4) affirms that entrepreneurs' personal networks are the "most significant resource of the firm". Empirical studies have illustrated that entrepreneurs use informal network contacts (family, friends, and business people) more than formal network contacts (bankers, accountants, and lawyers) as information sources (Aldrich, Rosen and Woodward, 1987: 158). An entrepreneur's personal network ties can expand the boundaries of rationality by creating and allowing access to knowledge and information. Once an entrepreneur has determined which relationships are crucial to the success of the new venture, most of the time is spent building, negotiating, and maintaining these relationships. This view that entrepreneurship is a social process, and that entrepreneurs act largely as social rather than solo players, should not lead researchers and educators to conclude that entrepreneurs' individual knowledge and skill is irrelevant to the success of a new venture (Byers et al., 1997). Rather, the essentially social nature of establishing connections and fruitful relationships with both insiders and outsiders means that the study of entrepreneurship should focus on social behaviour. This includes how people identify which relationships will be crucial to the success of their venture, and how they develop and maintain the relationships that enable their firm to obtain the resources needed for their firm to survive and grow. Granovetter (1973: 1367) claims that weak ties act as "bridges" to information sources not necessarily contained within an entrepreneur's immediate (strong-tie) network. Since an individual does not interact with weak ties regularly, it is likely that weak ties provide more unique information than strong ties.

### **RESEARCH METHODOLOGY**

The purpose of this paper is to present results from a study of the role of networking in different ethnic entrepreneur group in South Africa. The aim is to make intelligible how and why different group use networking in different ways to acquire and organise capital, within the specific socio-economic and institutional context of South Africa.

Data for the analysis was collected from more than 300 entrepreneurs in Durban, the largest city in the province of KwaZulu-Natal, South Africa. Entrepreneurs were requested to fill in a structured survey instrument to ensure reliability and validity in responses obtained. The sample was selected from entrepreneurs from the three dominant ethnic groups in the region: African, Indian and European. The three ethnic groups chosen for this study will contribute more to our understanding of how networking in entrepreneurs is conducted within a developing country.

The sample was selected largely by personal contacts and referrals and introductions by those interviewed. Given that a great deal of ethnic businesses are still operated in areas dominated by specific ethnic groups, research assistants from the same ethnic group as the respondents' were used. This methodology was utilised by Ram (1991) and Basu and Goswami (1999) in studies conducted in England, Light and Bonacich (1988) in studies in the US, whereby having interviewers with the same ethnic background led to more access and acceptance by the entrepreneurs.

Comparison of means using analysis of variance (ANOVA) and t-tests of several networking variables were conducted to determine significant differences of entrepreneurs based on different personal characteristics. Furthermore, a stepwise multiple regression analysis was conducted to determine the best demographic predictors of respondent's scores on several network variables. Network Activity is measured by the size of the network (number of contacts the entrepreneur discusses the business with) and how actively entrepreneurs use these contacts (hours spent developing and maintaining contacts & percent of time spent networking). Network Density is measured by how well the entrepreneur knows each contact's network, the number of years the entrepreneur has known the contacts and how well the contacts know each other.

## **RESULTS AND DISCUSSION**

In this section, a profile of some of the characteristics of the entrepreneur, their utilisation of networks, the extent of their networking activity, density and diversity, and a comparison of the three ethnic groups of key networking variables are presented.

### **Characteristics of the entrepreneur**

The sample size was 325, of which 34.2 percent (N=111) were African entrepreneurs, 37.2 percent (N=121) were Indian entrepreneurs, and 27.7 percent (N=90) were European with 1 percent (N=3) classified as other. Several descriptive characteristics are presented in table 1. In order to test if there are significant differences between African, Indian and European entrepreneurs on the demographic data collected, a Chi-square ( $\chi^2$ ) test was performed.

At the  $p = .001$  level, there were significant differences between the three groups on gender. The majority of the entrepreneurs in the three ethnic groups were male, except for the European group. Less than 22 percent of the Indian respondents, 41.4 percent of the African, and 51.1 percent of the European entrepreneurs were female.

The  $\chi^2$  results show that at  $p = .001$ , there are significant differences in the ages between the entrepreneurs from the three ethnic groups. It is apparent that that the African ethnic entrepreneurs are younger, with the majority (63%) below the age of 40. In contrast, 71.7

percent of the Indian and 85.8 percent of the European respondents are over the age of 40.

With regards to education, the results show that at the  $\rho = .05$  level, there were significant differences between the ethnic groups on education. In the three groups, the majority had completed twelve years of schooling (African 87.2%; Indian 80.8%; European 91.1%). A higher percentage of Indians (53.3%) had finished 12<sup>th</sup> grade, although more Africans (45.9%) had a degree or diploma.

Looking at the marital status of the entrepreneurs, the  $\chi^2$  results also indicate significant differences between the three ethnic groups. The majority of entrepreneurs in all three ethnic groups are married, with 55.7 percent of the Africans, 80.8 percent of the Indians, and 66.7 percent of the Europeans being married. The  $\chi^2$  results show that for all ethnic groups, very few of the respondents had parents who were entrepreneurs. However, at the  $\rho = .001$  level, there were significant differences between the three groups on whether they had close relatives who were entrepreneurs. Only 24.3 percent of African entrepreneurs, while 68.6 percent of the Indian group, and 66.7% of the European sample had indicated that they had a close relative who was an entrepreneur.

### **Networking variables**

In table 1, differences in activity and size of networks of South African entrepreneurs classified according to ethnic group of the entrepreneur are presented. In response to the question “with how many people did you discuss your business?”, the mean score for African entrepreneurs was 4.50, whereas the score for the Indian group was 11.70, and 10.24 for the European group.

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Table 1 Here  
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At the  $\rho = .05$  level, there was a significant difference between the three groups with the Indian and European entrepreneurs on average discussing their business with almost three times more people than their African counterparts.

The scores in response to the question “how many hours per week developing contacts?” gave very similar results with all the groups spending about six hours per week developing contacts. The responses to the question “how many hours per week maintaining contacts?” again revealed similar results, with the three groups spending between 6.33 – 7.74 hours maintaining their contacts. The ANOVA results indicate no significant differences between the three ethnic groups on the number of hours spent developing and maintaining contacts.

Table 1 presents three variables measuring different aspects of network density: how well the entrepreneur knows his contacts’ network, the number of years the entrepreneur has known the contacts and how well the contacts know each other. The table also includes the results that indicate how these contacts were met. At  $\rho \leq .001$ , the ANOVA results show that there are significant differences between ethnic groups on the three variables measuring network density. European entrepreneurs know their contacts better and have known their contacts for a longer period of time compared to their Indian and African counterparts. Members of the European entrepreneurs’ network also knew each other better compared to the Indian and

African entrepreneurs'. Overall, Indian respondents had better results than Africans when it comes to all three network density variables.

In order to determine whether the demographic data (from table 1) can predict the respondent's scores on the network variables, a stepwise multiple regression analysis was conducted. The scores on network activity (number of people the entrepreneur has discussed his business with, number of hours per week developing contacts, number of hours per week maintaining contacts) served as the dependent variables. The entrepreneur's demographic data were used as independent variables (gender, age, education, marital status and entrepreneur's in the family).

Of the three regressions performed on network activity variables, the variance of only one variable was found significantly explained by demographic variables. The findings of the multiple regression analysis with "how many people did you discuss your business" (NUMPEO) as the dependent variable (refer to table 2). The best solutions for the NUMPEO dependent variable, in terms of  $R^2$ , significance of t and significance of F were obtained with model 2. Only about 9 percent of the variation of NUMPEO was explained by close relative and age variables with  $R^2=9.2$  percent. Analysis of variance indicated that  $F=11.120$ ,  $\rho=.000$  for the model. The t value of the coefficient for close relative was significant at the 1 percent level ( $t=3.961$ ,  $\rho=.000$ ), and significant at the 5 percent level for age with  $t=2.173$ ,  $\rho=.031$  respectively.

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Table 2 Here  
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Of the three regressions performed on network density variables, the variance of all three variable was found significantly explained by demographic variables. Table 3 illustrates the findings of the multiple regression analysis with "how well network of contacts are known" (AVECON) as the dependent variable.

The best solutions for the AVECON dependent variable, in terms of  $R^2$ , significance of t and significance of F were obtained with model 1. About 32 percent of the variation of AVECON was explained by ethnic group with  $R^2=32.1$  percent. Analysis of variance indicated that  $F=100.693$ ,  $\rho=.000$  for the model. The t value of the coefficient for ethnic group was significant at the 1 percent level ( $t=10.035.961$ ,  $\rho=.000$ ).

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Table 3 Here  
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Table 4 illustrates the findings of the multiple regression analysis with "number of years contact is known" (AVEKNOW) as the dependent variable. The best solutions for the AVEKNOW dependent variable, in terms of  $R^2$ , significance of t and significance of F were obtained with model 2 (table 2). Approximately 16 percent of the variation of AVEKNOW was explained by age and ethnic group variables with  $R^2=16.2$  percent. Analysis of variance indicated that  $F=23.538$ ,  $\rho=.000$  for the model. The t value of the coefficient for age was significant at the 1 percent level ( $t=4.174$ ,  $\rho=.000$ ), and significant at the 1 percent level for

ethnic group with  $t=3.892$ ,  $p=.001$  respectively.

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Table 4 Here  
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## CONCLUSIONS

This study looks into the different network characteristics of South African entrepreneurs. Three features of networks were used: activity, density and diversity. Overall findings indicate that South African entrepreneurs are not maximising the use of their networks.

Network activity looks into the size of the network and the amount of time spent developing and maintaining networks. The regression results also reveal that age and having close relatives that are entrepreneurs can explain the variance in the number of people the entrepreneur discusses the business.

Density refers to how tightly connected the persons in a network are to each other. The regression results also indicate that age and ethnic group are significant variables for explaining variances in the number of years that the entrepreneur has know his contacts.

A network that is highly dense means that persons in the network know each other and to a large extent may share redundant or overlapping information. The results of the regression show that ethnic group can significantly explain variations in how well the entrepreneur knows his contacts. Upon further investigation using t-tests and ANOVAs, results show that when these three network density variables are classified according to ethnic group, significant differences emerge. European entrepreneurs know their contacts better, longer and their contacts know each other better compared to Indian and African entrepreneurs. The regression results suggest that age is a significant explanatory variable for how well contacts know each other.

The density of the entrepreneur's network is also indicated by how his contacts were met. Obviously, referrals would indicate that the entrepreneur's existing contacts help him generate other possible sources of information or complementary assets. Regardless of ethnic group, most entrepreneurs' existing contacts were met through their own effort.

To conclude, this paper has attempted to add to our understanding of ethnic entrepreneurs in South Africa. It is widely accepted that entrepreneurship is a social activity, embedded in a social context. The unique political situation in South Africa which rendered the majority group marginal, raises questions over whether theories of marginality in ethnicity which have been developed in the study of minority groups, may be relevant to a marginalised majority group. Furthermore, one needs to question whether theories of ethnic business, based on immigrant groups, apply to ethnic groups that are indigenous to the country, such as the African ethnic group.

**Table 1: Comparison of Networking Variables**

| Item   | Ethnic Group | Marital Status | Education Level | Gender | Father's Occ | Mother's Occ | Close Relative |
|--|--------------|----------------|-----------------|--------|--------------|--------------|----------------|
| With how many people did you discuss your business | 7.67*        | 1.546          | 0.773           | -0.893 | 0.359        | 0.643        | -4.692         |
| How many hours per week developing contacts        | 0.077        | 1.165          | 1.205           | -0.258 | 0.877        | 0.606        | -0.042         |
| How many hours per week maintaining contacts       | 0.504        | 1.312          | 1.777           | 0.830  | 0.350        | -0.789       | -0.054         |
| How well network of contacts are known             | 10.547-      | 3.158*         | 0.951           | -0.251 | 1.236        | 0.267        | -2.096*        |
| Number of years contacts are known                 | 21.669*      | 2.880*         | 2.278           | 1.247  | 1.189        | -0.324       | -3.114*        |
| How well contacts know each other                  | 4.267*       | 0.752          | 2.152           | 1.182  | -0.414       | -0.611       | -0.450         |

\* p &lt; 0.05

**Table 2: Regression of Network Activity Variable (NUMPEO) and Selected Demographic Data**

|                                  |           |                            |                    |          |             |
|----------------------------------|-----------|----------------------------|--------------------|----------|-------------|
| Multiple R                       |           | .303                       |                    |          |             |
| R <sup>2</sup>                   |           | .092                       |                    |          |             |
| Adjusted R <sup>2</sup>          |           | .084                       |                    |          |             |
| Standard error                   |           | 11.590                     |                    |          |             |
| <b>Analysis of variance</b>      | <b>DF</b> | <b>Sum of Squares</b>      | <b>Mean Square</b> | <b>F</b> | <b>Sig.</b> |
| Regression                       | 2         | 2987.673                   | 1493.837           | 11.120   | .000        |
| Residual                         | 220       | 29553.824                  | 134.336            |          |             |
| <b>Variables in the equation</b> | <b>B</b>  | <b>Standard error of B</b> | <b>Beta</b>        | <b>t</b> | <b>Sig.</b> |
| Constant                         | 1.346     | 2.098                      |                    | .641     | .522        |
| Close relative                   | 6.176     | 1.559                      | .256               | 3.961    | .000        |
| Age                              | 1.446     | .666                       | .140               | 2.173    | .031        |

**Table 3: Regression of Network Density Variable (AVECON) and Selected Demographic Data**

|                                  |           |                            |                    |          |             |
|----------------------------------|-----------|----------------------------|--------------------|----------|-------------|
| Multiple R                       |           | .567                       |                    |          |             |
| R <sup>2</sup>                   |           | .321                       |                    |          |             |
| Adjusted R <sup>2</sup>          |           | .318                       |                    |          |             |
| Standard error                   |           | .51226                     |                    |          |             |
| <hr/>                            |           |                            |                    |          |             |
| <b>Analysis of variance</b>      | <b>DF</b> | <b>Sum of Squares</b>      | <b>Mean Square</b> | <b>F</b> | <b>Sig.</b> |
| Regression                       | 1         | 26.423                     | 26.423             | 100.693  | .000        |
| Residual                         | 213       | 55.894                     | .262               |          |             |
| <hr/>                            |           |                            |                    |          |             |
| <b>Variables in the equation</b> | <b>B</b>  | <b>Standard error of B</b> | <b>Beta</b>        | <b>T</b> | <b>Sig.</b> |
| Constant                         | .702      | .088                       |                    | 8.006    | .000        |
| Ethnic Group                     | .436      | .043                       | .567               | 10.035   | .000        |

**Table 4: Regression of Network Density Variable (AVEKNOW) and Selected Demographic Data**

|                                  |           |                            |                    |          |             |
|----------------------------------|-----------|----------------------------|--------------------|----------|-------------|
| Multiple R                       |           | .402                       |                    |          |             |
| R <sup>2</sup>                   |           | .162                       |                    |          |             |
| Adjusted R <sup>2</sup>          |           | .155                       |                    |          |             |
| Standard error                   |           | 6.50081                    |                    |          |             |
| <hr/>                            |           |                            |                    |          |             |
| <b>Analysis of variance</b>      | <b>DF</b> | <b>Sum of Squares</b>      | <b>Mean Square</b> | <b>F</b> | <b>Sig.</b> |
| Regression                       | 2         | 1989.426                   | 994.713            | 23.538   | .000        |
| Residual                         | 244       | 10311.566                  | 42.261             |          |             |
| <hr/>                            |           |                            |                    |          |             |
| <b>Variables in the equation</b> | <b>B</b>  | <b>Standard error of B</b> | <b>Beta</b>        | <b>t</b> | <b>Sig.</b> |
| Constant                         | 3.189     | 1.298                      |                    | 2.457    | .015        |
| Age                              | 1.554     | .372                       | .257               | 4.174    | .000        |
| Ethnic Group                     | 2.134     | .548                       | .240               | 3.892    | .001        |

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# **ENTREPRENEURSHIP IN BIOTECHNOLOGY INDUSTRY - A CASE STUDY OF SWEDEN**

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## **Abstract**

Sweden is the leader in per capita outlays on research and development among developed countries. This fact combined with the country's unique law regarding grant of patent rights has made Sweden the leader of biotechnology inventions. Swedish law grants university teachers, rather than the universities employing them, the patent rights to their inventions. Some believe that the 1995 merger of Swedish drug company Pharmacia and the American drug company Upjohn as well as the merger of Astra with the British company Zeneca sparked the growth of biotechnology research in Sweden by displacing thousands of Swedes from the merged company. The paper analyzes Swedish entrepreneurial activities in the biotechnology industry using Schumpeter's five-factor model of entrepreneurship and draws policy implications for entrepreneurship in relation to patent law.

## **Introduction**

Pharmacia & Upjohn Inc was formed through a merger of Pharmacia AB and The Upjohn Company and began operating in November 1995. In December, 1999 Monsanto, the American drugs group famous for its research into genetically modified foods, merged with Pharmacia & Upjohn Inc. The merger of Monsanto with Pharmacia and Upjohn, Inc. created a new company, the Upjohn Corporation, with annual sales of \$17 billion, making it the eighth largest pharmaceutical company in the world. Later in 2003, Upjohn Corporation was acquired by Pfizer which became the world's largest pharmaceutical company. The decade of the 1990s also witnessed the merger of Swedish pharmaceutical company Astra with the British drug company Zeneca. Many analysts believe the merger of the culturally diverse companies created strong synergies in the biotechnology industry from a strategy perspective; however, the new companies displaced a significant number of scientists. The displaced scientists, aided by the Swedish law on patents and innovations accounted for a high growth rate of biotechnology innovations in Sweden. The purpose of this paper is to analyze Swedish entrepreneurship in the biotechnology industry using Schumpeter's five-factor model.

## **Swedish Patent Law**

According to Swedish Patent Act, "Any person who has made an invention susceptible of industrial application, or his successor in title, is entitled to apply for and to obtain a patent... For the purposes of the international preliminary examination, a claimed invention shall be considered industrially applicable if, according to its nature, it can be made or used (in a technological sense) in any kind of industry. "Industry" shall be understood in its broadest sense, as in the Paris Convention for the Protection of Industrial Property." (Department of Justice, Sweden. Adapted from <http://listbox.wipo.int/wilma/scp-orum/2001/msg00012.html>)

As Boklund (2003) mentions, for a long time, Swedish biotechnology industry was synonymous with two large pharmaceutical companies, Astra and Pharmacia; however, the emergence of many small and innovative biotechnology companies has made Sweden the leader in biotechnology inventions.

Historically, Sweden has been a leader in the biotechnology industry. During the 1940s, a number of foreign pharmaceutical companies began launching their own products on the Swedish market, thus pushing Sweden's pharmaceutical corporations to invest in research and development in biotechnology. Another factor that helped the growth of Swedish biotechnology industry was the good cooperation that the scientific community of Sweden enjoyed between corporations, universities and the healthcare sector. This was further aided by a well functioning system of clinical testing which meant that drugs could be tested faster and introduced onto the market more quickly. The patent law also helped the chemical industry, allowing the production of medical instruments to pick up speed and further contributing to the development of the pharmaceutical corporations.

### **Mergers and Growth of New Biotech Companies**

During the 1990s, when Astra and Pharmacia merged with foreign companies, a significant number of highly qualified workers of the two Swedish pharmaceutical firms were laid off. Of the laid off workers, between 10 and 20 per cent possessed doctorate degrees (Boklund, 2003). These scientists started their own venture and obtained patents for their inventions. Very soon, the larger pharmaceutical companies found it advantageous to outsource their research to new small biotech companies where the environment for research and development conducted by small teams is more creative. The 1990s also witnessed a rapid growth of the venture capital sector in Sweden in parallel with the diversification of the biotech industry contributing further to the growth of the biotech industry. By 2003, the total number of biotech companies in Sweden rose to over 200, making Sweden's biotech industry the fourth largest in Europe. Relative to gross domestic product, taking into account its size, Sweden has arguably the most successful biotech industry in the world. Relative to its population, Sweden is one of the top three countries in the world in terms of biotechnology research and publication.

### **The Model**

The emergence of Sweden as the world leader in biotechnology inventions can be analyzed using the model of entrepreneurship developed by Schumpeter. Although the literature on entrepreneurship dates back to the Mercantilist era, Schumpeter is the first economist who distinguished between an entrepreneur and a capitalist (Schumpeter, 1939, 1950). According to him, assumption of risk involving innovation is the role of the entrepreneur, while assumption of risk involving potential for profit is the role of a capitalist. Both an entrepreneur and a capitalist undertake risk; but their *domains* are separate. Individuals who own business and take risk with their capital in pursuit of profit, but do not innovate, are capitalists. There are individuals who take risk by introducing a new product, adopting a new production process, creating new markets, introducing new technology or creating a new economic organization. Schumpeter referred to these individuals as "entrepreneurs" who belong to a "distinct sociological class". According to him, the process of discovery and innovation modifies the past and creates new

opportunities for the creation of wealth in the future. This is what Schumpeter described as the process of “creative destruction”.

According to Schumpeter, “the function of entrepreneur is to reform or revolutionize the pattern of production by exploiting an innovation or, more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way, by opening up a new source of supply of materials or a new outlet for products, by reorganizing an industry...” (Schumpeter, 1950, 1939). He went on to attribute innovation as the business activity that brings about a new production function as a result of one or more of the following five economic activities:

1. introduction of a new good
2. adoption of new inputs to produce a new good or the previously produced good
3. introduction of new technology
4. opening of a new market; and
5. creating a new economic organization.

Figure 1 links innovation to Schumpeter’s five elements of entrepreneurship.

[Insert Figure 1 about here].

We discuss briefly the five economic activities of Schumpeter’s model as they apply to the inventions in biotechnology sector in Sweden.

**Introduction of a New Good:** The pharmaceutical companies of Sweden have developed and introduced many new products in the market during the past two decades. Notable among these are the COX-2 Specific Inhibitor, valdecoxib tablets and launching of 17 new drugs after the merger of Pharmacia with Upjohn. Additionally, on the basis of population per capita, the smaller pharmaceutical companies of Sweden with less than 500 employees developed and introduced the highest number of biotech products in the market after the merger of Astra and Pharmacia during the 1990s.

**Adoption of New Inputs to Produce a New Good or the Previously Produced Good:** The merger of Monsanto with Pharmacia Upjohn Corporation created the Pharmacia Corporation. This merger created opportunities for the Pharmacia Corporation to adopt new inputs previously unique to Monsanto Corporation.

**Introduction of New Technology:** The Mergers created synergies for the Pharmacia Corporation allowing for an investment of \$2 billion in research and development for the new corporation. A portion of this fund was outsourced to smaller companies which used the enhanced resources to develop new technology.

**Opening of a New Market:** The biotech products developed in Sweden are sold worldwide.

**Creating a New Economic Organization:** As noted, the mergers created global economic organizations, which were much bigger in size.

## **Summary and Conclusions**

Sweden is the leader in per capita outlays on research and development among developed countries. This fact combined with the country's unique law regarding grant of patent rights has made Sweden the leader of biotechnology inventions. The 1995 merger of Swedish drug company Pharmacia and the American drug company Upjohn and the merger of Astra with the British company Zeneca sparked the growth of biotechnology research in Sweden by displacing thousands of Swedes from the merged company. On the basis of population per capita, Sweden has the most biotech-intensive industry in the world.

The post-merger biotech sector of Sweden combined with the country's unique patent law lends itself to the Schumpeterian model of entrepreneurship. In this model, the biotech inventions play the pivotal role in changing the production function of the biotech industry through introduction of a new good, adoption of new inputs to produce a new good or the previously produced good, introduction of new technology, opening of a new market; and creating a new economic organization.

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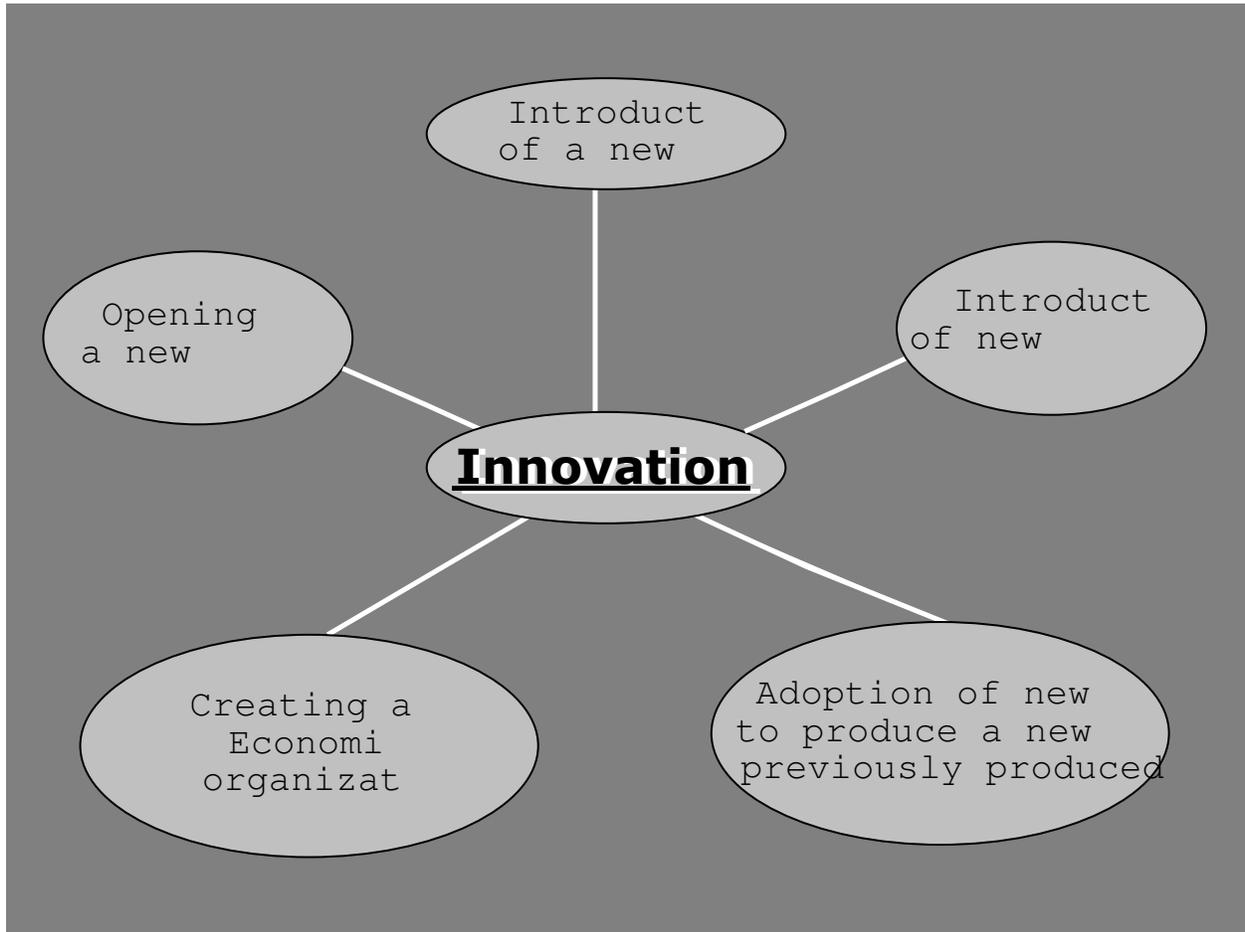
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Figure 1: Innovation and Entrepreneurship



**E-business and the development of SMEs:  
Promising initiatives in the context of local and regional development**

**50<sup>th</sup> World Conference of the International Council for Small Business**

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**Abstract**

E-business and information technologies in general offer potentially powerful means to boost the development of SMEs in the context of today's global economy. Many e-business and IT-based regional development initiatives have been put forth by governments around the world, including virtual communities, local or regional portals, and e-marketplaces. Starting with a four-step model of local and regional development (LRD) initiatives, a survey and two focus groups allowed us to characterize the needs of manufacturing and technological SMEs in the Mauricie region of the province of Quebec, Canada. On this basis, promising initiatives for the development of SMEs in a LRD context are identified, including the integration of tools and advanced business practices within a regional e-business appropriation portal. A prototype of such a portal is presented in conclusion.

**Résumé**

Dans un contexte d'économie mondiale, les technologies de l'information (TI) et les affaires électroniques (AÉ) sont potentiellement de puissants catalyseurs de développement des PME, ainsi que des communautés locales et régionales. Plusieurs initiatives concernant les TI et les AÉ ont été entreprises de par le monde, incluant des collectivités numérisées à base de « portails » locaux ou régionaux ou encore de places de marchés électroniques. Partant d'un modèle en quatre étapes caractérisant les initiatives de développement local et régional (DLR) par les AÉ, une enquête et deux groupes de discussion ont permis de caractériser les besoins de PME manufacturières et technologiques d'une région canadienne, soit la Mauricie au Québec. Sur cette base, des initiatives prometteuses pour le développement des PME dans un contexte de DLR sont identifiées, incluant l'intégration d'outils et de pratiques d'affaires avancées au sein d'un portail d'appropriation régionale des AÉ, dont un prototype est présenté en guise de conclusion.

## **E-business and the development of SMEs: Promising initiatives in the context of local and regional development**

### **1. Introduction and issues**

For the past few years, information technology (IT) has been accessible to people throughout the world; IT seems to have done away with distance and time (Cairncross, 1997). This phenomenon not only affects the individual, but enterprises of all sizes and sectors as well. Among the advantages in adopting IT, that of improving competitiveness can appear to be one of the more important because of the lowering of geographical and temporal barriers. Small and medium-sized enterprises (SMEs) adopt IT hope, among other things, to increase their market share and growth, and to outdistance their competitors (Raymond and Blili, 1998). However, can improving their competitiveness influence local and regional development? Can local and regional development have a significant effect on the economy of a state and, in the limit, a nation? This subject raises several questions, being a vast area, complex and undergoing continuous change. And above all, the challenge between IT and regional development is that the rate of change is not the same for both; it is as rapid for IT as it is slow for local and regional development (Julien, 1997).

This research presents the study of the adoption of e-business and IT in general by SMEs. The main objective of this project is to understand this phenomenon and the process of stimulating local and regional development by an adequate support for SMEs. In the next section of this article, we will discuss the environmental mutations and IT in the new economy. An inventory of the principal obstacles as well as initiatives will be presented. The methodological considerations of this research will be discussed with the Mauricie region as a basis. The results of the investigation will be presented by identifying the principal solutions that emerge from this research, and suggestions for further work will be discussed in conclusion.

### **2. Environmental mutations and IT**

SMEs make up more than half the total number of enterprises in Canada and more than 90% in one of its provinces, Quebec. These enterprises now play a dominant role, but must always share the market with large enterprises (LEs). Both have to deal with the same realities of international competition, but do not have the same means at their disposal, whether financial or technical. In addition to competing with LEs, SMEs must often deal with them as business partners. New forms of inter-organizational relations, such as the introduction of networks, the creation of partnerships, or the establishment of strategic alliances are among the measures taken in order to adapt to the new environmental realities.

Local and regional development has also undergone transformations following mutations of the enterprises. The small enterprises have scattered over the territory, bringing with them their economic and social fallout. Regions that must avoid dependence on a single enterprise or on a single industry find that SMEs are a solution to their problem.

In general, IT and e-business<sup>1</sup> can constitute powerful vectors of development at the local and regional levels. These technologies can in this way play an innovative role in economic activities, a role in which time and distance are redefined in accordance with the new standards (Jeffcoate et al., 2002; Charlton et al., 1998). The appropriation of IT by SMEs can maintain or improve their market share: the abolition of frontiers permits them to extend their zone of influence beyond their usual territory, or improve their quality by the time or the fluidity of the sequence of the operations of supply, production, and shipping of goods (Bigras and G  linas, 1998). E-business can constitute a global and worldwide network of links between partner enterprises. This network brings to these enterprises a competitive advantage and improves their performance. However, SMEs will need to acquire new skills and adapt their business models in the light of their new electronic activities (C  t  , Sabourin and V  zina, 2004).

One of the competitive advantages of SMEs is based on continuous and diffuse innovation, that is, they must build and manage their knowledge (or distinctive skills). In this way, these enterprises will be characterized by a more "open" and "learning" management and organization. Their technological capacity must be continuously updated by training, by the accumulation of rich information, and by the transformation of this information. These learning SMEs utilize knowledge to create added value (Wright et al., 1995), which has become more than necessary for regions in the present context of the new economy (Pol  se and Shearmur, 2002). In order for these regional SMEs to be allowed to develop, there must be a dynamic milieu, based on a common culture of norms, knowledge, and know-how, that stimulates the entrepreneurial contagion as well as a culture of networking by the enterprises and other stakeholders in local and regional development. Figure 1 presents a schematic of this innovating regional SME.

### Figure 1

Networking is an essential activity for SMEs desiring to be in a position to innovate, since rich and varied information, which is the source of innovation, comes precisely from outside the enterprise (Julien et al., 2003). Thus, networks are based on the detection and the sharing of rich information, allowing learning and innovation as well as the creation of a culture of regional cooperation and a feeling of belonging. The purpose of electronic networks remains the same as that of the traditional ones, but IT can facilitate the emergence of networks in the regions by serving as a physical support to the exchange of rich information. This would increase the effectiveness of these networks. The netMetal<sup>2</sup> portal is a good example of an electronic network aimed at establishing a culture of collaboration between business partners while at the same time having the objective of increasing their respective performance (Raymond, Talbot and V  zina, 2002).

St-Pierre et al. (2003) have categorized the regional SMEs into four business models in two development dimensions: innovation and internationalization. These business models, shown in Figure 2, are: first, "innovating" SMEs, whose development is centred on innovation (new

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<sup>1</sup> The "e-business" expression electronic business is utilized in a more inclusive sense than "e-commerce". It includes aspects that are not only informational and transactional (electronic commerce), but also business relational (Greenstein and Vasarhelyi, 2002: 2).

<sup>2</sup> NetMetal ([www.netmetal.net](http://www.netmetal.net)) offers its members in the metallurgical industry various tools that allow them to enhance their visibility and develop new markets.

products and services, new production processes) aimed at cost reduction, increased flexibility, and the strengthening of bonds with business partners (customers, suppliers, prime contractors, etc.); second, “exporting” SMEs, whose development is centred on internationalization; third, “world-class” SMEs, whose development is centred as much on innovation as on internationalization (these SMEs are characterized by their exemplary practices and their open leadership); and fourth, "local" SMEs, whose development is centred on stability and profitability (these SMEs are characterized by their limited desire for growth and their wish to restrict their market/range of products; in addition, their management generally is less educated and less apt to devote time to seeking out rich information).

It is in this fourth group that the majority of the regional SMEs find themselves. According to an approximation based on research carried out at the Research Institute on SMEs, about 60% of SMEs are "local" in terms of their business model (Raymond and St-Pierre, 2003). Moreover, this is the model whose definition is closest to the characteristics peculiar to SMEs, such as small size, centralized management, low degree of specialization, an intuitive or informal strategy, and a system of internal and external information that is uncomplicated or little organized (Julien, 1997).

According to the specificities of each of the models presented in Figure 2, IT can offer support and business solutions to the SMEs that wish to centre their development on innovation and/or on internationalization. For "local" SMEs, access to the Internet could help them find information, allowing them to improve a product or process, for example.

### **Figure 2**

Across the industrialized world over the past few years, several initiatives involving IT and e-business have been put forward in order to support and accelerate local and regional development (EuroCom, 2002) in spite of the economic slowdown that has recently hit the IT sector. The world over, enterprises and governments have taken advantage of the Internet to improve their productivity. Thus, governments of some countries have advanced several projects in order to follow suit, while in other countries projects have emerged from the grassroots: various stakeholders or socioeconomic partners have encouraged small enterprises to adopt IT and e-business. Several local or regional electronic portals have seen the light of day, and electronic markets have been proposed as well (see the Appendix for examples in the United Kingdom and in France).

A study on the impact of the Internet carried out by the *Canadian e-Business Initiative* (CeBI, 2003) compares Canada favourably to the United States and the European Union on matters of e-business adoption by SMEs. Thus, Canada finds itself first in certain key areas like e-government. Half of Canadian SMEs (50.2%) utilize e-business or are in the process of setting it up, while 20.3% plan to adopt it over the next three years. However, more than one fourth of the SMEs (28.4%) have no intention of adopting these technologies, these firms thus running the risk of being kept out of integrated global supply chains. Maintaining the competitiveness of the Canadian economy is a matter of accelerated adoption by SMEs of these technologies (Jopko et al., 2001). Thus, it is important to clearly understand the situation of SMEs in order to provide them with adequate support in their growth and economic development, and to offer them programs designed to promote their adoption of IT in general, and e-business in particular. Why

do many SMEs not adopt e-business? As a consequence, are there promising e-business adoption initiatives that can provide for the growth and development of SMEs in the context of local and regional development.

### **3. Obstacles to the adoption of e-business: initiatives and programs**

A number of studies have identified the obstacles that the SMEs encounter when they wish to adopt e-business (e.g., Bégin et al., 2000; ICCE, 2003; Mora-Monge et al., 2001; Poussart, 2002; TableRonde, 2001; Terry, 1999). In short, the obstacles most often noted involved security and confidentiality, the absence of an adequate business model and of a business plan, a negative perception of e-business technologies among owner-managers, the weak enthusiasm of customers and suppliers to utilize e-business, the legal questions, the inaccessibility of a wideband network infrastructure, the lack of e-business skills and know-how, little or no qualified human resources as well as the lack of appropriate technologies, the high cost and the uncertainty in the return on investment, access to financing, the high level of competition, a product or a service not adapted to e-business, an inadequate organizational structure, the complexity of product delivery as well as all the cultural and linguistic barriers that can be added to this list.

The adoption of e-business by SMEs in any region of the world thus constitutes a sizeable challenge. A variety of programs and initiatives have been introduced in order to overcome these obstacles, as much for the SMEs as for the stakeholders of local and regional development. These initiatives were analyzed and grouped according to different criteria. Clearly, certain initiatives were difficult to categorize explicitly given their polymorphous character. Examples of initiatives that captured our attention stem mainly from governmental organizations, such as in the United Kingdom with portals for SMEs such as Merseyworld ([www.merseyworld.com](http://www.merseyworld.com)), or in France with the Nord-Pas-de-Calais region ([www.decllic.net](http://www.decllic.net)). Figure 2 sets out initiatives brought to light in the preceding summary, using the four SME business models previously described. Thus, certain programs like *Trade UK* or *First Steps Workshop* are intended more for "exporting" SME. Others such as *Netherlands goes Digital* are aimed at "local" SMEs., whereas "exporting" SMEs find valuable assistance thanks to efforts such *Exportool* and *Passeport-Export*..

Our objective is not to analyze the initiatives in terms of their success or lack of it, but rather to highlight the importance that the various political and economic stakeholders grant them. Consequently, a new model was developed that presents a logical progression to follow by SMEs having at first little understanding of IT and e-business, leading eventually to a complete integration of all business possibilities made available by these technologies. This model also takes into account the factors that influence the development of regional SMEs, as previously identified in Figure 1.

This progression is made up of four main stages that characterize previous and current initiatives of local and regional development through e-business:

1. Alert enterprises to networking and to e-business; it is a matter of helping SMEs discover the advantages of e-business through information. Public organizations develop or introduce policies intended for the economic stakeholders of the region. Such initiatives are of a very general nature, since they aim "very wide."

2. Develop an environment favourable to the utilization of IT when enterprises are created. This involves the introduction of programs to stimulate the economy through the development of new enterprises. The Crossroads of the New Economy (CNE) program is one example. Once again, it is a matter of general initiatives targeting all enterprises.
3. Assist the development of enterprises and their projects through programs of support, financial help, etc.
4. Develop networking with the idea of making it possible for enterprises to do business among themselves. This initiative is at once individual and collective. Indeed, the needs of networking are peculiar to each enterprise.

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**Figure 3**

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The outcome of the application of this model is a contribution to local and regional development. Indeed, for a given region or territory (the Mauricie region of Quebec, in our case), the more SMEs integrate IT-enabled processes within the scope of their business activities, and the more they can contribute to the economic development of the region.

#### **4. Research methodology**

The unit of analysis is the Quebec SME, and the sample consists of SMEs of the Mauricie region (Moreau et al., 2004). The region is especially dependent on the pulp and paper industry, but this sector has been slowing down for about 15 years. In addition, qualified human resources are not available in certain sectors, and the entrepreneurial culture is weak when compared to other Quebec regions such as the Beauce region (Julien, 1997). However, for the past two years, the Mauricie region has been experiencing an economic restructuring that should result in the creation of several SMEs, including some in high technology. Nonetheless, the evolution of this region, both cultural and social, takes place at a slow pace. The Mauricie region is not a "silicon valley", but perhaps IT and e-business can provide it advantages, and thus support it in its local and regional development.

Our approach, an exploratory field study, was carried out by means of a telephone survey. Two focus groups were also conducted. The principal objective of the study is the analysis of the needs of SMEs so as to facilitate adoption of IT and e-business in a perspective of local and regional development. The survey included 34 questions dealing with networks and partnerships, technologies and e-business practices, programs for developing e-business and incentive measures for SMEs, and the development of the Mauricie region. Given the exhaustive nature of the questionnaire (duration of the interview between 30 and 45 minutes), a small but representative sample of 56 SMEs was selected in all sectors of activity as identified and segmented by Statistics Canada. Among these respondents, 31 SMEs were located in an urban environment versus 25 in a rural environment, with 13 in the manufacturing/technology sector and the 42 others in trade and distribution. As far as the two focus groups are concerned, the first one was made up of 13 stakeholders in the region's development (associated to different public and semi-public agencies and organizations), and whose role is directly linked to SMEs. The second group was made up of 12 entrepreneurs from different industries.

## **5. Analysis of the results**

The results of our survey and of the two focus groups will be presented in three parts: networking, the region's infrastructure, and the adoption of e-business by the SMEs.

### **5.1 Networking in the Mauricie region**

As far as networking between SMEs of the Mauricie region is concerned, most have no collaborative relations between them. The SMEs do not perceive the benefits that they can draw from networking. Yet, 65% of these SMEs are members of an association, a group, or a social network. On the other hand, little time is devoted to these networks; entrepreneurs generally consider that these groupings cannot help them settle their problems. Moreover, 74% of SMEs do not wish to join a new network, whether electronic or not.

Entrepreneurs believe that IT, and networks supported by IT, are useful only for certain sectors and for very specific products and services. Moreover, they believe that networks and partnerships should be used to attract new enterprises to the region. In addition, they admit that only specific projects can be carried out by networking SMEs. They are well aware that IT can reduce problems involving distance, but face to face communication remains one of the most crucial activities in business for them. Only 7% of the SMEs utilize one or several portals available to them, whereas 20% do business with their suppliers by this means of electronic communication. Generally, they are uncomfortable with the idea of sharing information by means of an electronic network.

There is still no established business practice concerning the collection of information and its management on the Internet. Moreover, there does not yet exist well-known "success stories" on the use of e-business by the milieu that would have a positive effect on other SMEs. The managers mainly relate setbacks related to IT adoption. Thus, the SMEs of the Mauricie region have not yet adopted new network practices and new business practices. They experience a lack of training concerning the new IT. Returning to Figure 1, these factors of training, information, and networking constitute a very important obstacle to the birth of the new economy in the region.

As a whole, the region is characterized by a weak networking culture. These results confirm those of Julien et al. (2001). In addition, the support for the SMEs by the stakeholders in local and regional development is fragmentary and lacks coordination. Few of these stakeholders employ IT to establish or facilitate networking activities between themselves and the SMEs of the region.

### **5.2 Technological and social infrastructure of the Mauricie region**

First, entrepreneurs and other stakeholders in local and regional development agree on the fact that one of the major obstacles to the adoption of e-business is access to a wideband (high-speed) Internet connection. At the present time, this access is possible on only a small portion of the territory of the Mauricie region (urban SMEs). However, a collective project of public and private participants is setting up this infrastructure in the region. The enthusiasm of regional SMEs for this project has not yet been confirmed.

Second, other technological infrastructure needs, such as service providers for electronic commerce Web sites, have been voiced. Other entrepreneurs speak of a shortage of qualified human resources specialized in IT and e-business. Only a third of SMEs in the region have access to a high-speed Internet connection. Essentially, an insufficient technological infrastructure characterises the Mauricie region. Local and regional IT service providers in regard to Web sites and e-business applications are rather rare and under-staffed.

### **5.3 Adoption of e-business by the SMEs in the Mauricie region**

In our sample of 56 SMEs, 29% utilize the electronic data interchange (EDI) with at least one supplier. The Internet is utilized by 57% of the SMEs to exchange information with suppliers, 71% with clients, 49% with financial institutions, and 44% with at least one level of government. Whereas only 11% of the SMEs are familiar with a government program to assist them in adopting e-business or e-commerce tools. Note that the technologies most often utilized to communicate with suppliers, clients, and governments remain the telephone and the fax machine.

Web sites are 95% informational, while 42% allow visitors to order on line and 21% offer the possibility of on-line payment. Interestingly, 89% of the SMEs know that the Internet provides economic and social benefits to enterprises in general, but only 62% of them believe that this would be true in their case. Many entrepreneurs do not see the urgency in adopting e-business tools because they consider the Internet as not being secure enough and as intruding too much in the privacy of individuals and the confidentiality of enterprises. Several have a negative opinion of e-business because of Internet "horror stories" experienced by certain enterprises and reported in the media.

Another important element for entrepreneurs is that they sense a lack of training and understanding of e-business practices and tools. They doubt that these tools are very appropriate for their own products or services. Moreover, they feel unable to face a major growth in sales because they lack the added investment capacity. Several wonder about the return on investment of an e-business project. They are also conscious of the fact that adopting e-business will force them to reengineer their business processes, and therefore are not necessarily ready for such a leap.

In short, SMEs in the Mauricie region are characterized by weak integration of IT and e-business in their business models. Other factors that have negative effects include the fact that few SMEs in the region have experienced success in using e-business (few "success stories"), limited access to a high-speed Internet connection, insufficient training and knowledge about IT and e-business, and the absence of an IT culture and a networking tradition among SMEs.

## **6. Promising initiatives and conclusion**

One way of promoting and supporting local and regional development in the Mauricie region is to introduce initial conditions that would help the SMEs become more productive and competitive in the new knowledge-based economy. The results of the survey and of the focus groups show that the adoption of IT and e-business by SMEs of the Mauricie region will not happen overnight. These enterprises will not be able to join the new economy if they do not acquire the necessary means. These means can be summarized under three central themes:

networking, technological and human resource infrastructure, and training in IT and in e-business.

First, an improvement in networking should allow SMEs to share information and knowledge. They would cooperate and create collective resources and skills. As for the other stakeholders in local and regional development such as public agencies, they would collaborate in a more effective and integrated manner in order to better respond to the needs of SMEs. Thus, they will contribute to the creation of a regional dynamism that will make it possible to promote development and entrepreneurship in the region.

Second, an improved technological and human resource infrastructure should permit SMEs easy access to a high-speed Internet network anywhere in the region. The stakeholders in local and regional development will collaborate with the management of SMEs in order to attract qualified human resources, i.e., individual that have specialized IT and e-business expertise. Moreover, these stakeholders would imagine ways of attracting and convincing entrepreneurs and employees to settle in the Mauricie region.

Third, training in IT and in e-business should allow entrepreneurs to adopt a positive attitude, open and proactive, to the integration of IT in their business processes. For this to happen, varied training and information activities via networks (including e-learning) would allow entrepreneurs to acquire a better understanding of the business practices in the new economy. Such training and information activities would include strategic and technological dimensions of e-business, including new business models and infrastructures. The SMEs would have easy access to adequate means of communication (including e-conferencing and e-collaboration) and rich information (including e-business intelligence). In addition, they would be able to maintain their existing markets and be favourably positioned to compete for new ones.

As shown in the model presented in Figure 3, several promising initiatives can be proposed that would make it possible to respond to the needs of SMEs and of other stakeholders in the region's development in matters of e-business awareness, training, and networking. The initiative proposed here is the development of a portal for the collective appropriation of electronic business in the Mauricie region. Figure 4 is a display of the portal prototype's home page.

This proposed portal prototype responds to the needs expressed by the region's entrepreneurs and development stakeholders, and fits on the region's characteristics in terms of infrastructure and networking. The objective of the portal is to propose a helpful tool permitting both SMEs and local or regional development agencies to find answers to the problems of training, networking, and human resources in IT and e-business. Moreover, the solution proposed is realizable within a reasonable time-frame in that it does not target all SMEs but specific strategically important sectors or industries that have been identified as actual or potential strengths for the region.

#### **Figure 4**

While such an initiative may be promoted from the top, it must be requested, accepted and assimilated and requested by the grassroots, i.e., the SMEs. As well, this solution should allow a maximum utilization of networks and IT as facilitating tools. In addition, a wise selection of credible participants should be made to assume leadership of the project and see to the

promotion, development, implementation, and evaluation of the proposed initiative. Finally, success factors of this initiative include the engagement and participation of various stakeholders as well as the financial support of the milieu and governmental authorities.

Can the creation of this portal introduce the idea of a met@-network, that is, a regional virtual space of learning management, exchanges, and co-construction of knowledge? The networks set up by SMEs and the regional stakeholders can be seen as extremely rich reservoirs of explicit and tacit learning that remain badly exploited at present (Julien et al., 2003). With the potential offered by IT and e-business, would it be possible to increase the region's intellectual capital and make it accessible in real time to all the members of the met@-network? And how could we persuade members of this met@-network to join in virtual collective processes of co-construction of knowledge in view of the accelerating pressures on SMEs in regard to globalization? These are questions that call for further research on the potential of IT and e-business to enable the strategic development of SMEs and their region, that is, their market development (internationalisation), product development (innovation), and network development. (social and intellectual capital).

### **Acknowledgements**

The authors wish to thank Professor Sylvain Delisle and the research assistants who participated in this project: Caroline Jacob, Claudia Pelletier, Claudia St-Pierre, Jean-Gabriel LeSauteur, and William Menvielle. We also wish to express our gratitude to the Centre francophone d'informatisation des organisations ([www.cefr.io.qc.ca](http://www.cefr.io.qc.ca)) for its financial support.

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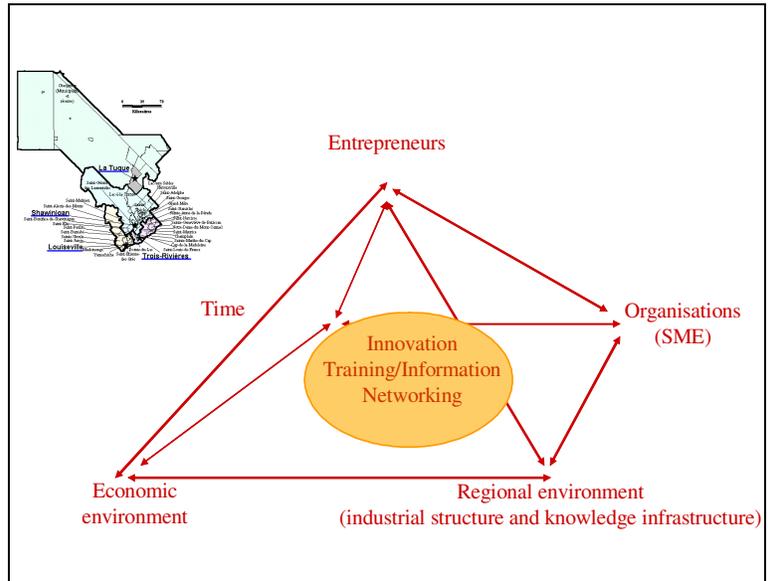
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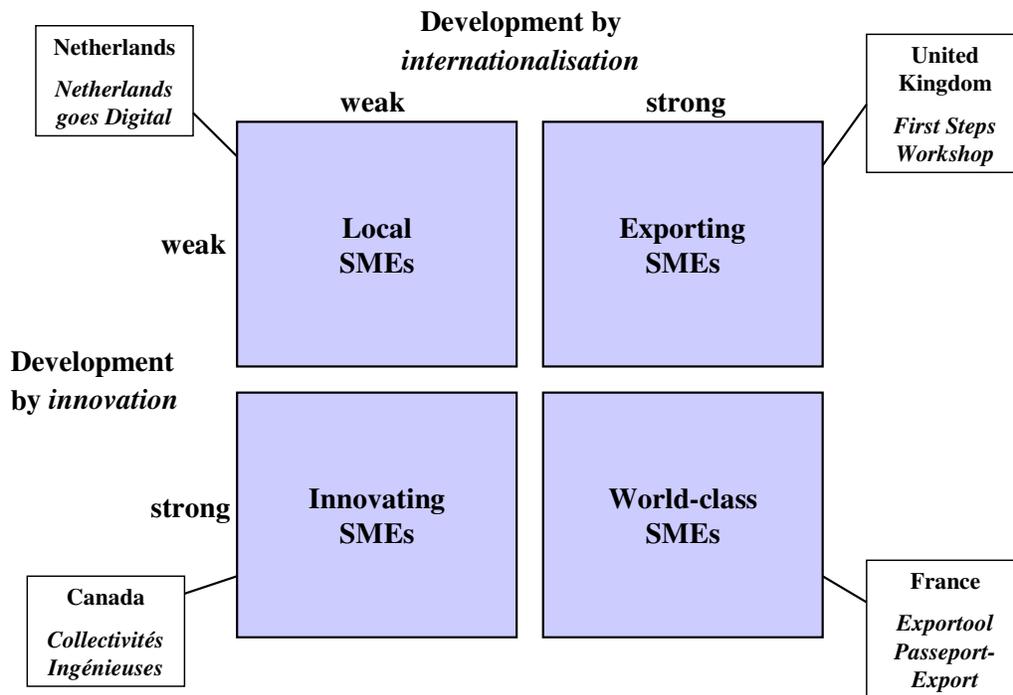
## Appendix: Examples of e-business development initiatives

| Coutry, region, name and Web site of the initiative                               | Objectives  | Sector of activity | Actors at the origin of the initiative  | Target         | Category                          |
|---|---|--------------------|---|----------------|-----------------------------------|
| United Kingdom<br>Wales<br>Opportunity Wales<br>www.opportunitywales.co.uk        | <ul style="list-style-type: none"> <li>• Render SMEs aware of e-business opportunities</li> <li>• Induce SMEs to use e-business</li> <li>• Mesuring e-business impacts</li> </ul> | All                | Universities, Welsh labour unions, British Telecom, HSBC Bank                               | SMEs           | Networking support                |
| United Kingdom<br>Scotland<br>First Steps Workshop<br>www.scottish-enterprise.com | <ul style="list-style-type: none"> <li>• E-business counselling</li> <li>• E-business training</li> </ul>   | All                | Scottish business development agency  | Exporting SMEs | E-business awareness and training |
| France<br>Rhône-Alpes<br>Achatville<br>www.achatville.com                         | <ul style="list-style-type: none"> <li>• Evaluate ICT consequences</li> <li>• Adapt technological tools appropriate for retailers</li> </ul>                                      | Retailing          | Chamber of commerce, Rhône-Alpes region, city of Grenoble, Caisse d'Épargne                 | Local SMEs     | Portal for SMEs                   |
| France<br>Nord-Pas-de-Calais<br>Décllic<br>www.decllic.net                        | <ul style="list-style-type: none"> <li>• Business intelligence</li> <li>• Promotion</li> <li>• Information exchange</li> <li>• Support e-business development in SMEs</li> </ul>  | All                | Regional and departmental governments , DRIRE, chambers of commerce and private enterprises | SMEs           | Portal for SMEs                   |

**Figure 1: The development of SMEs in the new economy**



**Figure 2: SME business models and E-business initiatives**



Source : adapted from St-Pierre, Audet and Mathieu (2003)

**Figure 3: Model of SME development initiatives involving e-business**

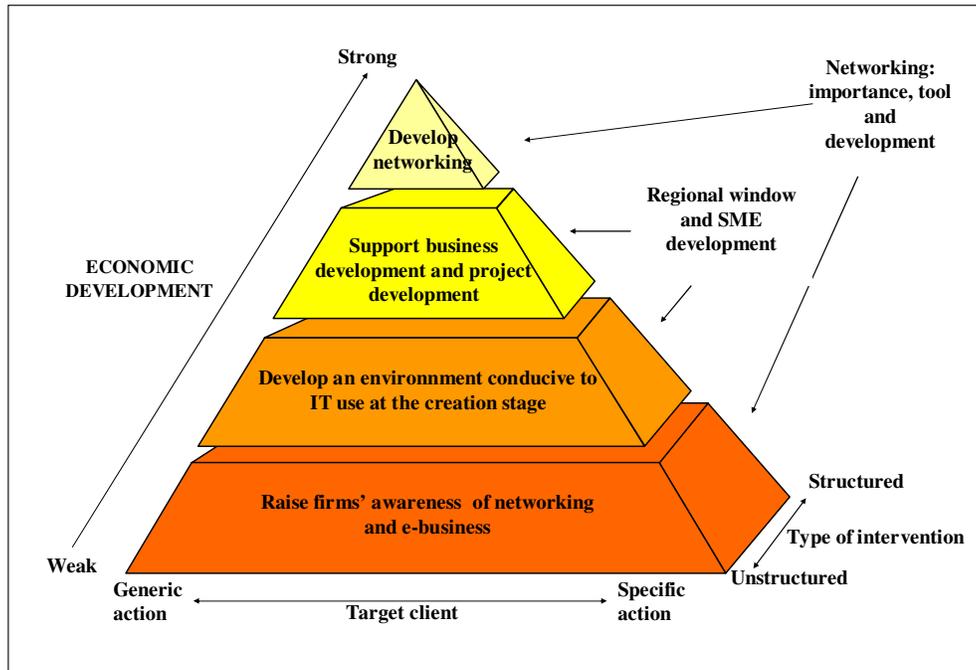


Figure 4: Home page of portal prototype

The screenshot shows the home page of a portal prototype. At the top, there is a navigation menu with links: Accueil, Mission et Partenaires, Informations, Glossaire, Contactez nous, and Recherche. Below the menu is a search bar. The main heading reads "La communauté des Affaires Électroniques en Mauricie".

The central part of the page features a map of the Mauricie region. Various actors and SMEs are marked on the map with icons and labels: C3e Technologies, CLD Les Chenaux, GDG Environnement Ltée, Municipalité de Trois-Rivières, Meubles EG, Infotek Centre de l'ordinateur, Carrefour virtuel de la mauricie, Claude Noël Consultants, CRDM - Conseil régional de développement de la Mauricie, Municipalité de Shawinigan, CIVAM, Mégatech Électro Inc., Technopole Vallée-du-Saint-Maurice, Autobus 2001, CLD de Maskinongé, and Sogi Informatique. A legend below the map identifies the icons for "Acteurs" and "PME".

On the left side, there are three main sections:
 

- PME**: Includes "Développement de la PME" (Introduction aux affaires électroniques, Formations, Meilleures Pratiques, Ressources pour passer à l'action, Veille sur les affaires électroniques, Veille stratégique) and "Réseautage" (Tableau de bord de la Mauricie, Contacts).
- Vitrine Régionale**: Includes "Portrait de la Mauricie", "Cas succès de PME en affaires électroniques", and "Municipalités".

On the right side, there are two panels:
 

- Filtre**: Contains checkboxes for "Acteurs" and "PME", both of which are checked.
- Actions**: Contains six icons representing different actions: a document, a telephone, a computer monitor, a printer, a mail envelope, and a person with a speech bubble.

At the bottom left, there is a detailed information box for CIVAM:
 

**CIVAM**  
**Adresse:** CIVAM, 121, rang de la Petite Rivière, local 25, Louiseville (Québec), Canada J5V 2H3  
**Téléphone:** (819) 228-0466  
**Télexcopieur:** (819) 228-2399  
**Courriel:** [info@civam.qc.ca](mailto:info@civam.qc.ca)  
**Site web:** <http://www.civam.qc.ca/>

**Do they learn by Doing It?**  
**A Cross-Border Effectiveness Evaluation of Entrepreneurship  
Education Techniques in the United States, Singapore, New  
Zealand and China**

4-Nation Review as Part of the "International Study of Entrepreneurship  
Education" (I SEE) [www.sifeaction.com/survey](http://www.sifeaction.com/survey)

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## **Summary**

We have reviewed an activity-based program with the objective to teach students managerial skills by empowering them to teach entrepreneurship within their communities. The Students in Free Enterprise (SIFE) program brings together executives (who sponsor the program globally), students (from any tertiary school), faculty (to coordinate the student effort) and communities (where the students teach others to perform real projects). Students in the US, Singapore, China and New Zealand report significant learnings from the program, with distinct differences in the benefits reported in the different cultures. Communities report lasting benefits long past the student involvement, and students indicate quality interactions with corporate leaders

## **Background**

Globalisation has resulted in the emergence of a new entrepreneurial economy, bringing two fundamental globalization factors: Firstly, the availability of low cost but highly skilled competition in Central, Eastern Europe and Asia. Secondly, the technology revolution which has reduced the cost of shifting standardized high economic activities out of high cost location like Europe into low cost location elsewhere in the world (Audretsch, D & Thurik, R, 2001). This shift from a managed economy to an entrepreneurial economy has intensified the need and market for entrepreneurial education which produces graduates with practically relevant skill sets. Entrepreneurship education has been identified as a critical factor in preventing future high levels of long term unemployment, and there is evidence of a strong correlation between educational level achieved and high income over a lifetime (De Faoite, D., Henry, C., Johnston, K., Van der Sijde, P., 2003).

The skills and knowledge, as developed through training and education, are one of the few areas where a country can engineer a competitive advantage (Kennedy, 1993), and our interest in this cross-border research is to identify how effectively different nations use a specific entrepreneurship education approach. We hope to be able to identify better and not-so-good performers and speculate as to the reasons why in some Asian countries certain entrepreneurship education techniques are more effective than in others. As suggested by Ulrich (1997), the importance of entrepreneurial education is derived from the importance of the entrepreneur throughout the economic system, and we believe that there remain significant differences in the entrepreneurship

education sector throughout the world, even after the onset of globalization efforts which 'shrink' the world of business. As entrepreneurship educators, our challenge is to identify the most effective means of teaching entrepreneurship principles and techniques, and we hope to describe the relative effectiveness of one technique throughout several countries within the Asia region, and in contrast to other countries throughout the world.

Many global businesses, as well as large national firms in the United States and overseas, utilize access to participants in the Students in Free Enterprise (SIFE) program as an efficient and effective method to identify senior level students with a demonstrated track record of managerial experience, and a background of practically relevant business education (Mueller, J., Wyatt, R., 2005)

SIFE uses the approach to stimulate students to teach entrepreneurship and free market principles within their own communities. This method presumes that the preparation for the teaching, the education itself and the subsequent effectiveness evaluation, in combination, greatly increase the learning effect for the students, and develop project management skills. At the same time, communities benefit through the reality-based application of projects intended to teach the effect of entrepreneurship, teach specific skills and review the outcomes. The SIFE requirements place a heavy emphasis on ethical and sustainable project design and execution, elevating the level of business education to include contemporary themes. Anecdotal evidence from areas where these SIFE teachings have been offered for several years, i.e. teaching poor villagers in Ghana how to use palm fronds to make commercially viable soaps (SIFE, 2004), indicates that these projects have the potential to operate for many years, generating their own profits.

Corporate executives, the sole financial supporters of the more than 1,800 SIFE student teams worldwide, report with a high degree of enthusiasm from their experience as judges at the student competitions, or when discussing their interest to recruit these student-turned-managers. In Singapore, the Managing Director of Korn/Ferry International writes: "We support SIFE because SIFE gives emerging managers the chance to tackle practical management challenges – and to demonstrate their commitment to their communities at the same time" (Chai, 2004). In the United States, KPMG's Vice Chairman Industries writes: "SIFE has a leveraging impact. We are reaching out to the next generation, getting them excited about free enterprise. This is a meaningful, long-term fundamental cause" (Moser, 2005). Personal observations indicate that corporate executives see value in the

interaction among each other, creating a sub-selection of firms with a strong interest in a public commitment to sustainable and ethical enterprise, actively and immediately approach students for recruitment and use their involvement in this program to support their competitive positioning. There appears to be a strong personal commitment of these CEOs and Board Chairmen, to the cause of enabling students to perform managerial work while still at university.

### **Framing of the Issue**

We have surveyed students in China, New Zealand, Singapore and the United States as to their performance and self-perceived outcomes of these intense projects, in which they invested several hundred hours of personal time over the academic year. By reviewing the same project in different countries we hope to eliminate program-specific variables and focus on the net effect of this entrepreneurship education.

### **Methodology**

Students are eligible to participate in SIFE when they are enrolled in a tertiary school, and we have distributed a net-based survey (Appendix A) to students in Australia, Singapore, China and the United States, through their faculty advisors at their universities. A total of 124 replies were collected, with responses from 24 Chinese students, 16 New Zealand students, 72 United States and 12 Singaporean students.

## Study Results

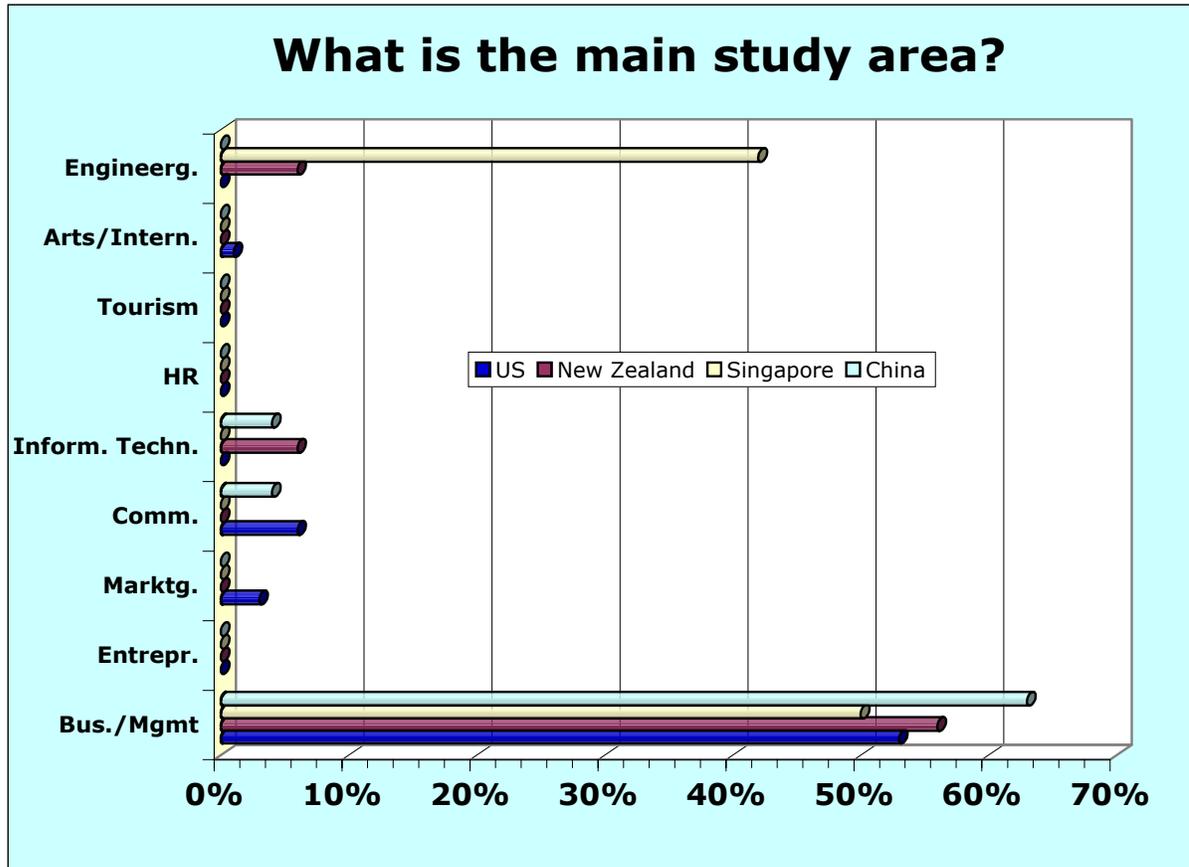


Table 1

With the exception of Singapore, where a significant number of students were from an engineering program, the majority of students were from business and management schools, and related areas, such as Communications and Marketing. One of the objectives of SIFE is to approach students in different disciplines, to broaden the community experience they bring to the program, and it appears that the uptake by non-business students is still slow.

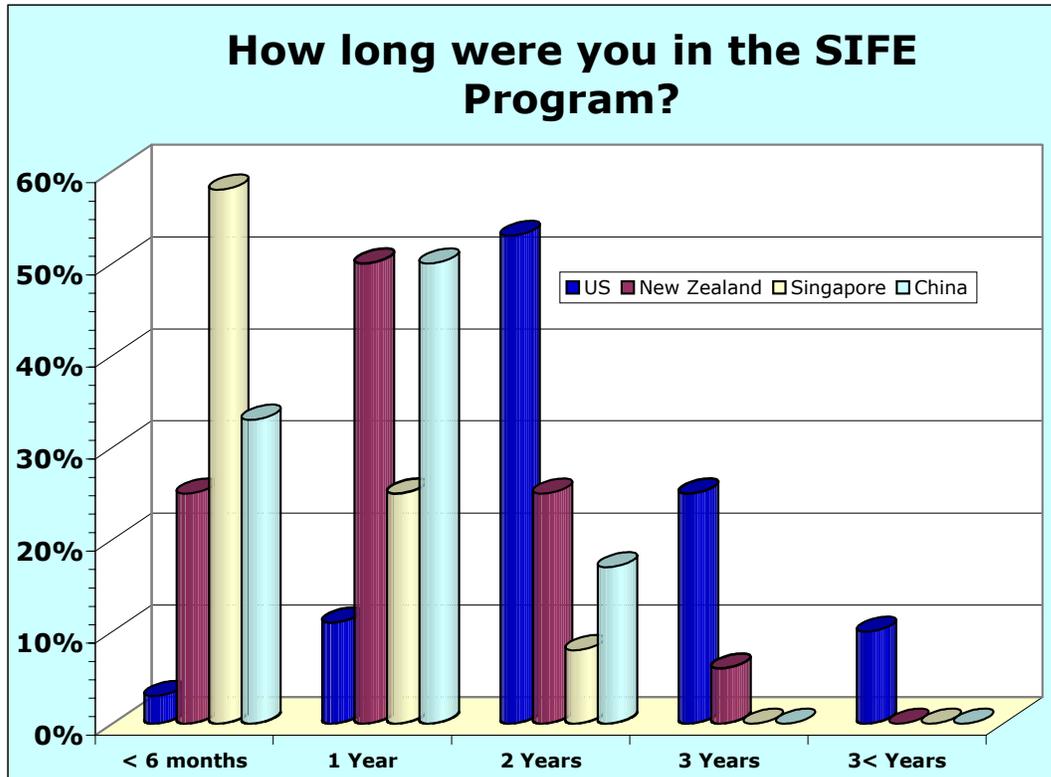


Table 2

While the United States students had been involved with SIFE for several years, not surprising given the program's origin in the US in the 1970s, students in the other countries have had only limited experience, some reporting less than 6 months' exposure (nearly 60% of the Singaporean students). We are therefore even more curious as to the effect the program might have on these students based on their short-term participation. A longer participation period likely would amplify any benefits and allow for internal governance procedure to be established within the SIFE teams, allowing for succession planning and a wider inclusion of students with different backgrounds.

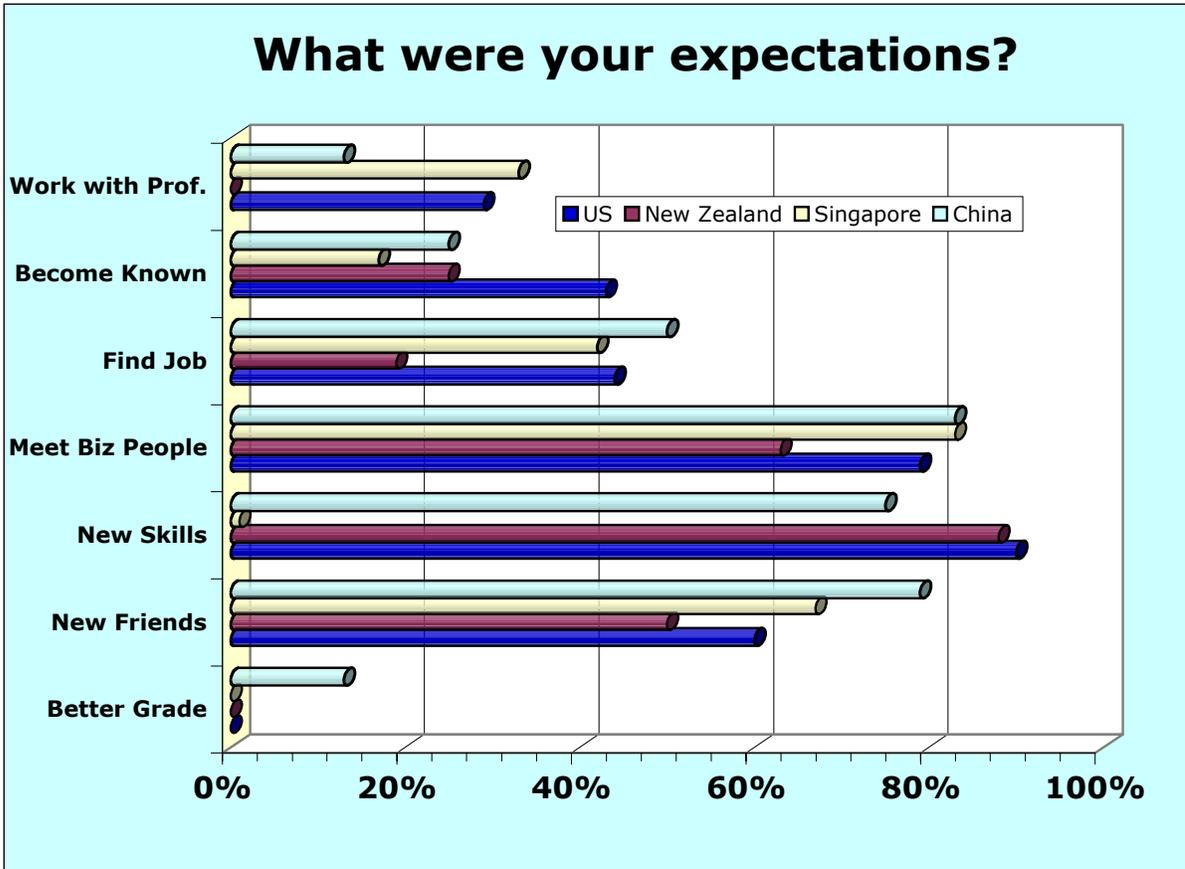


Table 3

Students expected most frequently to learn new skills and to meet business leaders, a universal reply for all four countries. “Making Friends” ranked highly in the Singapore, US and China programs, and to a lesser extent in New Zealand. The expectation of a better academic grade was not a factor in any country, indicating that the students are prepared to engage in significant extra-curricular work in return for networking opportunities and career-positioning. The authors’ first-hand experience, during their part-time work for SIFE, indicates that several SIFE students are hired by sponsoring corporate leaders directly ‘off the stage’. Several other SIFE students are hired following the exposure they get during the national competitions, where executives and their HR managers can interact with students on a more effective basis than during a job interview. These students therefore have a justified expectation that their SIFE participation assists them with their job search, either directly related to a SIFE event, or indirectly through the membership in the program.

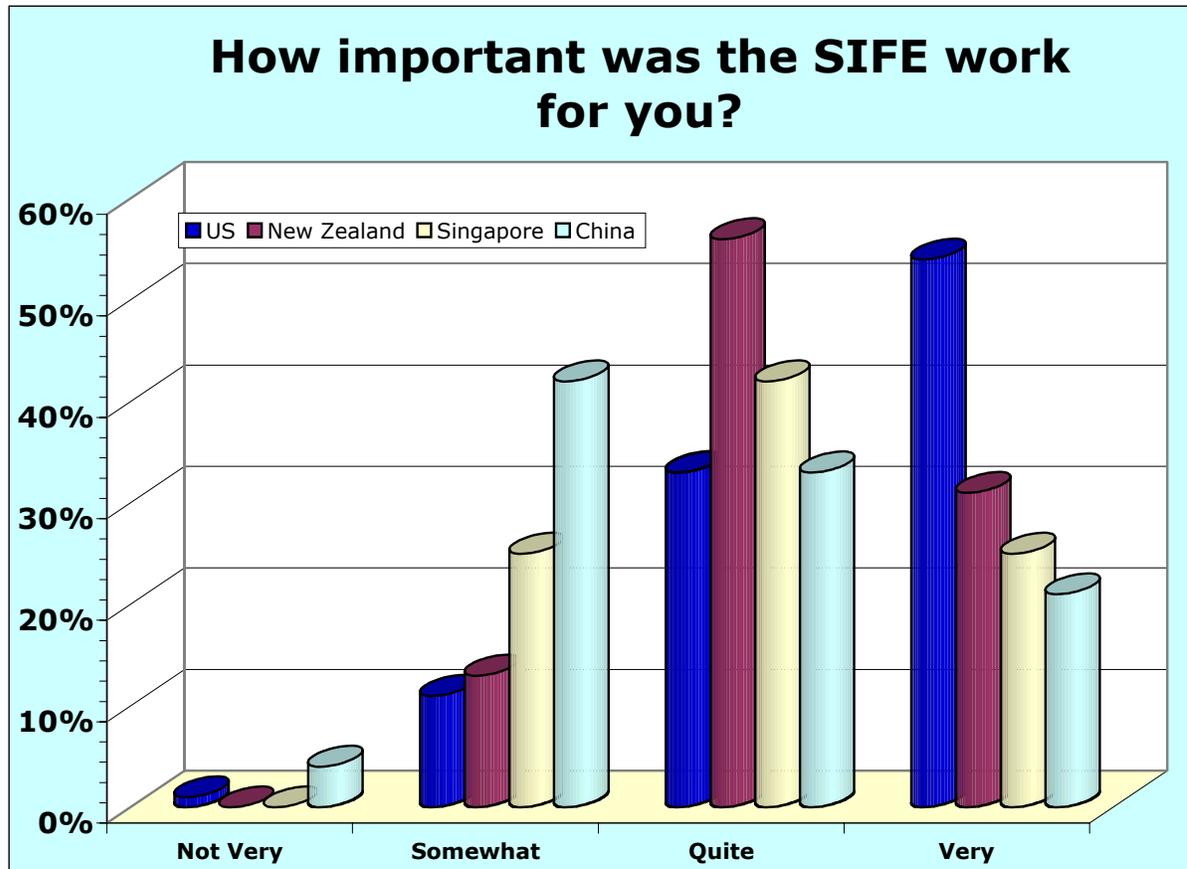


Table 4

The vast majority of students in all countries, led by students in the US and New Zealand (with more than 90% of all replies), indicated the SIFE participation was either “quite” or “very” important to them. This bodes well for their interest in entrepreneurship and community involvement, and confirms that these students have the willingness and resources to engage in practical work outside of the classrooms. With the several hundred hours each SIFE student performs during project work per year, this is an extraordinary commitment by the students.

## What was the effect of your SIFE work on others?

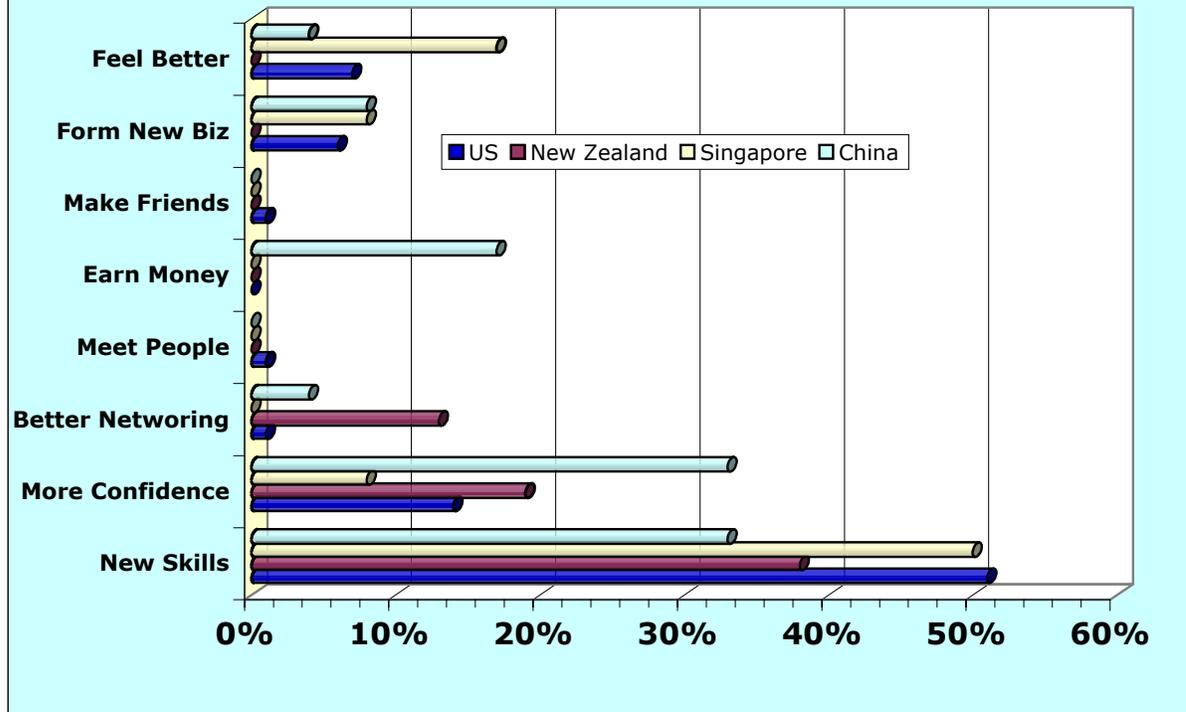


Table 5

With the exception of China, where some 15% of students reported monetary gains for their community clients, the effect on the communities was more intrinsic. Students report to a large extent that they helped build commercial skills during their work, helped increase the confidence level of community members and, in New Zealand, increased the networking abilities of communities. The teaching abilities of the students, building economically relevant skills among third parties, are important for the students' career progression as it demonstrates managerial abilities in project design, implementation, salesmanship and performance evaluation. The China student efforts resulted in a significant income increase for farmers in rural China, where the students recruited the help of multi-national Cargill, to develop a crop rotation scheme which tripled local farming incomes (to appr. \$300/year). To achieve this goal, the Shanghai-based students travelled a total of more than 15,000 railroad miles to visit the farmers several times, to conduct local workshops, educate on the benefits of multiple crop yields, and to monitor the project's progress. The program connected urban students to rural remote communities, demonstrated

the students' effectiveness in promoting a new scheme to a sceptical farming community, and resulted in clear learning results for all parties.

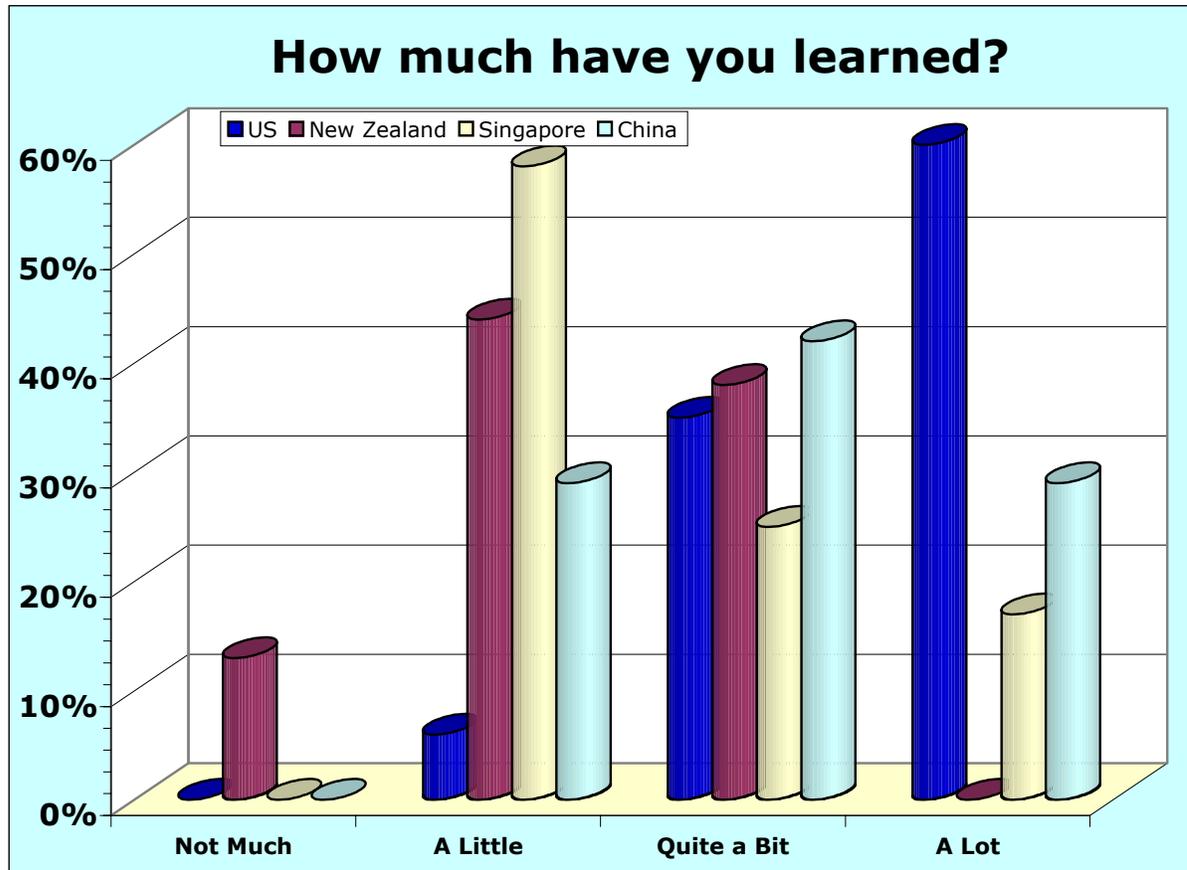


Table 6

As educators we always wonder whether the students actually appreciate the learning we offer at universities. In this case, the vast majority of students admits to "quite a bit" or "a lot" of learning, with only Singaporean and New Zealand students (the newest participants in the program) reporting approximately 50% of "a little" learning. In the United States, where the students were involved in the program for the longest period of time, the learning is indicated at the highest level, answering our earlier question whether longevity in the program deepens the experience. We conclude that it would be advantageous for students to be enrolled early during their academic career so that they have a longer time period during which to actively participate in SIFE, to participate in the community teachings and to interact with corporate leaders and sponsors.

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## **Appendix A**

Please tell us about yourself:

1. How old were you when you joined SIFE?

AGE in years

2. At which university did you join SIFE?

UNIVERSITY Name Here

3. Which campus of the university did you attend?

CAMPUS Name Here

4. Which discipline did you study at university?

Business/Management

Entrepreneurship

Marketing

Communications

Information Technology

Human Resources

Tourism/Hospitality

Arts/International Studies

Engineering

Other DISCIPLINE here:

5. Did you study:

Full-time?

Part-Time?

6. For how long were you a member of SIFE?

1/2 year or less

1 year

2 years

3 years

More than 3 years

7. What year of study were you in, when you joined SIFE?

Undergraduate 1st year

Undergraduate 2nd year

Undergraduate 3rd year

Undergraduate 4th year

Undergraduate 5th year

Masters/PhD Program

Post-Graduate School

8. Did your SIFE team win any awards? Check all that apply

Special Competition

Rookie Award

Regional Winner

Opening Round Runner-Up

Opening Round Winner

Final Round Runner-Up

National Champion

Tell us about your reasons for joining SIFE:

9. How/from whom did you first hear of SIFE?

Lecturer at institution

Institute-wide announcement (bulletin board, internet, etc.)

Fellow student

University Club/Societies Office

SIFE web site (local country or worldwide)

Newspaper, etc.

Business/Corporate contact

OTHER:

10. Why did you join SIFE? (check all that apply)

SIFE was part of a course I took

A friend was in SIFE

I was curious

I wanted contact to potential employers

I wanted to travel to a SIFE competition

I got academic credit for SIFE

It sounded like fun

OTHER reasons:

11. What did you expect from your participation in SIFE? (check all that apply)

A better grade for my course

Making new friends

Learning new skills

Meeting business people

Finding a job

Being known within the university

Working more closely with my lecturer

OTHER expectation:

12. What role did you have in your SIFE team? (check all that apply)

No special role

Chief Executive/Team Leader

Technical Support

Presenter

Project Management

Recruitment

Public Relations

OTHER role:

Tell us about your commitment to SIFE:

13. How many hours did you spend on SIFE each WEEK on average?

Less than 5 hours 6 - 10 hours 11- 20 hours 20 and more hours

14. What importance did your SIFE work have for you?

Not very important

Somewhat important

Quite Important

Very Important

15. Did you have to give up other activities in order to perform your SIFE work?

Yes, gave up some leisure activities.

Yes, gave up some academic activities.

Yes, gave up some of both academic and leisure

No, gave up nothing

Tell us about the outcome of your SIFE work for others:

16. What kind of projects did you do? (check ALL that apply)?

Educating children about business  
Improving the environment  
Teaching adults about business  
Helping existing businesses develop

Helping start new business(es)

Working with Government organizations

Projects outside the country

Projects together with other SIFE teams

OTHER Projects:

17. How many projects did your team do in an average year?

1 2 3 4 5 6 7 8 9 10 11 and more

18. How many people do you estimate your project(s) affected, touched, helped, etc.?

NUMBER of people:

19. How did your work affect the people you taught/dealt with?

They learned new skills

They felt more confident about business

They developed new networks

They met new people

They earned more money

They made new friends

They started a new business

They felt better about themselves

OTHER results:

Tell us about the outcome of your SIFE work for yourself:

20. How much have you learned?

Not much A little Quite a bit A lot

22. Have you developed new skills?

Not much A little Quite a bit A lot

23. Has SIFE participation helped your career?

Not much A little Quite a bit A lot

24. Has SIFE participation helped you with your personal relationships, or your family?

Not much A little Quite a bit A lot

25. To what extent has SIFE participation added to the teaching at your university?

Not much A little Quite a bit A lot

26. How important is it that SIFE participation carry academic credit at your university?

Not much

A little

Quite a bit

A lot

Please share some reflective thoughts with us:

27. How well were your expectations met?

My expectations were NOT met

SOMEWHAT met

Met to a LARGE EXTENT

My expectations were EXCEEDED

28. If your expectations were NOT met, why not?

29. If you could made 3 changes to the SIFE program, what would they be?

30. Which 3 statements would you use to recruit a new student to SIFE?

***OWNERSHIP STRUCTURE AND BUSINESS EVALUATION***  
***PRACTICES IN FAMILY SMEs: EVIDENCE FROM***  
***EMPIRICAL RESEARCH IN ITALY.***

*Donata Mussolino – Amedeo Pugliese – Riccardo Viganò*

*University of Naples “Federico II”<sup>1</sup>*

**Abstract**

This paper presents early results from a pilot project which aims to investigate the relationship between proprietary structure of small and medium- sized Italian family firms and their owners’ orientation towards a “business evaluation process”.

Evidence from many studies point out the importance of family business in a worldwide economic environment: in Italy 93% of the businesses are represented by family firms; 98% of them have less than 50 employees (Italian Association of Family Firms, 2004) so we judged family SMEs as a relevant field of investigation.

In this study we assume a broad definition of family business as “a firm whose control (50% of shares or voting rights) is closely held by the members of the same family” (Corbetta, 1995).

“Business evaluation process” is intended here both as “continuous evaluation process” (which is the expression of a well developed managerial attitude) or as an “immediate

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valuation” (i.e. in the case of new shareholder’s entrance, share exchange among siblings, etc).

We set two hypotheses to be tested in this paper: the first is “quantitative” and aims to verify whether the number of owners (independent variable) in a family firm is positively correlated to the business evaluation process.

If a family firm is led by only one subject, it is more likely that personal values, culture and feelings may affect his choices more than “purely economic opportunities”; so there is less concern about monitoring economic performance or about the economic value of the firm. As the shareholders’ number increases, economic aspects in managing the firm grow in importance over the personal values and "value orientation" acquires a central role.

The second hypothesis investigates if and to what extent the presence of “non- family members” among the owners affects their orientation to the business evaluation process.

The “Cramer’s V” test has been used to test the hypotheses; both were not confirmed from these early results; next steps will lead to make an inferential analysis on a representative sample of the population.

### **Introduction and theoretical assumptions.**

This research investigates the relationship between ownership structure of family small and medium enterprises (SMEs) and their owners’ attitude towards the firm’s evaluation process. Below we present some results from a pilot project of an ongoing empirical analysis in the Italian context.

Evidence from many studies point out the importance of family business in a worldwide economic environment: according to a joint survey led by the Bank of Italy and the Italian Association of Family Firms (AIdAF), family firms represent the 93% of total firms and 98%

of the workforce in manufacturing companies fewer than 50 employees in Italy (Bank of Italy, 2004). Relevance of family firms is combined with importance of small and medium-size firms. Most small and medium firms are family owned and account for a significant portion of the Italian economy: small and medium-size firms employ 93% of the workforce and represent over 99% of total companies, according to the national Institute of Statistics (ISTAT, 1991).

The ownership structure of family firms has been widely investigated in two different fields: *Corporate Governance* and *Family Business*. Distinctions between alternative forms of ownership (family business versus non family business) have been a viable assumption for many researchers; they consider it a “discrete determination” (Astrachan, Klein & Smyrnios, 2001) since their interest has been to define a “continuum spectrum” which goes from the “entrepreneurial business” to “professionalized firms” in order to exploit the differences between family and non family firms (Daily & Thompson, 1994).

Since the leading idea is that ownership typology conditions firm processes, outcomes and value, many researchers disagreed as to whether, and to what extent, there are differences between family and non family firms. On this point academic literature is not unanimous.

While Gudmundson, Hartman & Tower (1999) found no difference in strategic orientation and behaviour between family and non family firms (Daily & Thompson, 1994), Ward (1988) states that strategic planning processes in family business significantly differ from non family business, also assuming it remains necessary to manage the firm.

Ownership structure has also been tested to assess whether family firms perform better or not than non family firms (Gallo, Tapies & Cappuyns, 2000); accordingly, a few studies suggest that family ownership per se does not create or destroy value (Villalonga & Amit, 2004), alleviating simply the conflict of interests between owners and management (Berle & Means, 1932).

When the focus switches to family firms alone, researchers define the ownership configuration according to the different phases they (FB) pass through, each with challenges and characteristics (Ward, 2001). As the interaction of business and family life-cycle with owners' decisions changes, it determines the shareholders' composition. It varies through six different phases from entrepreneurial to collaboration and family syndacate.

We found little evidence as regards the relationship between ownership configuration and the "business evaluation process".

The F- Pec scale (Astrachan, Klein & Smyrniotis, 2001) defines the "ownership configuration" as one of the most influencing determinants for the "power level" of the family over the firm; it increasingly affects family involvement (Astrachan & Shanker, 1996) as the overlap of family, ownership and management groups grows within the firm (Davis & Tagiuri, 1999).

If on the one hand the level of family involvement is determined by the ownership configuration, on the other it strongly influences the system of values (or the values themselves), aims and objectives of the firm itself; since the firm is seen as an instrument to reach owners' objectives (Ferrero, 1987) these may vary across people and time, taking shape diversely from firm to firm. Emotional attachment to family firm ownership may detract from the firm's focus on economic goals; thus a typical family firm violates almost all the underlying assumptions of traditional governance theories (Mustakallio, Autio & Zhara, 2002).

At the same time the "shareholder value approach" (Fernandez, 2001) and "shareholder value maximization" (Copeland, Koller & Murrin, 1996) cannot be fully applied to the family business model; owners' expectations and objectives rely upon a personal system of values which could overwhelm the economic and financial perspective. Existing duality between economic and non-economic goals help us to define "value assessment" within the family

firm: private benefits and “amenity (potentials)” are a relevant part of the whole value configuration (Demsetz & Lehn, 1983).

Hence interest towards economic value assessment varies through the different scales of family involvement over the firm: the “family effect” seems to be inversely correlated to the “purely economic goals”; as a consequence, owners are less concerned with monitoring economic aspects while running the firm.

Literature about firm value and evaluation process focuses mostly on the several objectives of firm value assessment and its evaluation techniques; a common concern is that business evaluation is essential for the decision making process and management of all firms.

There are two main approaches when considering the firm’s value assessment: the first one is immediate, evaluation occurs either with an extraordinary transaction (such as merger, share exchange, acquisition, shareholder’s exit and entrance, split, etc..) or during a succession phase; the second approach is systematic and it emerges as a recurrent performance evaluation, intentional strategy and investment project (Viganò R., 2001).

### **Hypotheses formulation**

We set two hypotheses to be tested in this paper as regards the influence of the ownership structure of family firms over the family- owners’ attitude towards economic appraisal.

Shareholders’ composition may modify the extent of the “family effect” over the firm; as family involvement grows, the more likely it is that private benefits and non- economic goals will gain importance over the pure economic goals: family- owners have little (or no) interest in monitoring the value of the firm when approaching strategic decisions.

If a family firm is led by only one subject (ownership configuration), it is more likely that personal values, culture and feelings may affect (family involvement) his choices more than

“purely economic opportunities” (value assessment); thus there is less concern about monitoring economic performance or the total value of the firm. As the number of subjects increases, even if they are still family members, social interaction decreases (Mustakallio, Autio & Zhara; 2002) and economic aspects in managing the firm gain more importance than personal values: monitoring the "value creation" gains a central role.

---

Insert figure 1 about here

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*H<sub>p</sub> 1: in family firms there is a positive correlation between the number of shareholders and their attitude towards a firm evaluation process.*

The second hypothesis investigates a more “qualitative” aspect about the structure of the family firm; it examines whether the presence of “non- family members” among the owners may affect their leaning towards the business evaluation process.

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Insert figure 2 about here

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*H<sub>p</sub> 2: in family firms, the presence of non- family members among the shareholders increases the owners’ attitude towards a firm evaluation process.*

We expected both hypotheses to be confirmed; hypothesis 1 will be verified if “Cramer’s V” test is significantly far from zero (approximately around 0.6), while hypothesis 2 will be confirmed in case the test- value is higher than the other.

## **Methods**

Below we present results from a pilot project carried out between July and December 2004 on a group of Small and Medium Family Businesses.

As no official database exists for Family Enterprises in Italy, we lack information on the real size and the main features of such a group of firms. The survey has been led through a web-questionnaire, emailed to 1.105 companies chosen from the databases of the “Entrepreneurial Association” of Naples and Milan; a cover letter from the Association they belong to was gone ahead the questionnaires.

A total of 120 completed questionnaires were returned, with a response rate of 10,9 %.

The final sample is of 88 firms as we erased non- family firms, large corporations and incomplete or incorrect answers.

### *Definition of family firm.*

In this study we assume a broad definition of family business as “a firm whose control (50%+1 of shares or voting rights) is closely held by the members of the same family”.

Whenever a firm is owned by only one subject, we considered it as a family firm only when at least another family member is involved in the enterprise activities. In our final sample, we identified family firms crossing the questions about the percentage of capital (rights to vote) owned by one family, with the presence of family members among the employees -managers.

### *Definition of SMEs.*

We consider as “small or medium firm” an enterprise whose turnover is less than 50 million of euros per year, and if it employs less than 100 people in one year. Two questions are set up to meet those parameters: turnover ranges across nine different levels, from less than 2,7

million up to more than 1.000 million of euros per year; employees' average number per year varies across six different levels, from "less than 20" to "more than 1.000".

*Questionnaire overview.*

The questionnaire is structured and semi- closed; it was addressed to owners, managers or members of the board. They were asked to fill in all the three parts according to the instructions.

- Section A (5 items) is addressed to the person him/herself: it defines the respondent's profile in terms of position, tenure, ownership, relation to founder (if existing), sex and age.
- Section B (12 items) deals with the firm's profile in terms of age, generation, (involvement) in a succession process, geographical location, core business, legal organization, sales performance, number of employees, industry and business growth rate, ownership structure in terms of shareholders' concentration and number of non family members among the owners.
- Section C (8 items) focuses on the business evaluation process: first they were asked whether the firm has ever been evaluated. Should the answer be positive, they also specify 1) on which occasions they took this step (multiple choices depict all the different objectives in a firm evaluation process: selling off the activity, shares exchange among siblings, mergers & acquisition, financing, succession or performance assessment); 2) frequency of the evaluation process (if it is a one- off or recurrent); 3) who leads the value assessment (consultants, managers, owners); 4) the evaluation techniques and if "family discount rates" were applied. Should the answer be negative, respondents are asked if they have any interest in knowing the firm value, and if they perceive any advantages or disadvantages in ignoring it. The last question concerns the presence of a "Family Pact" or if, in some ways, a succession process has been planned.

*Measuring the two investigated variables.*

“Ownership structure” is intended here simply as the shareholders’ composition; in order to define this variable through all firms, we set up three specific items about the following issues: i) how many owners the firm has; ii) the percentage of shares owned by a single family; iii) the presence of non family members among the owners.

When assessing the variable “firm evaluation process”, we investigated three specific items:

1. the first uses a “binary variable” on responses to the question concerning whether the firm has ever been evaluated or not;
2. the second item investigates the objectives of the firm appraisal: it might occur “external and occasional circumstances” (selling off entirely or partially the firm, share exchange, etc.), or during a “firm’s performance measurement”;
3. the third aspect raises the question about the frequency of the evaluation process, if it is an “immediate evaluation” or a continuous (periodic) one.

The two variables have been crossed in a double entry matrix according to a “bivariate analysis model”; hence we obtained the total frequencies for the investigated relationship and the “Cramer’s V test” was performed.

## **Results.**

To test the effects of ownership structure on the firm evaluation process, we analysed a final sample of 88 firms.

Table 1 represents the ownership structure of all the firms in the sample; it summarizes their frequency distribution into the different classes according to their shareholders’ number.

Since we did not find any firm with more than 9 owners, we identified only five classes. In

the column “conditioned frequencies” we classify only the firms with at least one non family member among the owners.

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Insert table 1 about here

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Table 2 shows the frequency distribution of the evaluation process. In the third column (evaluation process) we sub- divide the firms according to their answers about the frequency of the evaluation process whether it is a continuous approach or an immediate one. Events are dichotomous.

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Insert table 2 about here

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The table above, shows that 48.8% of the firms in the sample have been involved in a “business evaluation process”; 31% of them do it recurrently, while the remaining 69% took into step only occasionally.

We did not analyse specifically the reasons which led to the evaluation process, but it seemed quite interesting to cross them with their frequency (matr. 1).

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Insert matrix 1 about here

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As we chose a “pilot project”, we had support only from the descriptive statistics methods and no inference was attempted. Our sample is not representative of the whole population, consequently we can describe our results through a bi- variate analysis and a double- entry contingency matrix.

The “ $\chi$  square test” in a preliminary stage and the “Cramer’s V” were used to test both the hypotheses (table 3).

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Insert table 3 about here.

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Cramer's V index is used to measure the strength association for the contingency table. Since its value ranges between 0 (no connexion) and 1 (maximum connexion), our result (Cramer’s V = 0,08) suggests that the two variables are totally unrelated.

The third column shows how the percentage of frequencies for each class does not change significantly as the shareholders’ number increases, leaving frequencies around the general average of 48,8%.

*Hypothesis 1 is not verified.*

Such counter- intuitive results led us to go ahead with an in- depth analysis between the two variables.

Since there are relevant differences among a continuous evaluation practice of the firm and an immediate one, we tried to split them up to check whether or not ownership structure may have an impact on an on- going value orientation (table 4).

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Insert table 4 about here

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Neither does table above support our initial hypothesis. The possibility that firms are oriented towards a “continuous evaluation approach” does not depend on the shareholders’ number.

“Cramer’s V test” presents a result of 0.125, which is slightly larger than the overall value (0,08 ) but is not enough to suggest any connexion. The same results occur in case we analyse the occasional evaluation process since it is complementary to the other event.

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Insert table 5 about here

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To test hypothesis n° 2 we used the “ $\chi$  square test” in a preliminary stage and the “Cramer’s V”; we aimed to verify if the firm’s evaluation process would be affected by the presence of non- family members among the shareholders. Results fail to adequately confirm our hypothesis since the “Cramer’s V” test scores 0.38, which is larger than the overall value (0.08) but it is still too close to zero. Moreover the percentage of firms involved in a business evaluation process does not vary with the presence of non- family members among the owners.

*Hypothesis 2 is not (entirely) verified.*

### **Conclusion and research implications.**

These results indicate there is no relationship between the ownership structure and the evaluation practices of small and medium family firms. Hypotheses have been tested through statistical descriptive procedures (Cramer’s V), and we found no connexion between the two variables: neither the number of owners nor the presence of non- family members among the shareholders seems to be affecting economic value orientation in a family business.

When approaching a plausible explanation for unexpected results, we identified two possible reasons. Since we investigated the ownership structure of firms whose control is closely held by one family, we can assume that increasing the number of owners or the presence of non-family members does not reduce the “family effect”, which still strongly influences both the business strategic orientation and value assessment.

The second reason is linked to the legal organization of Italian firms. Choices about the legal organization mainly depend on the tax benefits and the limited liabilities provided to the firms organized under the “corporation- type”. “Limited liability companies” necessarily comply with more than one shareholder, but many of them might be fictitious only to reap in those benefits: in this sense ownership structure does not truly reflect the real “proprietary configuration” and the decision- making process is held in the “real owner’s hands”. As the managerial attitude is not affected by ownership structure, firm value orientation does not substantially change as the shareholders’ composition modifies.

#### *Implications for Theory*

Growing evidence highlights the importance of studying ownership structure of family firms; nevertheless, existing literature is not exhaustive in explaining how the shareholders’ composition can affect managerial attitude and economic value orientation in family firms. This study has sought to go some way to filling this gap and the pilot project represents the first step to be taken before an inferential analysis. Early results suggest that a deeper analysis about the relationship between firms’ features (legal organization, turnover, number of employees, etc) and their “economic value orientation” is required. A model based on a multivariate analysis will be used to measure the extent of their reciprocal influences. As we cannot extend those early results to the whole population, forthcoming steps will aim to find a representative sample of the population to allow inferential procedures.

#### *Implications for practice*

When approaching to family- owners' attitude towards "economic value orientation" we moved from the acknowledged idea that value orientation and performance measurement are necessary for the managers to better run the firm. Few studies attempted to explore the "value assessment" for family firms and how it differs from the non family business; strong agreement among researchers emerges when recognising that non- economic goals are as important as economic ones. Hence, both need to be monitored in order to reach an economic value driven approach either in strategic choices or to managing some crucial events in the family firm's life, such as the succession process.

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APPENDIX – TABLES AND FIGURES.

FIGURE 1: Hypothesis n° 1

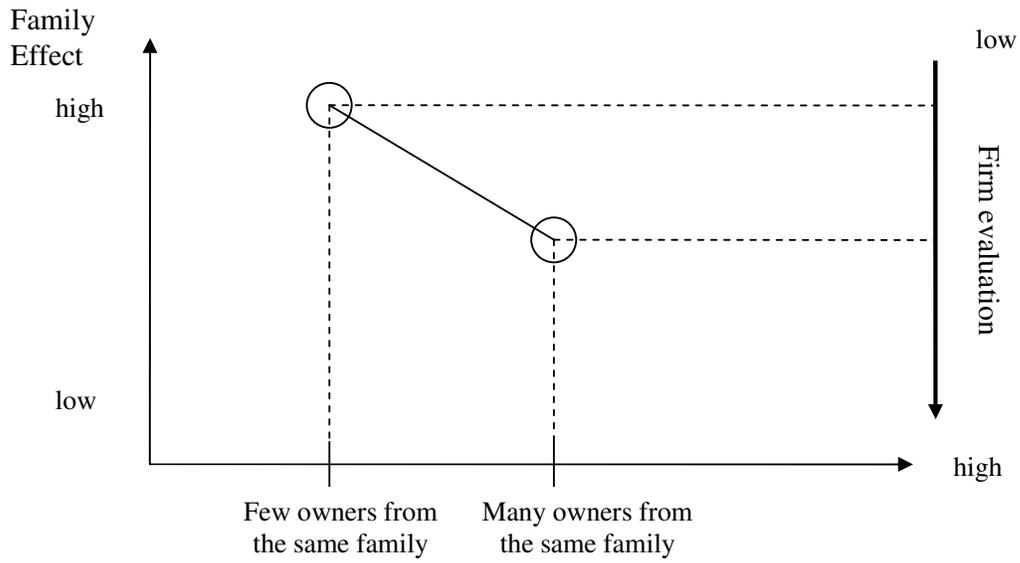
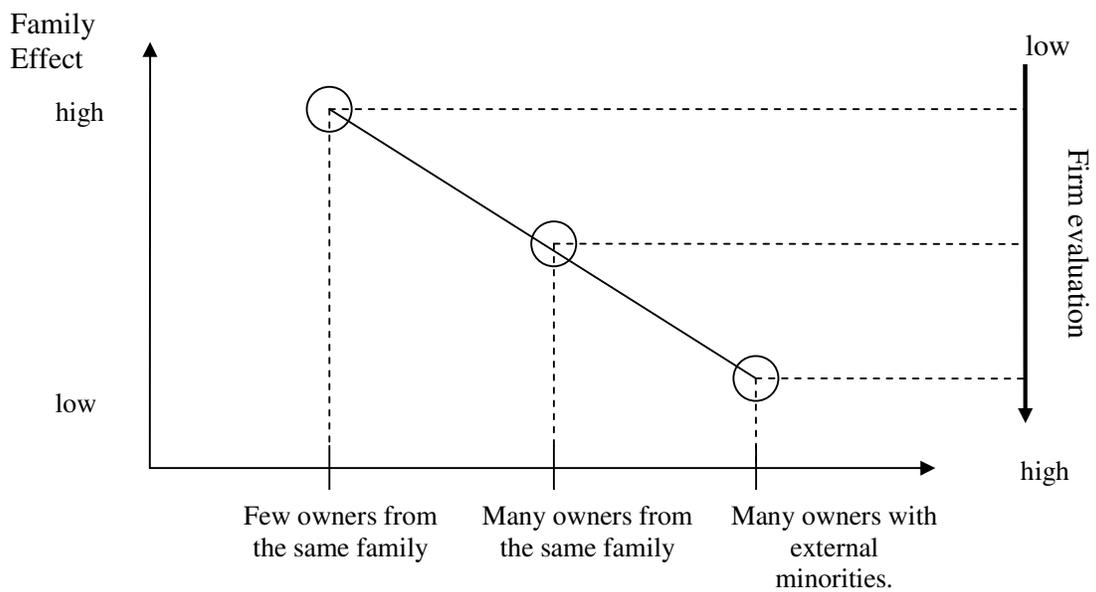


FIGURE 2: Hypothesis n°2.



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**TABLE n° 1: Frequencies of the ownership structure**

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| Number of owners | Frequencies | %<br>freq. | Conditioned<br>frequencies |
|------------------|-------------|------------|----------------------------|
| 1                | 9           | 10.2       | 1                          |
| 2                | 24          | 27.3       | 3                          |
| 3                | 29          | 33         | 6                          |
| 4                | 18          | 20.4       | 4                          |
| 5 – 9            | 8           | 9.1        | 3                          |
| <b>Total</b>     | 88          | 100        | 16                         |

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**TABLE n° 2: Frequencies in case of an evaluation process**

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| Have you ever carried<br>out a “business<br>evaluation process” | Frequencies | Evaluation process |                  |
|---|-------------|--------------------|------------------|
|   |             | <i>Continuous</i>  | <i>Immediate</i> |
| Positive answer   | 43          | 13                 | 30               |
| Negative answer   | 45          |                    |                  |
| <b>Total</b>  | 88          |                    |                  |

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**MATRIX n°1: crossed matrix of objectives and frequency of evaluation**

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|           |            | Objectives  |                  |    |
|-----------|------------|-------------|------------------|----|
|           |            | Performance | Other objectives |    |
| Frequency | Continuous | 10          | 3                | 13 |
|           | Occasional | 11          | 19               | 30 |
|           |            | 21          | 22               | 43 |

---

**TABLE n°3: Cross sectional analysis of the two variables.**

---

| Shareholders' numbers | Business evaluation process |             |                               | Total     |
|-----------------------|-----------------------------|-------------|-------------------------------|-----------|
|                       | Positive                    |             | Negative<br>Total frequencies |           |
|                       | Total frequencies           | (%)         |                               |           |
| 1                     | 4                           | 44,4        | 5                             | 9         |
| 2                     | 12                          | 50          | 12                            | 24        |
| 3                     | 13                          | 44,8        | 16                            | 29        |
| 4                     | 10                          | 55,5        | 8                             | 18        |
| 5-9                   | 4                           | 50          | 4                             | 8         |
| <b>Total</b>          | <b>43</b>                   | <b>48,8</b> | <b>45</b>                     | <b>88</b> |

Cramer's V  
= 0,08

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**TABLE n° 4: Frequency distribution in the case of business evaluation process.**

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| Shareholders' number | Continuous evaluation |             | Immediate evaluation |             | Total     |
|----------------------|-----------------------|-------------|----------------------|-------------|-----------|
|                      | Tot freq.             | %           | Tot freq.            | %           |           |
| 1                    | 1                     | 25          | 3                    | 75          | 4         |
| 2                    | 3                     | 25          | 9                    | 75          | 12        |
| 3                    | 5                     | 38,4        | 8                    | 61,6        | 13        |
| 4                    | 3                     | 30          | 7                    | 70          | 10        |
| 5-9                  | 1                     | 25          | 3                    | 75          | 4         |
| <b>Total</b>         | <b>13</b>             | <b>30,2</b> | <b>30</b>            | <b>69,8</b> | <b>43</b> |

Cramer's V  
= 0,125

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**TABLE n° 5: Total distribution in case of non family members among the owners**

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| Shareholders'<br>numbers | Business evaluation process  |            |                              | Total     |
|--------------------------|------------------------------|------------|------------------------------|-----------|
|                          | Positive                     |            | Negative                     |           |
|                          | <i>Total<br/>frequencies</i> | <i>(%)</i> | <i>Total<br/>frequencies</i> |           |
| 1                        |                              |            |                              |           |
| 2                        | 2                            | 66.6       | 1                            | 3         |
| 3                        | 4                            | 66.6       | 2                            | 6         |
| 4                        | 1                            | 25         | 3                            | 4         |
| 5-9                      | 1                            | 33.3       | 2                            | 3         |
| <b>Total</b>             | 8                            | 50         | 8                            | <b>16</b> |

Cramer's V =  
0.38

# WHY DO SOME CLUSTERS STAGNATE?: EVIDENCE FROM TWO RESOURCE BASED CLUSTERS IN KERALA, INDIA

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**Abstract :** The available literature on small and medium enterprise clusters, while focusing on success stories have not so much addressed issues related to stagnation and failure. The present study of two resource based clusters in India seeks to address the question using empirical materials. Both the clusters have a history of half a century. They emerged in the context of plentiful supply of raw materials and cheap and skilled labour. They achieved some amount of growth during certain periods, but in respect of the key cluster characteristics such as innovation and sustained growth, they failed. A chief factor accounting for the stagnation is the depletion of the resource base. Both the clusters lack innovative behaviour and inter-firm collaboration. The enterprises in the cluster did not develop extensive forward and backward linkages. Sectoral specialization and inter firm division

of labour did not adequately develop. Clustering does not seem to be playing any role facilitating division of labour, diffusion of technical information and other kinds of cooperation between enterprises that would lead to higher over all efficiency. Absence of service establishments, input suppliers, receptive markets etc. prevented innovation in the cluster thereby compelling firms to adopt a sweatshop strategy. Though business associations do exist they have not been successful in raising the clusters' competitive advantage through providing support measures. The macroeconomic policy existing in the country has not been salubrious. There has not emerged adequate local level policy initiative or appropriate supportive institutions.

## **Introduction**

The extant literature on small and medium enterprise clusters largely focus on success stories in Europe (Piore & Sabel, 1984; Becattini, 1989; Humphrey, 1996; Sengenberger & Pyke, 1992) and to a limited extent in developing countries (Rabellotti, 1997; Schmitz, 1992; Knorringa, 1992; Cawthone, 1995; Holmstrom, 1993). There is very limited literature that addresses issues related to stagnation and failure particularly in developing country contexts (Pillai, 2000; Weijland, 1994; Klapwijk, 1997; Pedersen, 1994; Nadvi & Schmitz, 1994). These studies, though do point to the depressed background of the clusters, do not go into the debilitating factors. The present empirical study of two resource based clusters in Kerala, in south west India – a saw mill cluster in Perumbavoor and an agricultural implements cluster in Shornur – seeks to address the above question using empirical materials. This study is based on field data collected using detailed questionnaires and by participant observation from 59 small and medium units in Shornur and 50 in Perumbavoor selected at random.

## **Brief Profile of the Cluster**

The area extending from Shornur to Palghat in northern Kerala is the abode of the agricultural implements cluster. The two factors that led to the emergence of the cluster in this locality are cheap availability of good quality raw materials and skilled labour. The railway loco shed at Shornur used to have plenty of rail scrap that is excellent for the making of agricultural implements. The *karuvan* community of Shornur and the surrounding areas used to supply the necessary skilled workers for the industry. Another factor responsible for the origin of the industry in this particular region was the presence of Mr. C.K. Menon who was trained in metallurgy in Sheffield. The W.W. 11 gave a boost to the industry in the region. The import substitution industrialization strategy adopted by the government of India in the 60s gave a major boost to the industry. The industry had its best growth in the 60s and the 70s.

The cluster consists of all size classes of units although the majority belongs to the tiny sector. There are nearly 25 large units including a public sector company that employs more than 50 workers. There are about 200 small scale units each of which on an average employs 10 workers. The tiny units are estimated to be 300 located mostly in homesteads. The small start up units need only a small amount of capital, a small shed and a few traditional tools like a lathe. The tiny units employ two workers or less, mostly family labour. A wide variety of implements are produced in the cluster. They are mainly of three types: estate tools, garden tools and cutlery items. Though the industry had a good time till the late 80s, the 90s marked its decline. The reasons are wide ranging. The condition of cheap availability of railway scrap no longer exists. Moreover, the stagnant technology and lack of innovation led to the further slow down of the cluster. However, in response to sagging demand and mounting costs of production, some amount of diversification has taken place in the cluster. Most such units are at the homestead of the owners. What all they need is a grinding motor, drill, air blower, a few dies and a few hand forging and finishing tools.

The saw-mill cluster in Perumbavoor is located in the north eastern part of Ernakulam District. The easy availability of timber from the nearby forests made Perumbavoor the centre of saw-mill industry. This cluster has nearly 600 saw-mill units. But it is reported that 80 percent of the trading in the timber market takes place unlawfully without keeping proper vouchers. Since 1995 no new business enterprise has come to the cluster. Because of the crisis in the cluster, there has been a shift in the activity from saw milling to plywood manufacturing. The plywood manufacturing units also are facing a crisis situation now. MDF Prelaminated particle boards and medium density fibre particle boards which are superior substitutes to plywood are being imported from Malaysia and Indonesia at prices which are cheaper by 25 % than the local product. Moreover, there is tough competition from new varieties of plywood such as new wood, marine plywood etc. that come from other states in India. After the mid90s no new unit has come to operate in the area

### **Cluster Characteristics**

Thus both the clusters have a history of half a century. They achieved some amount of growth during certain periods, but in respect of the key cluster characteristics such as innovation and sustained growth, they failed. Thus the two clusters present a picture of

stagnation and pessimism. Such clusters are often called survival clusters (Knorringa, 2002). Both the clusters lack innovative behaviour and inter-firm collaboration. Sectoral specialization and inter firm divisional of labour did not adequately develop. Clustering does not seem to be playing any role facilitating division of labour, diffusion of technical information and other kinds of cooperation between enterprises that would lead to higher over all efficiency. Absence of small scale service establishments, input suppliers, receptive markets etc. prevented innovation in the cluster thereby compelling the units to adopt a sweatshop strategy.

### **Inter Firm Linkages**

The European experience prompts us to ask: why the clusters under review did not forge inter-firm relations, become innovative and develop efficiency and competitiveness? The clusters under study exhibit the characteristics of “latent” clusters, which have not developed the level of interaction and information flows necessary to truly benefit from colocation. The degree of division of labour among the firms is extremely limited in the two clusters. In the Saw mill cluster only 12 percent of the sample units seem to be engaged in any kind of subcontracting. In the agricultural implements cluster, the percentages of firms engaged in subcontracting is 47. 5. But this does not mean that inter-firm division of labour exists in this cluster. A chief reason for the existence of subcontracting relations in the cluster is savings on premises. As raw-materials in both the industry are bulky and space consuming, the firms subcontract the work mainly to save on space (Table 1). Similarly, there is no other form of interaction between the parent firms and the subcontractors either in terms of technical collaboration or financial or consultancy matters. (Table 2) The firms in general do not seem to be possessing adequate knowledge of other firms in the cluster. They seldom visit other production sites or exchange ideas about business (Table 3). Similarly they do not seem to have interaction with other firms and individuals. Lack of a common enough vision of their future and lack of the requisite level of trust among firms to find and exploit common interests are some of the bottlenecks experienced by them.

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Table 1, 2 & 3 here  
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These groups of firms do not think of themselves as a cluster and as a result, do not think of exploring the potential benefits of close relationship with other local organizations. The enterprise structures, private and public services, labour markets and social networks have not adapted to each other and their specific environment. This probably is the main reason for the absence of collective efficiency in the cluster. These clusters are relatively disaggregated and less pronounced and consist of small firms operating under relatively poor and unregulated working conditions with less extensive backward and forward linkages. As the technology in the agricultural implements cluster is traditional, the workers have to spend a considerable amount of time near the fire at hazardous conditions. Besides, the use of charcoal for heating purposes pollutes the premises of the workshop. In the saw-mill cluster also no drudgery reducing technology has ever been employed. Similarly, the factory premises are polluted with wood dust. While

considering the forward linkages, it is seen that most of the sales of the units in the cluster are in near by localities. Only less than 25 percent of the out put is sold in distant markets in the country. Less than 4 percent of the output of the cluster is exported. The horizontal linkages are also not well developed. Though business associations do exist in these clusters, they have not been successful in raising the clusters' competitive strategy by providing support measures. These business associations have come up because there exists in Kerala the political culture of forming associations without much of a purpose. In both the clusters there are two associations. The interests of these associations are often conflicting. Moreover, the association is a decorative piece which does not perform any useful function. The activities of the association does not give an impression that the business men are aware of the fact that they are functioning in a cluster and that the environment of a cluster offers tremendous opportunity for growth by fostering inter firm relations ( Table 4). The relatively large units in the agricultural implements cluster have formed a separate business association, but they also do not share any critical information about technology or markets, particularly the foreign markets which they have access to. They fear that the leakage of business secrets will eventually deprive them of the opportunities to their competitors who are also members of their own association. In the saw mill cluster also one finds the relatively large units in collusion mainly to arrest the growing labour militancy. But apart from that they do not have any cooperation on the core business functions.

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Table 4 here  
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It is further seen that it is the absence of opportunities in the formal sector that forced individuals to be self employed as small entrepreneurs in these clusters. As they do not have any idea of areas of potential advantages of making investment, they entered into areas where other firms were doing relatively well without making significant investments. This is evident from the fact that in both the clusters a majority of the entrepreneurs have no previous experience in business and more particularly, almost nobody has experience in the same field (Table 5).

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Table 5 here  
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### **Innovation and Growth**

Innovation has been a casualty in both the clusters. In a developing country context innovation needs to be understood in a restricted sense: using different raw materials or economizing on the use of raw materials or energy, improving the design or introducing a new way to finance, distribute or stock products and changing the management of a small business (Van Dike and Sandee, 2002:4). Even in this limited sense the firms in the clusters have not shown any inclination towards innovation either in improving the quality or design of the products. The firms appear to be very conservative to changes. Unless there is strong market demand in their perception, they would not even adopt designs that are in fashion in the rest of the country. Moreover, the firms are very

cautious about spending money on design changing experiments. Similarly, the organizational structure of the units also has not changed even marginally at least during the preceding 5 years of the survey. The process of production has also remained more or less the same for decades (Table 6). On the whole, the entrepreneurs do not seem to be taking any initiative to introduce innovation for fear of high cost and insufficient demand in the market. They do not sufficiently realize that the market is in fact in the perception of the entrepreneur and that they can create market, if they want. They do not know that a cluster becomes successful only when they associate themselves with workers, traders, and other participants in the chain utilizing available and adaptable techniques and thus forming a collective production unit the scope of which goes beyond the individual enterprise. Almost all units surveyed do not want to share any information regarding purchase of raw materials, marketing of the products, financing or production with others in the cluster. Even when the entrepreneurs meet in the general body meetings of their business associations, they discuss entrepreneurial subjects in a general sense and not specific to the enterprises. The performance of the clusters does not paint a promising picture either. A majority of the units accounts for declining output and profit levels (Table 7)

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Table 6 & 7 here

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### **Policy Initiatives**

However, once there is a critical mass of small and medium firms in a cluster, policy intervention may be able to play a role in fostering networking and growth. Such policy initiatives have been proved successful in the Italian and other European cases ( Brusco, 1990; Schmitz,1992) . The success of a cluster is contingent on the propitious macroeconomic climate in which it operates (Cawthone, 1995). The macroeconomic context in India and particularly in Kerala was one of protectionism till the Nineties. There were 900 items reserved for the small sector alone. The economy was liberalized in the early 90s and a number of those items got dereserved. This made the going difficult for the small sector. More over, the environment in Kerala was characterized by frequent labour strikes, high degree of politicization and bureaucratic governance structure. The thrust of the extant government policy has been on price rather than on quality and competitiveness. In spite of the passage of a decade and a half of liberalization, Kerala has not yet geared its macroeconomic policy to keep up with the environment of liberalization. But whatever policy exists also suffers from the problem of path dependence. Cluster policy will have to depart from the beaten track and it is generally found to be difficult. Moreover, it may over lap other policy areas as there is bound to be a wide diversity in cluster policies as engendered by the diverse requirements of the cluster. While general policies focus on the individual firms, cluster policy should address network issues. In other words, the thrust of the policy should be on the importance of networking, the targeting of selected networks and the focus of innovation (Raines, 2002). Though there is much talk about encouraging enterprise clusters, cluster specific policies have seldom been in place. Industrial estates have attracted considerable

attention of policy makers, but estates are qualitatively very different from clusters and the policy support required is also very different. Resource sharing, joint purchase and use of machines, bulk buying of raw materials, sharing of skills etc. are possible if there is networking between the firms. In the Shornur case, if an adequate network is developed, the cluster as a collective unit can bid in the auction for railway scrap and get the raw material at a much lower price than what is paid for now. Also important is the creation of training centers and enhancement of existing facilities such as market and technology information and technology support. After identifying common skill shortage, the centers can design courses appropriate for the workers. Another policy initiative that the government may provide in collaboration with or without the business associations is common facilities and services relevant for the cluster. In this context, the role of creating appropriate supportive institutions needs to be emphasized. In Shornur, a Small Industries Service Institute (SISI) used to offer some amount of technical support to the units in the cluster. In the 90s, it was closed down as part of the government policy to wind up non-profit making enterprises. This was a major set back to the small units in the cluster. Therefore, what is immediately required is the reopening of the SISI as a supporting institution and widening its scope of activities. In all these things what is needed is a more comprehensive and integrated approach to local economic development keeping in view the growing importance of localized policy design and delivery (Nauwelaers, 2001). In Italy, the birth place of industrial districts policy initiatives come from the local governments because only the local government can clearly understand the importance of the local cluster and hence it's various needs. In Kerala, a massive movement was recently launched towards decentralized planning with great success. As much as 40% of the state resources are routed through village panchayats-the local bodies, but there has not been any devolution of policy making powers. If more policy making powers are transferred to the panchayants, probably they could play an important role in fostering the rural clusters in Kerala that could substantially raise output and employment. If an imaginative policy frame can be put in place along with the creation of appropriate institutions, the local bodies could profitably address the problems of inter-firm collaboration, innovativeness and competitive advantage in clusters.

**Table 1: Reasons for Subcontracting**

| Reasons for Subcontracting          | Shornur             | Perumbavoor         |
|-------------------------------------|---------------------|---------------------|
|                                     | Percentage of units | Percentage of units |
| Irregular demand                    | 13.8                | 24                  |
| Savings on premises and machinery   | 45.4                | 50                  |
| Greater efficiency of subcontractor | 9.1                 | 17                  |
| Lower wages of subcontractor        | 22.6                | 9                   |
| Others                              | 9.1                 | 0                   |

**Table 2: Type of Interaction Between Parent Firms and Subcontractors**

| Type of interaction                          | Percentage of Units Reporting |              |             |              |
|--|-------------------------------|--------------|-------------|--------------|
|  | Shornur                       |              | Perumbavoor |              |
|  | Frequently                    | Occasionally | Frequently  | Occasionally |
| Advance payment                              | 20.3                          | 11.9         | 0           | 2            |
| Organization of production                   | 0                             | 6.8          | 0           | 4            |
| Lending of machines and equipments           | 1.7                           | 5.1          | 0           | 0            |
| Repair/ maintenance of machinery & equipment | 1.7                           | 3.4          | 0           | 0            |
| Training of workers                          | 0                             | 1.7          | 0           | 0            |
| Transportation of parts or products          | 23.8                          | 3.4          | 2           | 6            |

**Table 3: Frequency of Exchanging Ideas in the Cluster**

| Frequency    | Percentage of Firms Reporting |             |                  |             |
|--------------|-------------------------------|-------------|------------------|-------------|
|              | Visiting Other Units          |             | Exchanging Ideas |             |
|              | Shornur                       | Perumbavoor | Shornur          | Perumbavoor |
| Never        | 69.4                          | 6           | 81.3             | 8           |
| Often        | 28.9                          | 90          | 1.7              | 12          |
| Occasionally | 1.7                           | 4           | 17.0             | 80          |

**Table 4: Purpose of Association Membership**

| Purpose                          | Percentage of Units reporting |              |       |             |              |       |
|----------------------------------|-------------------------------|--------------|-------|-------------|--------------|-------|
|                                  | Shornur                       |              |       | Perumbavoor |              |       |
|                                  | Often                         | Occasionally | Never | Often       | Occasionally | Never |
| Advice in legal matters          | 2                             | 82           | 78.2  | 2           | 82           | 2     |
| Information on other enterprises | 2                             | 76           | 81.6  | 2           | 76           | 6     |
| Courses & Seminars               | 0                             | 82           | 85.0  | 0           | 82           | 2     |
| Bargaining with Trade Unions     | 2                             | 82           | 85.0  | 2           | 82           | 0     |
| Information Bulletins            | 2                             | 82           | 88.4  | 2           | 82           | 0     |
| Lobbying with the Government     | 2                             | 82           | 78.2  | 2           | 82           | 0     |
| Other                            | 0                             | 2            | 71.4  | 0           | 2            | 0     |

**Table 5: Professional Background of Entrepreneurs**

| Professional Background | Percentage of Units Reporting |             |
|-------------------------|-------------------------------|-------------|
|                         | Shornur                       | Perumbavoor |
| Same filed              | 0                             | 4           |
| Business                | 8.5                           | 4           |
| Technical workers       | 13.5                          | 10          |
| Others                  | 0                             | 16          |
| No previous experience  | 78.0                          | 56          |

**Table 6: Change in Product Quality during the Preceding Five Years of the Survey**

| Change Characteristics | Percentage of Units Reporting |             |
|------------------------|-------------------------------|-------------|
|                        | Shornur                       | Perumbavoor |
| Declined               | 3.4                           | 24          |
| Remained the Same      | 54.2                          | 36          |
| Improved a Little      | 35.6                          | 34          |
| Improved a Lot         | 6.8                           | 6           |

**Table 7: Change in Output and Profit Levels**

| Change Characteristics | No. of Units |        |             |        |
|------------------------|--------------|--------|-------------|--------|
|                        | Shornur      |        | Perumbavoor |        |
|                        | Output       | Profit | Output      | Profit |
| Increased              | 32.2         | 8.5    | 22          | 0      |
| Constant               | 40.7         | 40.7   | 20          | 20     |
| Decreased              | 27.1         | 50.8   | 58          | 80     |

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# **BUSINESS INTERVENTIONS TO DEVELOP ENTREPRENEURSHIP AND NEW VENTURE CREATION**

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## **ABSTRACT**

This paper focuses on the business interventions to develop entrepreneurship and new venture creation in South Africa. The high level of unemployment, low economic growth, and the fact that the Global Entrepreneurship Monitor (GEM) report of 2003 ranked South Africa 36<sup>th</sup> out of 40 countries in the world in terms of entrepreneurial activities within established business, emphasizes the importance of entrepreneurship interventions in this field.

Primary data was collected by means of a questionnaire survey sent to a sample of businesses in South Africa. The first phase of the data analysis was to establish business level of agreement with the statements relating to the development of entrepreneurship and new venture creation as identified in academic literature. The results indicated that over fifty percent (50%) of respondents agreed with statements grouped under the following variables: structure, commitment, creativity, and innovation as essential to the development of entrepreneurship and new venture creation. Opinion was divided on the other two remaining variables of strategy and of training and development.

The second phase of the data analysis results' indicated a statistically significant relationship between the main activity/type of the business and the following dependent variables: structure, training and development, and commitment. The results also indicated a statistically significant relationship between the existence of a training department in a business and the following dependent variables: structure, training and development, creativity and innovation. It is recommended that businesses in South Africa adopt a holistic approach that embraces entrepreneurship at all organisational levels. Strategy, training and development need strong emphasis, with unwavering commitment from all levels of management.

## INTRODUCTION

One of the distinguishing features of the current global economy is the increasing evidence of decreasing job opportunities. In developing countries, big businesses tend to have limited success in job creation and the advancement of economic growth. The results of the Job Creation research conducted over 12 million companies in the United States revealed that businesses with fewer than 100 employees created more jobs than those with more than 100 employees (Finley, 1990:4). Timmons (1999:4) reveals that 81.5 percent of the new jobs in the United States were created by new and growing smaller firms as compared to 5 million jobs lost by the Fortune 500 listed companies.

In South Africa, the small, medium and micro enterprises (SMMEs) have created 53.9 percent of the new jobs as compared to 46.1 percent of job opportunities created by large enterprises (Ntsika, 2001:38). Taking into consideration the current unemployment level of 26.2 percent (Stats South Africa, 2004), the average economic growth of 3.2 percent (Budget speech, 2005), ongoing job losses as a result of the closure of gold mines (Bathong & Shone, 2004; Smith, 2005; Annon, 2005), and the restructuring and rationalization that is taking place in both private and public sector, the role of the SMMEs as agents for employment in South Africa cannot be overemphasised, especially within the context of a developing nation.

The trend of decreasing job opportunities explains why most countries all over the world have been searching for solutions to the problem of unemployment over the past decade. This worldwide search has for the past two decades focused on the entrepreneur and his or her ability to contribute to economic growth.

Bridge, O'Neill and Cromie (1998:207) state that governments all over the world are intervening in their countries' economies to promote economic growth and job creation. The South African government is also intervening through the Department of Trade and Industry (DTI), through agencies such as the National Small Business Council (advice the government on social and economic policy that promote the development of SMMEs), Ntsika Enterprise Promotion Agency (delivery of programmes for the support and promotion of SMMEs), Khula Enterprise Financial Limited (whole sale lending institution aimed to improve lending resources for SMMEs), Umsombomvu Youth Fund (provide finance to young emerging entrepreneurs), Business Partners (provide finance to prospective entrepreneurs who engage in start-ups, expansions, take-overs, Management Buy-Outs, Management Buy-Ins, and Leveraged Buy-Outs), and many other independent institutions such as universities and the media.

The success of government interventions depends on business participation in the implementation of intervention policies, engaging in entrepreneurial activities aimed at promoting economic growth and the creation of job opportunities. The research conducted by Tawney and Levitsky (2002) revealed that businesses in Eastern Europe intervened in the

development of entrepreneurship and new venture creation during the 1970 – 95 period of high unemployment, caused by the closure and rightsizing of companies, by engaging in the following activities:

- Assisting in the creation of new businesses initiated by redundant employees.
- Conducting training programmes in business skills.
- Former company employers offered vacated premises, used equipment and guarantees for orders or for bank loans to new small businesses.
- Where there has been a restructuring which has outsourced services or items previously made in-house, arrangements were negotiated for the new small businesses to carry out these operations as subcontractors.
- Large firms provided support to new and expanding small businesses in the form of technical assistance, help in finance, assistance with tools, equipment and premises.
- Management and employees buy out the whole troubled firm to save their jobs and make concession on employment, pay and/or benefits.

In South Africa businesses are promoting entrepreneurship through franchising and Black Economic Empowerment (BEE). According to the Franchise Baseline Census 2002, the franchise industry contributed 11.6 percent to GDP in South Africa in 2001, employed an estimation of 400 000 people, and 60 percent of new outlets went to black franchisees in 2002 (Barnard, 2004). The KPMG/SAVCA survey (2003) revealed that investments in BEE entities increased from R559 million in 2002 to R717 million during 2003.

However, research conducted by the University of Cape Town's Centre for Innovation and Entrepreneurship as part of 2003 Global Entrepreneurship Monitor ranked South Africa 36<sup>th</sup> out of 40 countries for entrepreneurial activity in an established business (Global Entrepreneurship Monitor, 2003). The results of the study conducted by Maritz, du Plessis and Nieman (2004) also revealed that South Africa have the lowest Total Entrepreneurial Activity (TEA) as compared to Australia and New Zealand.

Given the role played by the SMMEs in economic growth and the creation of job opportunities, business interventions to develop entrepreneurship and new venture creation have become a matter of urgency which cannot be ignored, especially since entrepreneurial activity is a prerequisite for the success of economic growth, development, social well-being and political stability (Antonites & Watson, 2004).

## **PROBLEM STATEMENT AND OBJECTIVES**

The results of the 2003 Global Entrepreneurship Monitor (GEM) revealed that South Africa ranked 22<sup>nd</sup> out of 31 countries in terms of new venture creation (Global Entrepreneurship Monitor 2003). Also Maritz, du Plessis and Nieman (2004) reveal an unfortunate situation regarding the development

of entrepreneurship in the country. This situation is particularly problematic as the South African economy is dependent on new ventures creation for economic development and employment.

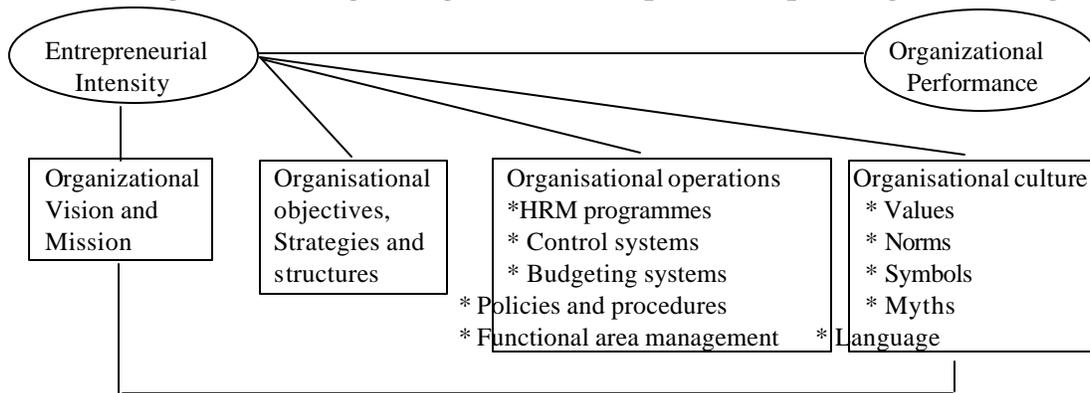
The primary objective of this study was to investigate South African business interventions to develop entrepreneurship and new venture creation.

In this paper a literature review will first be presented. Thereafter the methodology used in the empirical research is outlined. Information on the response rate and the results of the data analysis are provided. The paper concludes with a section that outlines the conclusion of the study and the recommendations thereof.

### LITERATURE REVIEW

In order to investigate business interventions to develop entrepreneurship and new venture creation in South Africa, Morris and Kuratko (2002:34) model of strategic integration of entrepreneurship illustrated in figure 1 was adopted.

**Figure 1: Strategic integration of entrepreneurship throughout the organisation**



**SOURCE: Adapted from Morris and Kuratko (2002:34)**

Figure 1 points out that the entrepreneurial activities of a business can only intensify if entrepreneurship is interwoven in the organisational vision and mission, organizational objectives, strategies and structures, organisational operations, and organisational culture. Figure 1 also illustrates that there is a direct relationship between entrepreneurial intensity and organisational performance. Thus an organisation that embrace the development of entrepreneurship tend to perform better as compared to organisations that do not embrace the development of entrepreneurship.

Taking into consideration that very little empirical study has been conducted in South Africa on business interventions to develop entrepreneurship and new venture creation, the following variables were identified

from Morris and Kuratko (2002:34) model as essential to the study.

### **Strategy**

Sathe (2003:2) argues that strategy provides a good starting point from which to examine corporate entrepreneurship. With a clear strategic intent, the core competence of a business can be effectively leveraged to create new businesses. Thompson and Strickland (1998:5) define a strategic vision as a road map of the business future, showing the direction it is headed, the business position it intends to stake out, and including the capabilities it plans to develop.

Strategy creates a sense of unity, or consistency of action, throughout the business. In order for people to work toward common objectives, they must know what the objectives are. Strategy is about performing different activities from those of competitors, or about performing similar activities but in different ways.

### **Structure**

Hisrich and Peters (1995:35) state that business management structures diverge significantly between the two domains, namely the administrative domain and the entrepreneurial domain. In the administrative domain, the organisational structure is formalised and hierarchical because of the need for clearly defined lines of authority and responsibility based on management theory and a reward system. The entrepreneurial domain must have its independence, and employs a flat organisational structure with informal networks throughout.

As a business designs more hierarchical levels into the organisational structure, the ability to identify market opportunities, achieve management commitment, reallocate resources, take risks, or implement effective marketplace moves becomes problematic. Moreover, hierarchies tend to be accompanied by two other entrepreneurial barriers: top-down management and restrictive channels of communication. The result is frequently intransigence, which leads to a lack of commitment to innovation and change at all levels of the organisation. There is also a tendency to narrow the span of control of managers and to compartmentalise operations as firms mature. The result is over-supervised employees who have little room to be creative or to improvise.

Hall (1996:169) highlights that organisational structures, with their varying sizes, technological sophistication, and degrees of complexity and formalisation, are designed to evolve into information-handling systems. The very establishment of an organisational structure is a sign that communications are supposed to follow a particular path. Research findings of De Coning, Kwinana, Lotter, Munnik and Smit (1997:24) reveal that the communication structure in organisations is an apparent impediment to a black manager's access to entrepreneurial power.

Open and honest communication is such a vital co-producer of entrepreneurial organization that it is considered its heart, and it is very difficult to imagine suitable access to entrepreneurial power without it. Bureaucratic practices often frustrate employees who have innovative ideas, so that employees often

keep their innovative ideas to themselves. Instead of encouraging innovation and creative thinking among organisational employees, many organizational structures unintentionally stifle it. Entrepreneurial organisations should have flattened organisational reporting structures in order to facilitate the smooth flow of communication/ information.

### **Training and development**

HRM policies are a reflection of a business culture, whether entrepreneurial or not (Morris and Kuratko, 2002:239). With such rapid changes in technology and the rate at which new products are introduced, achieving a sustainable advantage in the new competitive landscape requires managers to constantly empower their employees through training and development. Coetsee (1996,42) define empowerment as the provision of opportunities for employees to assist with the identification of problems, the defining thereof and inviting their inputs in decisions on how work should be done, how work methods could be improved and the delegating of more comprehensive powers and responsibilities.

Training and development programmes can be used as a vehicle for the development and operationalisation of entrepreneurship in an organisation. Training and development programmes afford employees the opportunity to engage in continuous individual learning to ensure life-long learning in the organisation.

The presence of research and development departments (R&D) in a business offers an excellent opportunity to prospective entrepreneurs to inculcate the spirit of innovation if given the opportunity. It is therefore important for businesses to involve as many people as possible in their R&D so as to nourish an entrepreneurial spirit among its employees.

### **Commitment**

Morris and Kuratko (2002:239) state that entrepreneurship requires a culture built around emotional commitment, autonomy, empowerment, sincere respect and strong work ethic.

Sathe (2003:222) argues that management culture has a major influence on new business creation.

Gerber (1995:26) describes the tension between management and the entrepreneur as follows:

- The entrepreneur lives in the future, the manager lives in the past. When the entrepreneur craves control, the manager craves order.
- Where the entrepreneur invariably sees the opportunity in events, the manager invariably sees problems.

Coetsee (1996:39) define commitment as ownership or full identification. If entrepreneurship is to be realized in a business, top managers should take ownership of the development programmes and display total dedication towards successful implementation of such programmes. The commitment of

leadership to developing and sustaining entrepreneurship in a business has the potential to help transform the organisation and unleash talent.

### **Creativity and innovation**

Creativity and innovation are essential components of entrepreneurship. Zeelie, De Beer, Jacobs, Rossouw, Stapelberg, Watson and Niewenhuizen (1998:140) define creativity as the generation of new ideas. Drucker (2001:22) defines innovation as the act that endows resources with a capacity to create wealth. Creativity leads to innovation. To innovate is to introduce within a company or marketplace new methods, processes, technologies, products or services (Morris & Kuratko, 2002:121). Creativity is a person's imagination and his or her ability to think of something original, while innovation refers to the use of creative abilities to create something (Zeelie et al, 1998:10).

Wickham (2001:218) and Sadler (2002:197) suggest that for creativity to flourish in a business, an entrepreneur does not have to rely on his or her own creativity. He or she should recognise, value and champion the creativity of others. This can be achieved by establishing a creative group within the business consisting of product experts, and encouraging them to think about the needs of a particular market and consider how those needs might be better served.

According to Timmons (1999:13), the advantage of using teams is that they can generate the creativity that a single person may not be able to generate. Using teams to generate creativity therefore gives more people the opportunity to develop entrepreneurial skills. Bridge et al (1998:47) stresses that creativity is enhanced when people have some freedom, a high internal commitment to the task, and many intrinsic rewards.

Drucker (2001:148) points out that policies, practices and measurements need to be put in place to facilitate positive entrepreneurship and innovation. If an existing business is to innovate, it has to create a structure that allows people to be entrepreneurial. It has to devise relationships that lead to the development of entrepreneurship. It has to make sure that its rewards and incentives, its composition, personnel decisions and policies, all reward the right entrepreneurial behaviour and do not penalise it.

## **DESIGN AND METHODOLOGY OF THE EMPIRICAL STUDY**

There is an absence of a comprehensive sample frame of small businesses in South Africa. As such, probability sampling was used to select a stratified sample total of 1000 businesses drawn from a list of businesses kept in a register by the Bureau of Market Research (BMR) of the University of South Africa (Unisa). The Bureau of Market Research (BMR) keeps different types of registers of businesses in a specific sector of the economy which are updated on an ongoing basis. The stratified sample was drawn from different types of businesses, based on the criteria laid down by the National Small Business Act (National Small Business Act No. 102, 27 November 1996). The sample consisted of the following businesses: manufacturing (50%), mining (10%), wholesalers (10%), retailers (10%), services (10%), and importers and exporters (10%).

### **The Measuring Instrument**

The questionnaire used in this survey consisted of two sections. Section A consisted of forty-four (44) questions/statements phrased with a possible response continuum, linked to a Likert-type five-point scale where 1 meant “strongly disagree”, and 5 “strongly agree”.

Respondents were to indicate the level of agreement with statements relating to the development of entrepreneurship and new venture creation. Levels of agreement with each statement were measured by taking the proportion of respondents who marked four (4) or five (5) on the five-point Likert-type scale. A four (4) meant that the respondents agreed with the statements, and a five (5) meant that the respondents agreed strongly with the statements.

To ensure validity, the questions/statements were tested by conducting a pilot study. The pilot survey involved twenty (20) businesses in the Ekurhuleni Metropolitan Area, Gauteng province, in South Africa. The businesses were chosen so as to be representative of the actual business to be surveyed.

Section B requested demographic/classification information such as the main activity/type of the business, the number of employees in the business, the current market share within the industry, the existence of a training department in the business, and the use of an outside consultant. One thousand (1000) questionnaires were sent out by mail.

### **DATA ANALYSIS**

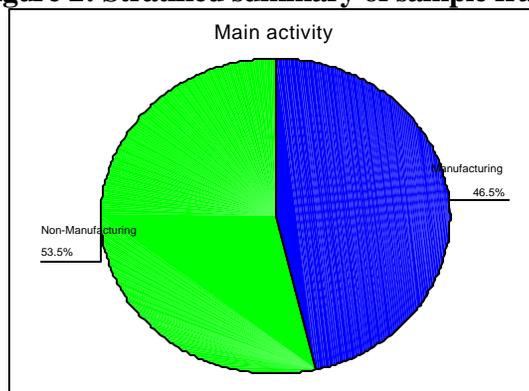
Data analysis relating to reported results was conducted in the following two stages:

- Firstly, in order to verify the internal reliability of the measuring instrument, Cronbach's alpha coefficients were calculated following (Emory & Cooper, 1991:187). Reliability coefficients 0.50 were deemed unacceptable, and those above 0.70 acceptable (Nunally, 1978:226).
- Secondly, descriptive statistics such as the frequency distribution, mean and the standard deviation were calculated to assess the level of agreement in South African businesses with statements relating to the development of entrepreneurship and new venture creation.
- Finally, inferential statistics were used to search for statistically relationships between the dependent variables (structure, strategy, training and development, commitment, creativity, and innovation), and the independent variables (the nature/type of the business, and the existence of a training department in the business).

Of the one thousand (1000) questionnaires posted to potential respondents, only two hundred and fifteen (215) were returned fully completed, thus achieving a response rate of 21.5 percent. The businesses that returned the questionnaires were manufacturing (46.6%), engineering (7.9%), importers and exporters (1.2%) mining (7.4%), wholesalers (6.0%), retailing (10.2%), business services (12.6%) and others (8.4%). Due to the small percentages of responses in some of the

business classifications, for analysis purposes, the businesses were reclassified as illustrated in figure 2.

**Figure 2: Stratified summary of sample frame**



This implies that more than half of the respondents (53.5%) are businesses whose main activity/type is non-manufacturing related (ie retailers, wholesalers, services and others), while the rest of the respondents (46.5) are classified as manufacturing. The information collected may thus be deemed representative of South African business as a whole.

## EMPIRICAL RESULTS

### Internal reliability assessment

Internal reliability results obtained Cronbach’s alpha are summarised in table 1.

**Table 1: Summary of Cronbach’s alphas**

| Statement groupings      | Cronbach’s alphas |
|--------------------------|-------------------|
| Strategy                 | 0.71              |
| Structure                | 0.76              |
| Training and development | 0.73              |
| Commitment               | 0.76              |
| Creativity               | 0.81              |
| Innovation               | 0.77              |

This table reveals that all the calculations of the Cronbach alphas are in excess of 0.70. The measuring

instrument can thus be regarded as reliable. The next step of the analysis was to assess the level of agreement with the statements relating to the development of entrepreneurship and new venture creation.

### **Findings on the level of agreement with statements relating to the development of entrepreneurship and new venture creation**

Table 2 depicts the descriptive statistics results.

**Table 2: Results of descriptive statistics**

| <b>Variable/statements</b> | <b>No. of respondents</b> | <b>% of agreement</b> | <b>Mean</b> | <b>Standard deviation</b> |
|----------------------------|---------------------------|-----------------------|-------------|---------------------------|
| Creativity                 | 215                       | 74.9%                 | 4.0         | 0.88                      |
| Innovation                 | 213                       | 70.7%                 | 3.81        | 0.89                      |
| Commitment                 | 213                       | 67.4%                 | 3.73        | 0.96                      |
| Structure                  | 212                       | 55.7%                 | 3.45        | 0.95                      |
| Training and development   | 214                       | 47.0%                 | 3.41        | 1.10                      |
| Strategy                   | 213                       | 46.9%                 | 3.28        | 0.99                      |

The results indicate that the mean scores vary for all variables identified as essential for the development of entrepreneurship and new venture creation. The highest mean score was allocated to the variable creativity (mean = 4.0). The vast majority of the respondents (74.9%) agreed with the strategy of fostering the spirit of creativity in the organization the statements. Mostly, respondents includes, agreed with the strategies of encouraging employees to seek and follow strategies that result in customer satisfaction (mean = 4.09), encouraging employees to be creative in their jobs (mean = 4.05), encouraging pro-activeness in all organizational level (mean = 4.0), encouraging greater employees participation in the identifying of new product or service, and encouraging employees to come up with new ideas of doing things (mean = 4.00).

Innovation followed with a mean score of 3.81, and thus achieving the level of agreement of 70.7%. Most of respondents indicated that they implement the following innovation policies: they understand the process of satisfying customers in innovative ways (4.31), they are committed to establish the spirit of innovation in all organizational level (mean = 3.85), they have set specific goals for innovation of new products/services in the market place (mean = 3.81), and have set specific innovation objectives for each department (3.37).

Commitment from management to develop entrepreneurship and new venture creation obtained a

mean score of 3.73. The extent to which respondents agrees with the level of commitment is 65%. Respondents agreed with statements that they are committed to economic growth (mean = 4.39), and that they are committed to the development of entrepreneurship (mean = 3.37).

Structure obtained a mean score of 3.45, and thus achieving the level of agreement of 55.7%. Most of the respondents agreed that the reporting structure in their businesses are user friendly for both employees and managers (mean = 3.61), they have a reporting structure that is process based (mean = 3.79), has a reporting structure that cuts across all levels in order to maximize opportunity identification (mean = 3.45), and the communication structure that is both top-down and bottom-up (mean = 3.04).

Training and development obtained the mean score of 3.41, and the level of agreement of 47%. Respondents agreed with the statements that they are involved in programmes that develop entrepreneurship (mean = 3.20), strive to improve the effectiveness of the business through the development of entrepreneurship (mean = 3.42), has a learning strategy to encourage entrepreneurship (mean = 3.21), develops entrepreneurship through effective training (mean = 3.02), regards training to be equivalent to learning (mean = 3.77), and offers Internship to young graduates who wish to gain practical experience in running a business (mean = 3.97).

Strategy as a variable for the development of entrepreneurship and new venture creation obtained the lowest mean score of 3.28, and the level of agreement of 46.9%. The most common statements agreed upon by respondents are: they are guided by a clearly defined mission (mean = 4.05) and, provision is made in the annual budget for workshops aimed at developing entrepreneurship (mean = 2.89).

### **Relationships between the main activity of the business and variables essential for the development of entrepreneurship**

The analysis of variance (ANOVA) and the independent t-test group statistics was undertaken to determine whether statistically significant relationships exist between independent variables and the dependent variables. Table 3 depicts the results of the t-test group statistics.

**Table 3: Results of the t-test group statistics of independent and dependent variables**

| <b>Dependent variables</b> | <b>Independent Variables</b> | <b>No. of Employees</b> | <b>Mean</b> | <b>Standard Deviation</b> | <b>Standard error mean</b> |
|----------------------------|------------------------------|-------------------------|-------------|---------------------------|----------------------------|
| Strategy                   | Manufacturing                | 94                      | 3.151*      | 0.627                     | 0.849                      |
|                            | Non-manufacturing            | 110                     | 3.371*      | 0.695                     | 0.663                      |
| Structure                  | Manufacturing                | 89                      | 3.366       | 0.558                     | 0.069                      |
|                            | Non-manufacturing            | 108                     | 3.431       | 0.558                     | 0.054                      |
| Training and development   | Manufacturing                | 95                      | 3.319*      | 0.588                     | 0.080                      |
|                            | Non-manufacturing            | 110                     | 3.660*      | 0.582                     | 0.066                      |
| Commitment                 | Manufacturing                | 98                      | 3.608*      | 0.662                     | 0.067                      |
|                            | Non-manufacturing            | 107                     | 3.837*      | 0.632                     | 0.061                      |

|            |                   |     |       |       |       |
|------------|-------------------|-----|-------|-------|-------|
| Creativity | Manufacturing     | 97  | 3.833 | 0.591 | 0.059 |
|            | Non-manufacturing | 115 | 3.919 | 0.653 | 0.601 |
| Innovation | Manufacturing     | 96  | 3.846 | 0.677 | 0.059 |
|            | Non-manufacturing | 110 | 3.777 | 0.642 | 0.061 |

\* Difference in mean values

The results of the t-test as illustrated in table 3 reveal differences in the mean scores between manufacturing and non-manufacturing businesses in the following variables: strategy (3.151; 3.371), training and development (3.319; 3.660), and commitment (3.608; 3.837). To further establish the relationship between the dependent and independent variables, a t-test for equality of means was conducted of which the results are illustrated in table 4.

**Table 4: Results of the t-test for equality of means of independent and dependent variables**

| Dependent variable              | T       | Df      | Sig. (2-tailed) | Mean difference | Standard error Difference | 95% confidence interval of the difference |         |
|---------------------------------|---------|---------|-----------------|-----------------|---------------------------|---|---------|
|                                 |         |         |                 |                 |                           | Lower                                     | Upper   |
| <b>Strategy</b>                 |         |         |                 |                 |                           |   |         |
| Equal variance Assumed          | - 2.356 | 202     | 0.019*          | - 0.219         | 0.093                     | - 0.404                                   | - 0.359 |
| Equal variance Not assumed      | - 2.376 | 201.394 | 0.018*          | - 0.219         | 0.093                     | - 0.402                                   | - 0.037 |
| <b>Structure</b>                |         |         |                 |                 |                           |   |         |
| Equal variance Assumed          | - 0.667 | 196     | 0.572           | - 0.045         | 0.079                     | - 0.203                                   | 0.112   |
| Equal variance Not assumed      | - 0.667 | 187.863 | 0.572           | - 0.045         | 0.079                     | - 0.203                                   | 0.112   |
| <b>Training and Development</b> |         |         |                 |                 |                           |   |         |
| Equal variance Assumed          | - 2.813 | 203     | 0.005*          | - 0.230         | 0.082                     | - 0.392                                   | - 0.069 |
| Equal variance Not assumed      | - 2.811 | 198.080 | 0.005*          | - 0.230         | 0.082                     | - 0.392                                   | - 0.089 |
| <b>Commitment</b>               |         |         |                 |                 |                           |   |         |
| Equal variance Assumed          | - 2.636 | 203     | 0.012*          | - 0.229         | 0.080                     | - 0.407                                   | - 0.061 |
| Equal variance Not assumed      | - 2.531 | 199.408 | 0.012*          | - 0.229         | 0.093                     | - 0.408                                   | - 0.051 |

|                            |         |         |       |         |       |         |       |
|----------------------------|---------|---------|-------|---------|-------|---------|-------|
| <b>Creativity</b>          |         |         |       |         |       |         |       |
| Equal variance Assumed     | - 0.992 | 210     | 0.322 | - 0.086 | 0.086 | - 0.266 | 0.084 |
| Equal variance Not assumed | - 1.001 | 208.940 | 0.318 | - 0.086 | 0.086 | - 0.254 | 0.083 |
| <b>Innovation</b>          |         |         |       |         |       |         |       |
| Equal variance Assumed     | 0.815   | 204     | 0.416 | 0.069   | 0.086 | - 0.099 | 0.238 |
| Equal variance Not assumed | 0.821   | 203.815 | 0.413 | 0.069   | 0.085 | - 0.098 | 0.237 |

\*Significant level at 0.05

The results of table 4 indicate a significant relationship in the following three variables: strategy (p-value 0.019), training and development (p-value 0.005) and commitment (p-value 0.012). Since the mean differences between manufacturing and non-manufacturing businesses is not that significant, it can be concluded that entrepreneurship can be developed in any nature/type of a business. Strategy, training and development, and commitment are key variables essential for the development of entrepreneurship and new venture creation in any nature/type of a business.

### **Relationship between the existence of a training department in a business and the variables essential for the development of entrepreneurship**

The majority of the respondents (61.7%) indicated that their businesses has a fully developed training department, 37.4 percent indicated that there exist no training department in their business, and 0.9 percent can be regarded as neutral or indifferent. The results of the analysis of variance (ANOVA) and the t-test undertaken are for this category are depicted in table 5 and table 6.

**Table 5: Results of the t-test group statistics for independent and dependent variables**

| <b>Dependent variables</b> | <b>No. of employees</b> | <b>Mean</b> | <b>Standard deviation</b> | <b>Standard error</b> |
|----------------------------|-------------------------|-------------|---------------------------|-----------------------|
| Strategy                   |                         |             |                           |                       |
| Yes                        | 123                     | 3.311       | 0.655                     | 0.059                 |
| No                         | 78                      | 3.185       | 0.693                     | 0.078                 |
| Structure                  |                         |             |                           |                       |
| Yes                        | 120                     | 3.497*      | 0.483                     | 0.044                 |
| No                         | 74                      | 3.329*      | 0.642                     | 0.075                 |
| Training and development   |                         |             |                           |                       |
| Yes                        | 126                     | 3.504*      | 0.627                     | 0.056                 |
| No                         | 76                      | 3.329*      | 0.522                     | 0.061                 |
| Commitment                 |                         |             |                           |                       |
| Yes                        | 126                     | 3.767       | 0.671                     | 0.598                 |
| No                         | 77                      | 3.655       | 0.631                     | 0.072                 |

|            |     |        |       |       |
|------------|-----|--------|-------|-------|
| Creativity |     |        |       |       |
| Yes        | 130 | 3.963* | 0.595 | 0.052 |
| No         | 79  | 3.743* | 0.655 | 0.073 |
| Innovation |     |        |       |       |
| Yes        | 128 | 3.932* | 0.583 | 0.052 |
| No         | 75  | 3.580* | 0.601 | 0.069 |

\*Difference in mean values

**Table 6: Results of t-test for equality of means of independent and dependent variables**

| Dependent variable              | T     | Df      | Sig. (2-tailed) | Mean difference | Standard error Difference | 95% confidence interval of the difference |       |
|---------------------------------|-------|---------|-----------------|-----------------|---------------------------|---|-------|
|                                 |       |         |                 |                 |                           | Lower                                     | Upper |
| <b>Strategy</b>                 |       |         |                 |                 |                           |   |       |
| Equal variance Assumed          | 1.315 | 199     | 0.190           | 0.128           | 0.097                     | - 0.064                                   | 0.319 |
| Equal variance Not assumed      | 1.299 | 167.271 | 0.196           | 0.128           | 0.098                     | - 0.066                                   | 0.322 |
| <b>Structure</b>                |       |         |                 |                 |                           |   |       |
| Equal variance Assumed          | 2.706 | 192     | 0.007*          | 0.219           | 0.081                     | 0.059                                     | 0.378 |
| Equal variance Not assumed      | 2.633 | 123.650 | 0.013*          | 0.219           | 0.089                     | 0.048                                     | 0.391 |
| <b>Training and Development</b> |       |         |                 |                 |                           |   |       |
| Equal variance Assumed          | 2.038 | 200     | 0.043*          | 0.175           | 0.086                     | 0.006                                     | 0.344 |
| Equal variance Not assumed      | 2.137 | 179.233 | 0.035*          | 0.175           | 0.086                     | 0.013                                     | 0.337 |
| <b>Commitment</b>               |       |         |                 |                 |                           |   |       |
| Equal variance Assumed          | 1.182 | 201     | 0.239           | 0.112           | 0.095                     | - 0.075                                   | 0.30  |
| Equal variance Not assumed      | 1.200 | 168.464 | 0.232           | 0.112           | 0.093                     | - 0.073                                   | 0.287 |
| <b>Creativity</b>               |       |         |                 |                 |                           |   |       |
| Equal variance Assumed          | 2.604 | 207     | 0.013*          | 0.220           | 0.088                     | 0.049                                     | 0.394 |
| Equal variance Not assumed      | 2.449 | 153.355 | 0.015*          | 0.220           | 0.090                     | 0.043                                     | 0.398 |
| <b>Innovation</b>               |       |         |                 |                 |                           |   |       |
| Equal variance Assumed          | 4.109 | 201     | 0.000*          | 0.352           | 0.086                     | 0.183                                     | 0.521 |
| Equal variance Not assumed      | 4.076 | 161.223 | 0.000*          | 0.352           | 0.086                     | 0.182                                     | 0.623 |

\*Significant level at 0.05

The result of the t-test analysis represented in table 5 reveals differences in the mean values of the following variables: structure, training and development, creativity and innovation. The t-test for equality of means as depicted in table 6 revealed a significant relationship in the

following four variables: structure (p-value 0.007), training and development (p-value 0.043), creativity (p-value 0.013) and innovation (p-value 0.000). It can therefore be concluded that the existence of a training department in a business has a positive influence towards the development of entrepreneurship and new venture creation.

## **CONCLUSION AND RECOMMENDATIONS**

Considering the fact that South Africa faces the problem of high unemployment and slow economic growth and that South Africa rank 36<sup>th</sup> out of 40 countries in the world in terms of entrepreneurial activities in established businesses, this study offer an alternative model that can be used to improve the status of business involvement in entrepreneurial activities.

The study shows that strategy, training and development, and commitment by management are key essential components for businesses to become entrepreneurial. Achieving sustainable advantage in the new competitive landscape requires managers to think and act strategically, and to formulate appropriate entrepreneurial strategies. Thus strategic planning is the primary step in anticipating and managing entrepreneurship in any business venture. A strategy, in essence, attempts to capture where the business wants to go and how it plans to get there. When entrepreneurship is introduced to strategy, the possibilities for where the business can go, and how far it can go towards getting there, are greatly enhanced.

With such rapid changes in technology and the rate at which new products and services are introduced, achieving a sustainable advantage in the new competitive landscape requires managers to constantly empower their employees through training and development. Training and development programmes in a business have a considerable influence on employee performance. A business that invests in training programmes as an empowerment vehicle will be better able to improve productivity than a business that does not invest in its employees.

The existence of a training department in a business creates a favourable environment for the implementation of training and development programmes, whereby employees are exposed to both a formal and an informal learning environment. It therefore follows that creativity and innovation will be favoured in such an environment because employees will get the opportunity to unleash their potential and become more productive. Having a training department in a business will also ensure the life-long learning of an organisation.

Changing job demands and the need to keep abreast of the newest technologies suggest a need for ongoing training. Training and development empower employees to be able to respond in a unique ways to new challenges, and to adapt to dynamic environmental conditions. Training and development should not only be limited to employees in a business, but should be extended to include external prospective entrepreneurs through internship and learnership.

Interns can be exposed to start-up businesses, high-growth businesses, or nonprofit organisations seeking innovative and entrepreneurial solutions, and thus expose them to real-life challenges. This way interns get a good opportunity to enhance entrepreneurial classroom education with the practical perceptions that can only come from confronting real entrepreneurial challenges.

Commitment is the nucleus that leads to the success of any undertaking. There cannot be any change in the direction of the business, unless management is committed to change. The results of the survey showed that respondents agreed strongly that traditional management style is no longer good enough for business success. A transformational leader who moves with the times, faces the challenges, and steers the business towards the changing competitive landscape is required. It takes a committed leader who is willing to take risks to tackle the challenges that are brought about by the changing market to respond accordingly, and engage in entrepreneurial activities that will keep the business abreast with their competitors.

It is therefore recommended that businesses in South Africa adopt a holistic approach that embraces entrepreneurship in all organisational levels as outlined in Morris and Kuratko (2002:34) model. Strategy, training and development need strong emphasis, with unwavering commitment from all level of management.

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# ROLE OF OPPORTUNITY RECOGNITION IN TEACHING ENTREPRENEURSHIP

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## ABSTRACT

Scholars and researchers in entrepreneurship have reported that small business management and entrepreneurship courses at both the 2 and 4-year college and university levels have grown in the number and diversity of course offerings from 1990-2004. This expansion of educational offerings has been fueled in part by dissatisfaction with the traditional Fortune 500 focus of business education voiced by students and accreditation bodies (Solomon & Fernald, 1991). The dilemma is not that demand is high but that the pedagogy selected meets the new innovative and creative mindset of students. Plaschka and Welsch (1990) recommend an increased focus on entrepreneurial education and more reality and experientially-based pedagogies such as those recommended by Porter and McKibbin (1988). The challenge to educators will be to craft courses, programs and major fields of study, meeting the rigors of academia while keeping a reality-based focus and entrepreneurial climate in the learning experience environment. One demand is that they must be able to initially recognize a potential opportunity, as a precursor to further behavior. The process that opportunity recognition entails can foretell the success or failure of a new venture – it is a crucible. There is a burgeoning body of literature in the young field of entrepreneurship and entrepreneurship education; however, little research exists regarding the specific competency of opportunity recognition, and even less of the research is empirical in nature.

## INTRODUCTION

The purpose of this paper is to review the entrepreneurship education literature to explore current thinking regarding entrepreneurs and the competencies necessary for success, and will investigate the opportunity recognition competency specifically. Models of the opportunity recognition process, creativity literature, and pedagogical methodologies will also be the subject of inquiry, along with their theoretical underpinnings. This paper will search for relationships between concepts and proposals for how we might best prepare students to follow their entrepreneurial dreams.

The entrepreneurial experience can be characterized as being chaotic and ill-defined, and our entrepreneurship education pedagogies should reflect this characterization. In addition, we often make the assumption that it is relatively easy for entrepreneurship students to develop new ideas for their business start-ups. Quite a number of researchers have written about entrepreneurial competencies; however, the competencies that are required for new business start-ups are often

addressed by educators in an ad-hoc manner. There is little consensus on just what exactly entrepreneurship students should be taught.

For entrepreneurship educators, the challenge is to provide the subject matter, resources, and experiences that will prepare entrepreneurship students to cope with the myriad of expectations and demands they will face as they start their new ventures. One demand is that they must be able to initially recognize a potential opportunity, as a precursor to further behavior. The process that opportunity recognition entails can foretell the success or failure of a new venture – it is a crucible. It would seem apparent, then, that adequate attention should be given to the pedagogies addressing this competency. There is a burgeoning body of literature in the young field of entrepreneurship and entrepreneurship education; however, little research exists regarding the specific competency of opportunity recognition, and even less of the research is empirical in nature.

## **METHODOLOGY**

For purposes of this paper, literature was reviewed from the proceedings of entrepreneurship and management conferences; indices and tables of contents of entrepreneurship, management, and creativity journals; online library databases; and online listings of entrepreneurship education courses and textbooks. The field of entrepreneurship education is a relatively young one (Sexton, 1982). Since the 1970's, there has been a huge increase in the number of articles written (for example, the USASBE online Bibliography lists 2,073 items for "Entrepreneurship Education"). The resources used primarily were those that specifically dealt with cognitive and learning needs, curriculum development and pedagogy.

## **ENTREPRENEURSHIP EDUCATION**

As we delve into the literature on entrepreneurship education, it would be helpful to define what we mean by "entrepreneurship education." Shepherd and Douglas (1997) propose:

The essence of entrepreneurship is the ability to envision and chart a course for a new business venture by combining information from the functional disciplines and from the external environment in the context of the extraordinary uncertainty and ambiguity which faces a new business venture. It manifests itself in creative strategies, innovative tactics, uncanny perception of trends and market mood changes, courageous leadership when the way forward is not obvious and so on. What we teach in our entrepreneurship classes should serve to instill and enhance these abilities.

We have seen an increase in entrepreneurship education programs, and research will likely continue as the field matures. Unfortunately, as reported by Gorman, Hanlon, & King (1997), "there is little uniformity in the programs offered, especially if one considers the relative similarity of other business programs" (p. 70), a topic to be explored in the next sections.

### **Overall "Essence" of Entrepreneurship Education:**

Entrepreneurship education programs exist, most generally, within established university business schools, and this presents a paradox that helps to explain the above-mentioned lack of uniformity in curriculum and pedagogies. Traditional business programs have come under increased criticism for failing to be relevant to the needs of today's changing business environment (Brown, 1999). One common criticism is that business education has become too functionally oriented – that it doesn't stress the cross-functional complexity of business problems. Other criticism focuses on the "lack of creativity and individual thinking required at both undergraduate and graduate levels" (Solomon, Fernald, & Weaver, 1993). Sexton and

Bowman (1984) note that most business school courses are highly structured and do not often pose problems which require novel solutions.

Even entrepreneurship courses fall into a left-brain-oriented trap. Bird (2002) describes many core entrepreneurship courses:

...require students to write and present a business plan and often students (in teams limited to fellow classmates who may not be rationally chosen as partners) choose the business concepts to pursue...Problems are presented and time frames for solving them given. There is often the illusion or reality of “right answers” (p. 217).

It is also quite common for entrepreneurship classroom situations to focus heavily on theory – “either management theory being adjusted to give advice for entrepreneurship and small business – or entrepreneurship theory explaining the emergence of entrepreneurs and their personal traits” (Blenker, Dreisler, Kjeldsen, & Meibom, 2003). Others echo this concern by noting that entrepreneurship programs often educate “about” entrepreneurship rather than educate “for” entrepreneurship (Kirby, 2003). The essence of entrepreneurship education, then, must reflect reality.

Garavan and O'Conneide (1994) suggest that the best methods suited to an entrepreneurial learning style are active-applied and active experimentation (p. 10), and these also include concrete experience, reflective observation, and abstract conceptualization (Davies & Gibb, as cited in Garavan et al., 1994). In short, “educational programs and systems should be geared toward creativity, multidisciplinary and process-oriented approaches, and theory-based practical applications. What is needed is a more proactive, problem-solving and flexible approach rather than the rigid, passive-reactive concept, and theory-emphasized functional approach” (Plaschka & Welsch, 1990, p. 61).

### **Pedagogy: Teaching for Competencies:**

Competency can be defined as an underlying characteristic of a person, which results in effective and/or superior performance in a job (Boyatzis, as cited in Bird, 2002; Spencer & Spencer, as cited in Bird, 2002). As in previous sections, there is little agreement in the field about the competencies or capabilities that are most valuable for aspiring entrepreneurs to learn.

Entrepreneurial educators teach for competencies; their syllabi reflect their beliefs and academic disciplines. Fiet (2000), for example, examined the syllabi of 18 entrepreneurship courses and found they covered 116 different topics; however, topics do not always reflect competencies (e.g., family business). Plaschka et al. (1990) note that “many programs are evolving on a trial and error or as needed basis, depending on the types of entrepreneurial projects currently undertaken in the program and on the feedback of students experiencing deficiencies, gaps, and difficulties in their courses. These are not necessarily poor approaches to program development...” (p. 66).

Quite a number of researchers have written about entrepreneurial competencies, and we chose several articles to see if there were any commonalities in competencies across authors.

Insert Table 1 here

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This was not meant to be a comprehensive list of competencies; in fact, it could be argued that some of the above mentioned are perhaps not behaviors at all, but traits. It is interesting to note

that the two competencies above, that were cited most often, are Creativity and Opportunity Recognition. In the 1999-2000 National Survey of Entrepreneurship Education (Solomon, Duffy, & Tarabishy, 2002), when respondents were asked what types of courses they were offering in their educational institutions, only 4% of respondents stated they offered a Creativity Management course. Relf (1995) states: “The intense need for American firms to become more competitive have heightened the need for an increase in creativity to develop new products, new services, and better ways of delivering existing goods and services. Isn’t it astonishing that in most curricula, creativity is absent?”

The literature exploring opportunity recognition and its counterpart, creativity, will be discussed in the following sections.

### **ENTREPRENEURIAL OPPORTUNITY RECOGNITION**

The topic of opportunity recognition is an important one; after all, it represents the foundation of a new entrepreneurial venture. A review of the literature in this area leads us to such rubric as intuition, alertness, intentionality, cognitive processing, personality traits, innovation, and creativity, among others; most of it is descriptive and definitional. The authors of this literature often define the concept, expand upon it, and then tell us how important the topic is to the discipline.

We believe the reason for a lack of consensus is that the entrepreneurship discipline doesn’t have unified definitions of many entrepreneurship concepts, including “opportunity recognition.” In the literature, opportunity recognition is proposed as *the* process or the *outcome* of the process, when it is possible, we believe, that *opportunity recognition is only part of a process – the creativity process*. Intuition, alertness, intention, and the other concepts mentioned above, are *components* of the creativity process.

Singh, Hills, and Lumpkin (1999) define opportunity recognition as “an activity that can occur both prior to firm founding and after firm founding throughout the life of the firm.” Although defining entrepreneurs, Chia (1996) also gives us a good description of opportunity recognition:

Etymologically, the term “entrepreneur” derives from two terms, *entre*, meaning to “enter” or to “penetrate in between” and *prendre* or *prehendere*, meaning to “grasp” or “seize hold of.” Therefore, the entrepreneur is one who *penetrates* the spaces between established boundaries and *seizes* opportunities that are otherwise overlooked by others (p. 413).

There is diverging literature about when opportunity recognition occurs. On one hand, some researchers suggest that opportunities are “discovered.” Koller (1988), for example, showed that “most entrepreneurial ideas seem to be recognized as they appear rather than actively sought out” (p. 203). In another study, Beattie (1999) reported that many of the entrepreneurs he interviewed “picked up opportunities rather than ideas, and were then able to convert the opportunities into ideas” (p. 146).

On the other hand, quite a number of researchers are calling opportunity recognition a process. It is the authors’ contention that opportunity recognition is actually part of a larger process, which will be discussed later in this paper.

#### **Models of Opportunity Recognition Process:**

Notwithstanding researchers who have proposed that opportunity recognition is a stand-alone “aha” moment, it is apparent that this is a process. In a more generic sense regarding the creative process:

Perhaps the creative process unfolds as the developmental sequence of

representational changes, from vague, syncretic, and implicit forms of knowledge into more differentiated, integrated, and explicit ones. In more technical terms, it is conceivable, at least, that the creative process might operate as a developmental translation - -from an implicit code of associative strengths among neural units into an explicit code of symbolic rules. In this cognitive system, implicit neural networks might precede and constrain the generation of symbolic rules (Policastro, 1995, p. 110)

In 1984, Long and McMullan proposed a model of the opportunity identification process with four stages: first, is a pre-vision stage which involves both uncontrollable and controllable factors that set a person up for opportunity discovery; second, is a “point of vision” – much like the “aha” moment of discovery; third, is an “opportunity elaboration” stage to “fill in the gaps and overcome anticipated problems” with the idea; and the fourth stage is a “decision to proceed.”

Hills, Shrader, and Lumpkin (1999) suggest that opportunity recognition is a special case of the creativity process. They used Wallas’ (1926) four-stage\* creativity process model as the basis for their opportunity recognition process model:

1. Preparation: At this first stage, the problem solver begins to gather information about the problem to be solved. Hills et al. note that this stage also refers to the background and experience that an entrepreneur brings to the opportunity recognition process.
2. Incubation: In this stage, gathering more information will be counterproductive. Efforts to solve the problem must be abandoned and allowed to sink into the unconscious mind. This appears to be a “mulling over” period, where the thinker has put the problem on the conscious back shelf for the moment. Hills et al. suggest that this period is typically unconscious, and is an intuitive, non-linear, non-intentional style of considering options.
3. Insight: Wallas referred to this style as the Illumination stage. In this stage, the problem solver suddenly experiences insight into the problem – it is the “Aha!” experience. Hills et al. suggest that there may be three different insights with regard to entrepreneurs: (1) is the experience of spontaneous recognition of a business; (2) would be the occasion when a person gets the idea that solves a problem that he or she has been pondering; and (3) is that it represents the moment when an idea becomes available to the entrepreneur via his/her social network (p. 218).
4. Evaluation/Verification: This stage is when the thinker tries and checks the solution. It involves research into whether a concept will work, whether the thinker has the skills necessary, and whether it is truly novel. Hills et al. note that this is the feasibility analysis stage for entrepreneurs.
5. Elaboration: This is the stage when the creative idea is actualized, or put into a form ready for formal presentation. Hills et al., propose that this is stage represents the process of business planning.

\* Note: Wallas’ creativity model only included the first four stages; subsequent researchers, however, often included the last stage or some variation that Hills et al. have used.

Hills et al. further note that “opportunity recognition” is a staged process that involves the possibility of feedback loops from the moment of insight or the results of evaluation to greater preparation and ongoing incubation (p. 223).

## DISCUSSION AND CONCLUSION

It would appear that entrepreneurs need certain competencies in order to enhance the probability of success of their new ventures, and one of those competencies is opportunity recognition. Opportunity recognition is primarily a cognitive process that most likely can be enhanced with training, and one of the purposes of education is to increase desired behaviors. If we look at the problem from that simplistic level, it would be possible that focused entrepreneurship education could increase the degree of the opportunity recognition competency, and hence, behavior.

Opportunity recognition is an important component of the entrepreneurial process, and it appears to be receiving some increased attention in the last few years. It can be a little daunting trying to get a picture of the process, however, because there are what appears to be a multitude (relatively speaking) of voices telling us how important opportunity recognition is, what it is, and how it works. It is this “how it works” that can be particularly confusing when we read about intuition, alertness, awareness, intention, and so on. Hills et al. (1999) had it correct when they stated that opportunity recognition is a special case of the creativity process. All creativity could be said to have the goal of opportunity recognition; in the case of entrepreneurs, the goal may or may not lead to a new venture.

Below is a proposed working model of the entrepreneurial creative process:

Insert Figure 1 here

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It is based on systems and cognitive theories, as well as Wallas’ theory of the creative process. The individual brings knowledge, skills/abilities, and experience (which includes memory) to the creative process. The creative process will not be reiterated here in great detail because it was discussed in the models of the opportunity recognition process above; however, additional comments are below:

- **Problem Discovery:** This stage has been separated from Wallas’/Hills et al. models, because the entrepreneur is alerted to a potential opportunity. This has also been called “problem finding,” or as Amabile (1996) calls it, “problem or task identification.” The individual is relatively passive at this stage, in terms of cognitive processing.
- **Preparation:** Focused attention, researching, intuition and intention all play a part in this stage. The entrepreneur begins “doing the research” – whether consciously or unconsciously, formally or informally. In other words, environmental scanning begins during this stage.
- **Incubation:** During much of this stage, the entrepreneur consciously engages in associations and patterning (this is where this model most differs from previous models). At this stage, divergent thinking is evident. This can be an uncomfortable time for the entrepreneur, as the cognitive processing can become almost overwhelming for the entrepreneur. It is towards the end of this stage, that the entrepreneur’s unconscious takes over; he or she unconsciously continues the cognitive processes to search for the answers he/she requires. Even though the entrepreneur has put the process “on the back shelf” as stated earlier, the unconscious processing continues.
- **Illumination:** It is during this stage that insight, or opportunity recognition, occurs. *In this model, opportunity recognition is synonymous with the “Aha!” moment.* Convergent thinking begins.
- **Verification:** This is the stage in which the entrepreneur does a formal (and indeed, informal in many cases) feasibility evaluation. The Formal Business Plan would ideally be the

outcome of this process; in any case, if the entrepreneur decides that the opportunity is a viable one, he or she begins the process of start-up.

The process in this model appears linear; it isn't. There is constant reiteration and feedback during the process (thus, the multiple arrows from feedback on the model). All of the capabilities or competencies that have been proposed as being important to opportunity recognition are included in this model. At any time during the process, the entrepreneur may decide that the opportunity isn't a good one, there aren't resources available, or the time isn't right. The social and economic environment also affects and is affected by the process; it is shown as a cloud because it is always changing. Because it is never static, it exerts differing amounts of pressure on the process. This process model does not take into account, "serendipity." Some researchers (e.g., DeTienne & Chandler, 2004; Martello, 1995) note that many discoveries appear to occur randomly or by chance. However, the entrepreneur will still go through the creativity process to cognitively determine an idea's potential viability.

Little research has been done to date dealing with entrepreneurial behavior once entrepreneurship education has been completed – and for good reasons. Since the discipline of entrepreneurship is a young one (relative to many other fields), we are not seeing rapid convergence towards a unified theory of entrepreneurship, much less agreement on necessary competencies. Measurement issues are still major roadblock. For example, do we continue to interview or survey nascent entrepreneurs, with the related reliability and validity problems that can ensue? We have seen, in the creativity training area, just such difficulties. In the area of innovation, we are beginning to see research using number of patents or new products developed as measurement tools, but that has inherent drawbacks as well.

If opportunity recognition is a part of the creative process, as the model above proposes, it may have implications for entrepreneurship education in this area. Perhaps we should be refocusing our attention on creativity as the competency. Even though the findings for the efficacy of creativity training are not overwhelming, it would appear that progress is being made for prescriptive approach to pedagogies in this area. Specifically, we propose that entrepreneurship educators consider the following when designing their entrepreneurship courses and programs:

- Stop focusing solely on entrepreneurial functional processes (after all, these are not totally different from the functional business courses that students already receive).
- Include an introductory creativity course in their entrepreneurship program.
- Introduce creativity and the use of heuristics experientially throughout their courses.
- Relate the results of creativity experiments to specific and generalizable situations in the entrepreneurial experience.

This can also have implications for future avenues of entrepreneurship study. For example, are the creative training research and training methodologies transferable into the entrepreneurship education discipline? Can we provide classroom experiences that will be appropriate for future entrepreneurs? Are there methods we can use that will increase patterning cognitions for entrepreneurs? These are just a few questions that may provide the impetus for future research.

By examining the discipline of entrepreneurship education and its related pedagogies, it is hoped that this paper will have accomplished something in the way of providing a measure of clarity as to the issues that are relevant in the discipline and furthered the position that we must continue to refine our perspectives and research methodologies. The field is still emerging; however, it will no doubt, continue to strive to provide the necessary tools to students so that they have a firm foundation on which to build their new ventures.

**Table 1: Entrepreneurial Competencies from a Small Sample of Journal Articles**

| Competencies                           | Bird, 2002* | Thompson, 1999 | Santi, 1994** | Fiet, 2000 | Hisrich, 1992 | Hood et al, 1993 | Nieuwenhuizen et al, 2002 | Vesper et al, 1988 | Ronstadt, 1985 |
|--|-------------|----------------|---------------|------------|---------------|------------------|---------------------------|--------------------|----------------|
| Achievement/task motivation            | X           | X              |               |            |               |                  | X                         |                    |                |
| Change-oriented                        |             |                |               |            | X             |                  |                           |                    |                |
| Create & utilize networks              | X           | X              |               |            |               |                  |                           |                    | X              |
| Create capital                         |             | X              |               |            |               |                  |                           |                    |                |
| Creativity/Idea generation             | X           | X              |               | X          | X             | X                | X                         | X                  | X              |
| Decision making/evaluation             |             |                |               |            | X             | X                |                           |                    | X              |
| Design business organization           | X           |                |               |            |               |                  |                           |                    |                |
| Design products or services            | X           | X              |               |            |               |                  |                           |                    |                |
| Discipline/Drive                       | X           |                |               |            | X             |                  |                           |                    |                |
| Functional                             | X           |                |               |            | X             | X                | X                         | X                  |                |
| Interpersonal skills                   | X           | X              |               |            |               | X                | X                         |                    |                |
| Leadership                             | X           |                | X             | X          |               |                  |                           |                    |                |
| Listening                              |             |                |               |            |               |                  |                           | X                  |                |
| Manage growth                          |             |                |               |            |               | X                |                           |                    |                |
| Manage project                         |             |                | X             |            |               |                  |                           |                    |                |
| Manage risk                            |             | X              |               | X          | X             |                  | X                         |                    |                |
| Maneuver in industry                   | X           |                |               |            |               |                  | X                         |                    |                |
| Monitor the work of others             | X           |                |               |            |               |                  |                           |                    |                |
| Motivate org. members                  | X           |                |               |            |               |                  |                           |                    |                |
| Need for control of financial outcomes | X           |                |               |            |               |                  | X                         |                    |                |
| Negotiation                            |             |                |               |            | X             |                  |                           | X                  | X              |
| Opportunity recognition                |             | X              | X             |            |               | X                |                           | X                  | X              |
| Oral communication                     | X           |                |               |            |               | X                |                           | X                  |                |
| Reality Testing                        |             |                |               |            |               |                  |                           |                    | X              |
| Resource finding/financing             |             | X              |               | X          |               |                  |                           |                    |                |
| Planning, comprehensive                | X           |                |               |            |               | X                |                           |                    | X              |
| Plan strategy                          |             |                | X             | X          |               |                  | X                         |                    | X              |
| Technology                             |             |                |               |            |               |                  |                           | X                  |                |
| Tolerance for ambiguity                | X           |                |               |            | X             |                  |                           |                    | X              |
| Vision                                 |             |                |               |            | X             |                  |                           |                    |                |
| Writing                                |             |                |               |            |               |                  |                           | X                  |                |
| Ethics                                 |             |                |               |            |               | X                |                           |                    | X              |

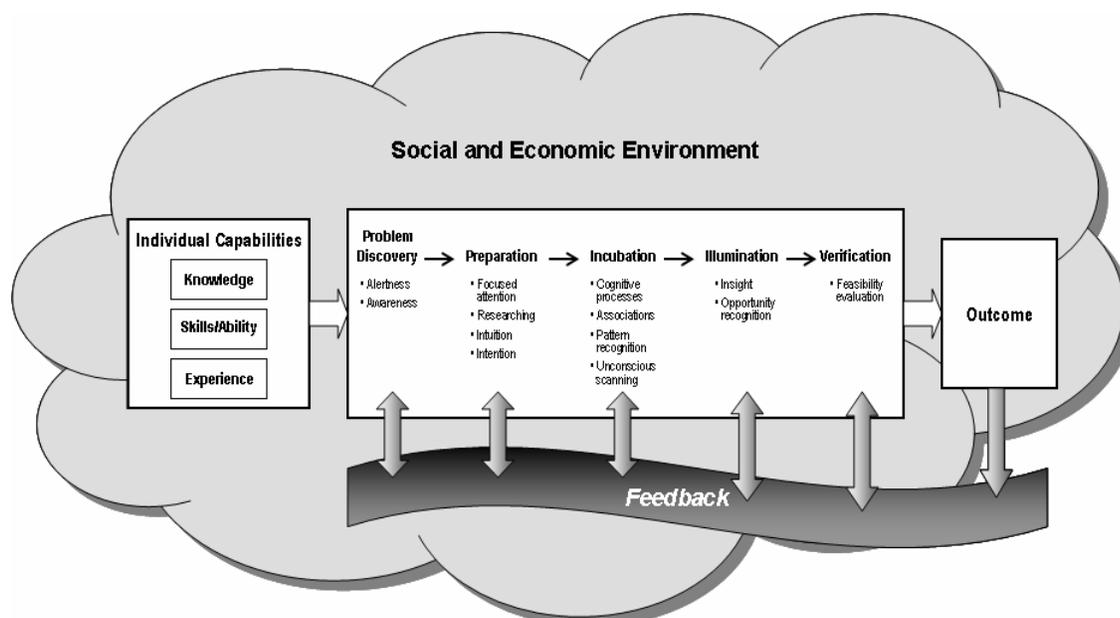
\*Success competencies with empirical support. Based on Working List of Entrepreneurial Competencies, Bird, 1995

\*\*As cited in Fayolle, 1998

Note: Hisrich lists three primary categories: technical, business management, and personal entrepreneurial skills

Note: Names of competencies may not match exactly those named in papers.

**Figure 1**



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**STRUCTURAL AND COMPETITIVE DETERMINANTS OF GLOBALLY-  
ORIENTED SMALL AND MEDIUM-SIZED ENTERPRISES: AN EMPIRICAL  
ANALYSIS AND CHALLENGES FOR SUCCESS**

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Submitted to

The 2005 50th World Conference of ICSB

## **Abstract**

Building on previous studies, this paper examines the factors influencing the globalization of a particular group of SMEs - Canadian agricultural equipment manufacturers. From a population of 240 firms identified, we received 81 useable responses to our questionnaire. Data from the responses were analyzed using the PLS-graph program.

Two sets of data were considered – the entire sample, and a sub sample consisting of globally oriented firms. Findings indicate a strong direct impact of internal factors such as manager's international experience (30%, 20%, respectively on the samples above), firm's size (70%, 42%), and distinctiveness (0%, 37%) on the total variation explained in globalization. In addition to their direct influences, size and manager's experience have also an indirect and significant influence through distinctiveness.

The direct influence of external factors on SME globalization are moderate for standardization and uncertainty. Competitive pressures have also a moderate indirect influence (through standardization and learning).

The influence of strategic actions is less than moderate. Only scanning has an indirect and significant influence through distinctiveness and a moderate influence through learning. We think that the moderate influence of strategic actions could be related more to methodological problems than to the constructs themselves.

Globalization has a significant influence on the variance explained in profitability (30%, 36%). However, the model explained only around 10% of profit variation. The paper calls for further research on constructs of the model using adapted indicators with more relevance for SMEs.

# **THE RATIO DEPENDENCE PROBLEM IN FINANCIAL RATIO ANALYSIS FOR SMALL FIRMS: AN AUSTRALIAN PERSPECTIVE**

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## **ABSTRACT**

Ratios determined from their financial records are often used to measure and monitor the performance of small firms. Understanding the nature of these ratios and possible problems in their computation and interpretation is a critical issue in the small firm domain. For example, the comparability of research studies demands a certain degree of constancy in variable definition and the interpretation of results. Also, developing assistance possibilities through public policy initiatives or advisory practice requires access to accurate and comparable sources of information.

Studies using factor analysis to select ratios from multi-business data bases have found that the number of factors may differ between data sets and that long-term stability may be questionable. Such differences give rise to the research question analysed in this paper – are the most commonly used predetermined ratios used in research and practice environments an independent set of ratios with respect to the data from which they are determined?

Factor analysis of the financial records of 3,986 Australian firms reduced an initial cohort of fifty-four ratios into eighteen independent factors. The null hypothesis that each of the six principal ratios most frequently used in research and in practice is an independent representative of one and only one factor is rejected. These results reinforce the need in studies of small firms to use factor analysis or other statistical approaches to determine independent factors rather than relying on a universal and predetermined set of ratios.

## INTRODUCTION

### SME Performance Categories

Small and medium enterprises (SMEs) are often placed into performance categories to assist analysis and understanding of separate firms and of aggregations of such firms. SMEs that grow, for example, is a category of SMEs associated with positive outcomes. These include: the creation of the major proportion of net new jobs in economies (Bridge, O'Neill and Cromie, 1998); contribution to innovative outputs (Holmes, Hutchinson, Forsaith, Gibson and McMahon, 2003); and, attractiveness to suppliers of funding because of prospects for financial returns as well as a "feeling of success through association" (Bridge *et al.*, 1998, p.163). On the other hand when a business ceases, due to bankruptcy for example, there are costs to the economy and costs to the firm that can bear disproportionately heavily on the SME owner (Robertson and Tress, 1985). Hence, SMEs that cease is another often used performance based category.

Where business assistance resources are limited, which is often the case, an appropriate way to maximise results is to apply those resources where they are most effective. Thus, when SME assistance (through, for example, public policy initiatives or consultancy based advisory practices) is focused on "what should be done and for whom?" (Larson and Clute, 1979, p.35), it is an important first step to be able to identify firms as 'belonging' to a particular performance category. For the growth firm, appropriate assistance may be in the form of "removing or easing impediments affecting development" (National Investment Council, 1995, p.15). For a firm with declining performance, appropriate assistance may be more in the form of managerial advice, resulting in corrective action and problem aversion (Robertson and Tress, 1985).

Financial information is generally important in many aspects of these processes. Identification of the performance category into which firms can be placed often relies on analysis of the financial characteristics of SMEs. Financial information is likely to be used to compare the performance of a firm with the average performance of a group of similar firms (e.g. industry groups). One approach to measuring and monitoring financial performance, especially in a comparative process, is the use of financial ratio analysis.

### Ratio selection

Financial ratios express relationships among items taken from financial statements. The traditional use of financial ratios has been as a measure of the liquidity, performance and profitability of a firm and thereby as a monitor of the efficiency and effectiveness of management (Thomas and Evanson, 1987). The ratio of current assets to current liabilities, for example, provides information about a company's ability to pay its current debts with existing current assets. Monitoring this ratio over time determines if this ability is increasing, declining, or is relatively stable. This ratio, known as the *current ratio*, also provides a measure that may be compared with a benchmark (e.g. the industry average of *current ratios*). The expectation is that managers use this information to improve the efficiency and profitability of their operation. Associated with this expectation is the implicit assumption that information from ratio analysis, especially trend analysis, enables management to foresee and possibly avoid business problems.

A common research focus relying on ratio analysis is the identification of discernible differences between the financial ratios of corporations that fail and corporations that do not fail. Beaver (1966) and Altman (1968) pioneered this approach and subsequently extensive work has been done in developing multivariate statistical models, which predict enterprise failure. Much of this work, however, has been developed using data from large firms, partly because an important ratio in Altman's model relies on data for the 'Market Value of Equity', which is not available for small firms. Edmister (1972) was one of the first to develop a failure prediction model specifically for small business in the USA. This was followed by studies in other countries such as those by Castagna and Matolsky (1981) in Australia and Taffler (1984) in the UK.

There has also been considerable debate in the traditional literature as to which ratios are most useful, and in particular, for assessing the likelihood of failure (Barnes, 1987). Ratio selection is a contentious matter because information overlaps individual ratios. On the one hand if all ratios were used the decision model would contain repetitive-redundant data, while on the other hand if only fully independent ratios were included the information content of the semi-independent ratios would be lost. The identification of those ratios, which contain complete information about a firm and also minimize duplication, "cannot be achieved purely by logic" (Barnes, 1987, p.456); in fact it is largely an empirical matter in which correlational independence is used as a statistical criterion.

Using data obtained from large firms, Gentry, Newbold and Whitford (1987) combined cash flow variables with financial ratios finding elements of both to hold predictive ability. With regard to financial ratios the study found that the ratios net income/total assets (NI/TA), total debt/total assets (TD/TA) and cash plus marketable securities/current liabilities (C/CL) were significant determinants of a firm's pending failure. A more recent study by Huyghebaert, Gaeremynck, Roodhooft and Van de Gucht (2000), using data from small to medium start-up firms in Belgium, obtained a similar result to that reported by Gentry *et al.* (1987). Huyghebaert *et al.* (2000) used the same ratios selected by Gentry *et al.* (1987) on the basis that Dimitras, Zanakis and Zopoundis (1996), in a review of business failure models over 12 different countries, had confirmed that those ratios are the "ones that are still most frequently used" (p.631). The seven most frequently used ratios identified in these studies were: net income/total assets (NI/TA), EBIT/total assets (EBIT/TA), total debt/total assets (TD/TA), cash flow/total debt (CF/TD), net working capital/total assets (WC/TA), current assets/current liabilities (CA/CL), and cash plus marketable securities/current liabilities (C/CL).

Huyghebaert *et al.* (2000), however, found multicollinearity problems with the Gentry *et al.* (1987) set of ratios. They found high correlations between the variables NI/TA, EBIT/TA and TD/TA, and between CA/CL and C/CL. Thus, the question is raised as to the wisdom of using a predetermined set of ratios on two grounds: Firstly, are they an independent set of ratios with respect to the data on which they are to be used? Secondly, is the scope of the set of ratios sufficient to capture the required information from the data? As previously indicated this is largely an empirical matter in which correlational independence is used as a statistical criterion. Correlational independence can be achieved by factor analysis (Dimitras *et al.*, 1996).

Ezzamel, Brodie and Mar-Molinero (1987), have recommended the more careful approach to ratio selection of seeking to re-identify the nature and magnitude of factor patterns for different

periods and for different countries. This study follows the suggestion by Ezzamel *et al.* (1987) and uses factor analysis to ‘re-identify’ the nature and magnitude of factors in Australian data in order to establish if the most used ratios as recognised by Dimitras *et al.* (1996) are the most suitable for a similar study to the one conducted by Gentry *et al.* (1987).

This decision to use factor analysis is supported by the following three arguments by Dimitras *et al.* (1996):

- The reduction or elimination of multicollinearity can be achieved by using factor analysis, an approach overlooked by many authors.
- If factor analysis is not used then it is still not clear which ratios ‘should’ be selected. For example, common ratios such as *Total Debt/Total Assets* and *Net Income/Total Assets* were reported by Dimitras *et al.* (1996), to be used widely in the United States but were not used at all in the UK studies in which they were interested (journal articles containing models pertaining to industrial and retail application). Thus, comparability would be an inherent problem whichever ratios were selected.
- The variable set should be constructed on the basis of (a) minimizing the cost of data collection and (b) maximizing the model applicability.

As indicated above, a number of studies using factor analysis to select ratios from multi-business data bases have found that the number of factors may differ between data sets and that long-term stability may be questionable. Such differences give rise to the research question analysed in this paper – are the most commonly used predetermined ratios used in research and practice environments an independent set of ratios with respect to the data from which they are determined?

## ANALYSIS

### Data

The data employed in the study was drawn from the Business Longitudinal Survey (BLS), conducted by the Australian Bureau of Statistics (ABS) on behalf of the Australian Federal Government (ABS, 1999), and released for independent analysis. This database contains data on business units employing fewer than 200 persons, which broadly represents SMEs (small and medium enterprises) in the Australian context. Data for 3,986 firms was used in the analysis.

Data collection in the BLS was achieved by the ABS through self-administered, structured questionnaires containing essentially closed questions. The questionnaires were piloted prior to their first use, and were then progressively refined in the light of experience after each collection. Various imputation techniques, including matching with other data files available to the ABS, were employed to deal with any missing data. The information collected in the BLS was sought under the authority of the *Census and Statistics Act 1905*. Thus, the Australian Statistician could legally enforce appropriate response to the mailed questionnaires. Consequently, response rates were very high by conventional research standards - typically exceeding 90 per cent.

The ABS Business Register was used as the population frame for the survey, with approximately 13,000 business units being selected for inclusion in the 1994-95 mailing of questionnaires. Approximately 6,400 business units were surveyed in each of 1995-96, 1996-97 and 1997-98 (a sub-sample of continuing businesses together with new business units added). Restricted industrial classification detail, no geographical indicators, presentation of enterprise age in ranges, and omission of certain data items obtained in the BLS all help to maintain the confidentiality of unit records. Furthermore, all financial variables have been subject to perturbation - a process in which values are slightly varied to provide further confidentiality protection.

As previously argued, the identification of ratios that contain complete information about a firm and also minimize duplication is largely an empirical matter in which correlation independence is used as a statistical criterion. Thus, this study uses factor analysis to 're-identify' the nature and magnitude of factors in Australian data related to small firms in order to establish if the most used ratios as recognised by Dimitras *et al.*, (1996) are the most suitable for a similar study to those conducted by Gentry *et al.* (1987) or Huyghebaert *et al.* (2000).

The set of financial ratios before factor analysis was applied is shown in Table 1. This set of ratios includes, where possible, those reported by Dimitras *et al.* (1996) in a review of business failure research. It also includes, where possible, the ratios used by both Gentry *et al.* (1987) and Huyghebaert *et al.* (2000). Finally it has been extended to include the ratios listed in the introductory accounting text by Atrill, McLaney and Harvey (2000) and by the addition of a ratio relating to superannuation.

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Insert Table 1 about here  
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The ratios not included in the list are those where the CURF data imposes constraints on ratio calculation. Those ratios referring directly to Debtors and/or Cash and have been eliminated since Current Assets is shown only as a total amount on the CURF and does not disclose the component parts. Specifically, the value of the current asset items *cash* and *marketable securities* could not be determined. Therefore, the ratio C/CL, one of the seven ratios recognised by Dimitras *et al.* (1996) as the 'most used' could not be included in this present study.

Set in terms of the null form, the hypothesis tested was:

The CURF financial data factors into at least six factors in which the six ratios - *net income/total assets (NI/TA)*, *earnings before interest and tax/total assets (EBIT/TA)*, *total debt/total assets (TB/TA)*, *cash flow/total debt (CF/TD)*, *net working capital/total assets (WC/TA)*, and *current assets/current liabilities (CA/CL)* - are each an independent representative of one and only one factor.

## Results

Factor analysis reduced the data into eighteen independent factors (Table 2). Of the six ratios listed in the null hypothesis above (shaded in Table 2), CA/CL and CF/TD belong to the same factor (Factor 1), EBIT/TA and NI/TA belong to the same factor (Factor 3) and, WC/TA and TD/TA belong to the same factor (Factor 4). Thus the null hypothesis that each of the six principle ratios is an independent representative of one and only one factor is rejected.

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Insert Table 2 about here  
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## Discussion

The exploratory nature of this study was deemed necessary because of the nature of the BLS data file: the data file is large; it covers a broad cross-section of Australian SMEs; and the confidentiality requirements have necessitated the perturbation of financial figures.

It would appear from the results that factor analysis is a suitable method for discovering independent factors from which independent variables may be selected. For example, combinations of ratios used in previous studies were found to correlate highly in this study posing a possible collinearity problem.

It should be noted that the Gentry *et al.* (1987) study did find that NI/TA, TD/TA and C/CL were significant determinants of a firm's pending failure. The factor analysis in this study found that NI/TA and TD/TA belong to different factors. (C/CL has been discussed above in relation to data being unavailable on the CURF.) This prompts a replication of the Gentry *et al.* (1987), study using the results of this factor analysis, together with cash flow components, to further investigate whether small firm financial determinants are similar to those of large firms.

Further, the rather large number of independent factors found in this analysis tends to suggest that other studies should be undertaken to reveal other information contained in the BLS data. For example, the data could be divided into the performance categories mentioned in the introduction to this study, SMEs that grow and SMEs cease, and then analysed for category determinants. The results of such studies may help in the determination of efficient and effective distribution of scarce business assistance resources.

## CONCLUSION

This study employed factor analysis to explore the CURF data with the view to test the null hypothesis that the six ratios - NI/TA, EBIT/TA, TD/TA, CF/TD, WC/TA, CA/CL - are each an independent representative of one and only one factor. The results have rejected the null hypothesis. Thus it would appear that factor analysis might be a more suitable method for discovering independent factors than is the use of a predetermined set of ratios.

The approach to this study, in terms of factor analysis, has been vindicated by the finding of multicollinearity between ratios used in those previous studies and that other factors were found that were not used in those studies.

Further research is needed to show the relevance of individual factors for particular research questions. For example, which factors, if any, help determine the financial characteristics of small firms that, in the future, are most likely to grow?

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**TABLE 1 - INITIAL SET OF RATIOS**

| RATIOS       |              | ABBREVIATIONS |                                |
|--------------|--------------|---------------|--------------------------------|
| AP/Purchases | LTD/NW       | AP            | Accounts Payable               |
| AP/S         | LTD/TA       | CA            | Current Assets                 |
| CA/CL        | LTD/WC       | CF            | Cash Flow                      |
| CA/S         | NI/CL        | CL            | Current Liabilities            |
| CA/TA        | NI/NW        | COGS          | Cost of Goods Sold             |
| CA/TD        | NI/S         | D             | Depreciation                   |
| CF/CL        | NI/TA        | EBIT          | Earnings before Interest & Tax |
| CF/S         | NI/TD        | FA            | Fixed Assets                   |
| CF/TA        | NW/(NW+LTD)  | GP            | Gross Profit                   |
| CF/TD        | NW/TA        | IE            | Interest Expenses              |
| CL/TA        | NW/TD        | Inv           | Inventory                      |
| CL/TD        | QA/CL        | LTD           | Long Term Debt                 |
| EBIT/NW      | QA/S         | NI            | Net Income                     |
| EBIT/S       | QA/TA        | NW            | Net Worth                      |
| EBIT/TA      | S/#Employees | QA            | CA - Inv                       |
| EBIT/TD      | (S-COGS)/S   | S             | Sales                          |
| FA/NW        | S/NW         | Super         | Superannuation Expense         |
| FA/TA        | S/TA         | TA            | Total Assets                   |
| GP/TA        | S/TD         | TD            | Total Debt                     |
| IE/EBIT      | Super/Wages  | WC            | Working Capital                |
| IE/S         | TD/TA        |               |                                |
| IE/TD        | Wages/Sales  |               |                                |
| Inv/COGS     | WC/TA        |               |                                |
| Inv/QA       | WC/(NI + D)  |               |                                |
| Inv/WC       | WC/NW        |               |                                |
| Inv/S        | WC/S         |               |                                |
| LTD/(LTD+NW) | WC/TD        |               |                                |

The set of financial ratios before the application of factor analysis includes, where possible, those ratios reported by Dimitras *et al.* (1996) in a review of business failure research. It also includes, where possible, the ratios used in the comparative studies by Gentry *et al.* (1987) and Huyghebaert *et al.* (2000). Finally it has been extended to include the ratios listed in the introductory accounting text by Atrill *et al.* (2000), and by the addition of a ratio relating to superannuation. Ratios not in the set include those where the CURF data imposes constraints on ratio calculation. For example, ratios referring directly to Debtors and/or Cash are not included because those items are not shown separately on the CURF.

**TABLE 2 - FACTOR ANALYSIS RESULTS**

| Ratio        | Factor |       |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
|--------------|--------|-------|-------|--------|--------|-------|--------|-------|-------|--------|-------|--------|--------|-------|----|----|----|--------|
|              | 1      | 2     | 3     | 4      | 5      | 6     | 7      | 8     | 9     | 10     | 11    | 12     | 13     | 14    | 15 | 16 | 17 | 18     |
| WC/TD        | 0.978  |       |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| CA/TD        | 0.977  |       |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| QA/CL        | 0.960  |       |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| CA/CL        | 0.953  |       |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| NW/TD        | 0.907  |       |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| NI/TD        | 0.770  |       | 0.322 |        |        | 0.418 |        |       |       |        |       |        |        |       |    |    |    |        |
| EBIT/TD      | 0.770  |       | 0.321 |        |        | 0.417 |        |       |       |        |       |        |        |       |    |    |    |        |
| CF/TD        | 0.759  |       | 0.313 |        |        | 0.431 |        |       |       |        |       |        |        |       |    |    |    |        |
| S/TD         | 0.495  |       | 0.420 |        |        |       |        |       |       |        |       |        |        |       |    |    |    | 0.247  |
| CA/S         |        | 0.960 |       |        |        |       |        |       |       |        | 0.213 |        |        |       |    |    |    |        |
| QA/S         |        | 0.960 |       |        |        |       |        |       |       |        | 0.213 |        |        |       |    |    |    |        |
| EBIT/S       |        | 0.960 |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| NI/S         |        | 0.959 |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| CF/S         |        | 0.958 |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| WC/S         |        | 0.800 |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| CF/TA        |        |       | 0.953 |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| EBIT/TA      |        |       | 0.950 |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| NI/TA        |        |       | 0.948 |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| GP/TA        |        |       | 0.922 |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| S/TA         |        |       | 0.868 |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| CL/TA        |        |       |       | 0.987  |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| WC/TA        |        |       |       | -0.984 |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| NW/TA        |        |       |       | -0.983 |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| TD/TA        |        |       |       | 0.983  |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| CA/TA        |        |       |       |        | 0.956  |       |        |       |       |        |       |        |        |       |    |    |    |        |
| FA/TA        |        |       |       |        | -0.956 |       |        |       |       |        |       |        |        |       |    |    |    |        |
| QA/TA        |        |       |       |        | 0.874  |       |        |       |       |        |       |        | -0.244 |       |    |    |    |        |
| Super/Wages  |        |       |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    |        |
| CF/CL        | 0.530  |       |       |        |        | 0.802 |        |       |       |        |       |        |        |       |    |    |    |        |
| NI/CL        | 0.535  |       |       |        |        | 0.794 |        |       |       |        |       |        |        |       |    |    |    |        |
| NI/NW        |        |       |       |        |        |       | 0.980  |       |       |        |       |        |        |       |    |    |    |        |
| EBIT/NW      |        |       |       |        |        |       | 0.979  |       |       |        |       |        |        |       |    |    |    |        |
| S/NW         |        |       |       |        |        |       | 0.543  |       | 0.524 |        |       |        |        |       |    |    |    |        |
| LTD/(LTD+NW) |        |       |       |        |        |       |        | -1.00 |       |        |       |        |        |       |    |    |    |        |
| NW/(NW+LTD)  |        |       |       |        |        |       |        | 1.00  |       |        |       |        |        |       |    |    |    |        |
| LTD/NW       |        |       |       |        |        |       |        |       | 0.913 |        |       |        | 0.299  |       |    |    |    |        |
| FA/NW        |        |       |       |        |        |       |        |       | 0.853 |        |       |        | -0.481 |       |    |    |    |        |
| LTD/TA       |        |       |       | 0.278  |        |       |        |       |       | -0.841 |       |        |        |       |    |    |    |        |
| CL/TD        |        |       |       |        | 0.286  |       |        |       |       | 0.825  |       |        |        |       |    |    |    |        |
| IE/S         |        |       |       |        |        |       |        |       |       |        | 0.869 |        |        |       |    |    |    |        |
| Wages/Sales  |        | 0.296 |       |        |        |       |        |       |       |        | 0.527 |        |        |       |    |    |    |        |
| Inv/S        |        |       |       |        |        |       |        |       |       |        |       | 0.822  |        |       |    |    |    | -0.271 |
| Inv/COS      |        |       |       |        |        |       |        |       |       |        |       | 0.765  |        |       |    |    |    | 0.235  |
| WC/NW        |        |       |       |        |        |       |        |       |       |        |       |        | 0.987  |       |    |    |    |        |
| LTD/WC       |        |       |       |        |        |       |        |       |       |        |       |        |        | 0.809 |    |    |    |        |
| Inv/WC       |        |       |       |        |        |       |        |       |       |        |       |        |        | 0.808 |    |    |    |        |
| AP/PURCHASES |        |       |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    | 0.778  |
| WC/(NI+D)    |        |       |       |        |        |       | -0.203 |       |       |        |       |        |        |       |    |    |    | 0.672  |
| AP/S         |        | 0.335 |       |        |        |       |        |       |       |        | 0.249 |        |        |       |    |    |    | 0.367  |
| (S-COGS)/S   |        |       |       |        |        |       |        |       |       |        |       | -0.287 |        |       |    |    |    | 0.733  |
| S/#EMPS      |        |       |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    | -0.635 |
| INV/QA       |        |       |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    | -0.751 |
| IE/EBIT      |        |       |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    | 0.743  |
| IE/TD        |        |       |       |        |        |       |        |       |       |        |       |        |        |       |    |    |    | 0.970  |

Ratios were grouped into eighteen factors by factor analysis according to the strength of correlation between each ratio and factor. (Only correlations greater than 0.200 are shown.)

# THE EXISTING SKILL PATTERN OF EMPLOYEES OF SMALL BUSINESS UNITS IN CHHATTISGARH STATE OF INDIA WITH REFERENCE TO PRODUCTIVITY, AND SUGGESTIONS FOR IMPROVEMENT

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## ABSTRACT

India is a developing country. Forty four per cent population of this country has a per capita income of even less than US\$1 per day. There are twenty nine states in India of which Chhattisgarh is a newly formed backward state. The economy of this state is dependent mainly on the abundantly available minerals, agriculture and a few major industries like the 'Steel Giant Four Million Ton Bhilai Steel Plant', an aluminum plant and a thermal power plant.

In addition, there are a few hundred small businesses including fabrication units, foundries, construction units, ceramics & tiles units, tobacco units, solvent extraction plants, rice mills, fruit preservation units, steel re-rollers etc. Very few owners of these units possess the necessary professional qualifications in engineering, finance or business administration. The situation is worse in the case of workers. They possess little or no technical education. Most of them have acquired their skills on- the- job, affecting the degree of productivity accordingly.

A study has been conducted on these small businesses and it has been concluded that the situation can substantially improve with –

Increased awareness of owners

Training & development of workers thru' :

On the job training

In house training

Sponsoring for outside training, &

Job Rotation

Better Wage Administration with Productivity based Incentive Schemes

Improved working conditions

Opening Additional Technical Institutes

The study recognizes the fact that the resources available with the small businesses in Chhattisgarh state are limited and therefore lays heavy emphasis on collective efforts and support from other big industries like **Bhilai Steel Plant of Steel Authority of India Limited** which is a socially responsible corporate citizen and already supports 170 ancillary industries in the region. The authors are reasonably convinced that this study would be useful for other developing nations too.

## INTRODUCTION

In the last decade the industrial scenario in India has undergone a considerable change. With new market economy resulting from liberalization, there is an influx of many companies as well as products at highly competitive prices and diverse functions. The local manufacturers have to face competition from indigenous as well as foreign products available at cheaper rates. Under the circumstances if an organization is not geared up to meet the challenges of this changing situation it will be thrown out of the business scene in no time. To meet the competition, a company has to be equipped with the necessary technical know-how so that it can make

optimum use of its resources to make a superior product quality-wise yet at a competitive price. This is possible only if the manufacturers can improve their productivity i.e. the no. of goods produced per unit of a resource and this can be achieved only through the best use of all their resources including the manpower.

## **INDIA : BASIC FACTS (1)**

India occupies a strategic position in Asia, looking across the seas to Arabia and Africa on the west and to Burma, Malaysia and the Indonesian Archipelago to the east. Geographically, the Himalayan ranges keep India apart from the rest of Asia. Spread in 3287 thousand square kilometers, the country has a population of more than 1000 million people, thus putting the population density to more than 275 people per square kilometer. The per capita income of this country is only about US\$300 per annum amounting to a pitiable US\$0.83 per day with 44.2 % population actually earning less than one US Dollar per day. India is basically an agricultural country with about 70 % population living in villages. After its independence in 1947 from the British rule, India has tried to take a leap towards industrial revolution but is still categorized as a developing nation belonging to the third world. Obviously, the economic growth has neither been at the required pace nor has brought affluence to the masses.

India is divided into 29 states on linguistic basis. The division of the country into states has been helpful in regional development. The state of Chhattisgarh, which is the subject of the current study, was recently carved out of a larger state called the Madhya Pradesh mainly because of the unmanageability of the vast forest areas and distant population in the erstwhile Madhya Pradesh.

## **CHHATTISGARH STATE (2)**

As stated earlier, Chhattisgarh is one of the twenty nine States of India having come into existence only on 1<sup>st</sup> November 2000. Spread over 135,133 square kilometers, the state occupies 4.14 % land area of this country and 20 million people, which is only 2.02 % of the population of India, live in Chhattisgarh. Eighty three percent of the population lives in 19,658 villages while the remaining seventeen percent lives in six big cities and seventy five other towns. The male- female ratio in the population is almost equal. The state's economy is basically dependent on agriculture. Forty five percent land is cultivated and although there are 39 big and small rivers yet only 12% land is irrigated. There are dense forests in about 45% land area of the state. Therefore, the modern civilization has not reached the population living in the distant forest areas, away from railway line.

The state is rich in minerals which include Coal, Iron Ore, Lime Stone, Dolomite, Bauxite etc. but the state is industrially backward. There are only three major industries namely the 'four million ton public sector steel plant' at Bhilai, a 2125 MW public sector thermal power plant and an Aluminium Plant at Korba. There are a few cement factories as well in the private sector. While another steel plant is coming up in the private sector, a 500 MW Power Plant has also been planned in collaboration with Gujrat State.

The *other industries are all in small sector* with many of them registered as 'small scale industries', many as 'cottage industries' and yet many as 'ancillary industries to Bhilai Steel Plant'. The industrial growth in the state has been dependent on agricultural and forest products as also on abundant Iron Ore. *The huge quantity of semi finished steel products and steel scrap generated from Bhilai Steel Plant has also led to the establishment of a number of steel re-rolling mills.*

Having started its production in 1959, **Bhilai Steel Plant, the flagship plant of Steel Authority of India Limited**, contributes very substantially to the economic development of Chhattisgarh state. Not only the Plant provides employment to about 37000 strong workforce but also has paid US\$ 570 million to the state exchequer so far by way of payment of sales tax, excise duty, power charges, water charges, property tax etc. The Plant also supports 170 ancillary industries in three adjoining districts and places orders on them to the tune of about US\$ 20 million every year. *Being a socially responsible corporate citizen, Bhilai Steel Plant is willing to contribute further to the welfare of small business units in this region.*

The fact still remains that Chhattisgarh is an industrially backward state. Except for those workmen employed in large industries, the remaining are mostly unskilled. Whatever little skills have they acquired, they have been mostly 'on-the-job'. This study is, therefore, an attempt to establish the existing skill pattern of employees in small business in Chhattisgarh state, the impact of skills on productivity and suggestions for improving the situation. *Acknowledging the fact that the small industries sector in Chhattisgarh can benefit from the help from Bhilai Steel Plant, suggestions for the same have also been incorporated.*

The state is divided into 16 districts for administrative convenience which are almost equal in respect of industrial development except a few namely the Durg district which is considered highly developed because of the Bhilai Steel Plant, the Raipur district being the capital of the state and the Bastar region which is undeveloped because of its dense forests and tribal population.

We would now present a detailed study in one of the sample districts of the state which is by-and-large a representative district of Chhattisgarh.

### **THE LOCALE : RAJNANDGAON (3)**

The district Rajnandgaon came into existence on 26<sup>th</sup> Jan. 1973, by way of division of district Durg. The district Rajnandgaon is in the south eastern part of the newly formed state of Chhattisgarh. The district headquarter Rajnandgaon is on the Bombay – Howrah line of South Eastern Railways. The National Highway Number 6 (The Great Eastern Road) also passes through the town of Rajnandgaon. The nearest airport to the district is at Mana (Raipur), about 80 kms away.

**General Details :** Total area - 6396.28 sq.k.m. Forest area – 2987.14 sq. k.m. Climate – tropical Average rainfall – 1274 m.m. Main crop - Paddy Population : 107890 as per census 2001. Literacy percentage – 48.39%. Minerals – limestone, china clay, quartzite, granite, white clay.

It is a developing city whose population is largely illiterate, poor and dependent upon agriculture as a means of living. Awareness towards education or technology is low and so is the economic standard of living. There are hardly any govt. technical educational institutions here. The people living in the city are mostly traders, who dominate the business scene from down the generations.

**The Industrial Scenario :** There are 119 medium, small & tiny industries in Rajnandgaon district (Refer **TABLE:I** at the end) and industrially it is categorized as 'B' – 'backward' by the Chhattisgarh Government. The development of industries here has been quite reluctant, with only a few local private business firms taking the initiative for industrial growth. The only Government textile industry, BNC Mills closed down a few years back after suffering from a long period of industrial sickness. Although there are a few public sector undertakings in the neighboring cities of Bhilai and Korba, industrialization of this primarily agricultural area has

been painfully slow. Barring a few, almost all industries are small scale units, with capital investment around US\$ 50,000 only. With the exception of a few fabricating units most of these are agriculture based like solvent extraction plants, rice and pulses mills and tobacco processing units. The growth of these industries can be attributed to the easy availability of raw material like iron & steel and agricultural products needed for these industries.

#### **AVERAGE WORKER PROFILE. (4)**

Before casting a glance on workers' profile, it would be prudent to have a look at the qualifications of the owners of the small business units in question. Except a few, most of the entrepreneurs do not have any professional qualification like an engineering degree or an MBA. They are simply graduates or post graduates who have inherited their family occupations. The individuals owning the agricultural and tobacco processing units mostly belong to this category. Some of the owners of these units are not even graduates. Only some manufacturers of fabricated items have a technical degree or diploma. Not a single MBA was found in the entire industrial sector of Rajnandgaon, the reason being that if at all there are MBAs in Rajnandgaon, they would not believe in wasting their qualifications in a small developing city, rather they would choose to move on to higher paying jobs in more developed cities

**Workmen:** Most of the workers learn on the job. The skilled workers generally belong to the guild of artisans who have inherited a particular craft traditionally. Although labour comes cheap here as compared to more developed areas, their lack of skills neutralizes any advantage that could have been gained from this fact. Another factor that adds to labour related problems is illiteracy which leads to a very low degree of motivation and a disinclination to learn. The employers also face problems of low turnout of workers during reaping seasons as most of the workers belong to farming families and work as seasonal workers.

There is one women polytechnic for diploma courses and only one industrial training institute in the district providing certificate courses in various trades like welding, fitting, rigging, carpentry, smithy etc. But the pass outs from these institute are attracted by bigger industries like the Bhilai Steel Plant and the small business units are left at the mercy of untrained labour mostly.

Thus, although labour is cheap here, owing to lack of technical training schools, there is a scarcity of trained industrial workers. Consequently, the industries have to be content with semiskilled or unskilled workers who can perfect a job through trial and error or experience. The limited funds available to the industry owners do not permit them to spend on training or counseling of employees even if they are aware that poor skills reflect adversely on their performance

Skill wise distribution of the workmen is reflected in **TABLES: II & III** at the end.

#### **PRODUCTIVITY (4)**

The output per unit of resource known as productivity of these small scale units in Rajnandgaon is reflected in **TABLE:III**. *It can be clearly seen that higher the skills, higher the productivity.* The skills are limited due to lack of funds and supporting infrastructure. As discussed earlier, this tiny part of Chhattisgarh is a developing city both economically and industrially. Industrial development here, like any other part of the country, can be related to such factors such as availability of material, funds, skills, power, market etc. Being a backward area, funds, skills and infrastructure are scarce, resulting in low productivity. In some units utilization of capacity is not even 40%. Further more, there are no research or development units that offer new technologies for improved productivity. Foreign collaborations are unheard of. Under the

circumstances it is hardly surprising that the products are manufactured through outdated technologies and hence lack quality.

**Very** few financial institutions are willing to make an investment here for industrial growth. Consequently the onus of monitoring the industrial growth lies on Government bodies like the Chhattisgarh State Industrial Development Corporation and Chhattisgarh Industries Consortium or a few enterprising individuals. With shortage of funds and absence of an infrastructure supporting industrial development, the performance of the existing industries is poor and they are in no position to compete with similar industries of developed areas. As a result they have to be content with the local market and low revenues only. The owners of these industries are more concerned about tackling the day to day problems related to survival rather than long term planning for improving their performance.

Obviously the manufacturers would like to operate more efficiently. Other factors remaining unchanged, a large amount of the company's funds are spent as salaries and wages. The manpower of the organization forms the substantial part of an organization's resources. If this resource is used to one's advantage, the benefits derived in the form of higher efficiency would be immense. Hence the manufacturers would like to use the available manpower more efficiently and improve the existing capacity.

**Future prospects** : Even with so many positive points on its side such as availability of raw material, cheap labor and transportation facility, the industrial growth in Rajnandgaon district has not been as fast as expected and on the whole it can be concluded that the prospects of industrial development are presently not very encouraging. *Only with the help of the big public sector industries in the region like the Bhilai Steel Plant, collective initiative of a few professionally qualified individuals for an overhauling program of the existing situation and through introduction of new supporting policies from the Govt. like providing subsidies on agricultural goods and change in taxation pattern it can be hoped that there will be a change for the better.* Financial institutions like the Industrial Development Bank of India, the Finance Corporation of India and other banking institutions have decreased their interest rates on midterm loans as well as cash credits and this may prove beneficial to the industries. There has also been a proposal for opening a Boys Polytechnic from the Govt. in the near future that may satisfy the manpower requirements of Diploma Engineers of this area and ascertain better productivity and quality and consequently a wider market.

Availability of funds is expected to inspire the manufacturers to pay more attention to training and development of skilled workers, the lack of which is probably the reason for its sustained growth. This coupled with the abundant supply of raw material is bound to result in increased productivity. *A study of this type that focuses on the influence of skills of workers on performance may provide the entrepreneurs a basis for taking concrete steps to improve skills as a means for improving performance.*

## SUGGESTIONS FOR IMPROVEMENT

### **Suggestions to improve Owners' Awareness**

The lack of technically/ managerially or financially qualified owners has made their overall awareness suffer to a large extent. They are ignorant about new processes or technologies that could be useful to them. Many of them are not even aware of the revised policies guiding the small industries sectors or the products reserved for Small Scale Industries. They have not heard of layout designing or value addition or product diversification.. No wonder the products are still manufactured through age old technology without any updating or change in utility or design.

Since the owners are long past the age of attending colleges and their limited time does not permit them to study further, it is suggested they be provided a minimum class room understanding on industrialization by the *big industries in the region like Bhilai Steel Plant*. This should be followed by these owners attending seminars and trade fairs that are arranged by CSIDC and other organizations to publicize new technologies and products. This should further be supplemented by hiring a consultant to suggest modernization of the existing units.

### **Suggestions for Training and Development of workers**

The limited financial resources of the industries based here do not permit the entrepreneurs to invest in training of the workers. As a result they manage somehow with unskilled and semiskilled workers expecting them to learn while working on the job. This costs them lower productivity in terms of high defectives and material wastage and poor quality. Recruitment of technically qualified workers means higher wages which they are unable to afford. Under the circumstances they have to be content with the poor performance of the industries. Moreover training the workers may entail hiring training personnel or arranging training workshops for them. This again would mean additional expenses for the owners.

Another factor that hinders training and development is the attitude of the workers as they do not show an inclination to learn as they have a deep rooted suspicion about the owners' intentions and they offer resistance to any new developmental process taking place in the organization. They do not hope to get any additional benefit from improved productivity and so they are not interested in learning more about their job.

Training and development of workers is the most important input for improving the skill pattern of the workers but as discussed earlier it is not an isolated process. Training and development can work only if all the employees are committed to achieve higher productivity through improved performance. This implies the change in the entire organizational culture and can be affected through the managements' efforts to inspire confidence in these changes that they are going to be beneficial to one and all. Only then can the workers be expected to cooperate with the management in getting trained.

The various methods of training that can be introduced in the Small Business Units without being extraordinarily expensive are described below.

**On the job training :** This is perhaps the most prevalent method already in use in the industries of Rajnandgaon district as it involves no additional costs. The workers learn while working on the job. But, this method is more suitable when the basics of the job are known to the workers. It aims at developing the skills of the workers to a higher level by polishing their existing skills through practice. The process improves the performance of an individual by adding to the accuracy in his work and reducing material wastage & defectives.

This type of training cannot work for very large periods for the same group of workers as improvement can take place only to certain level through this process.

**Apprenticeship:** It is recommended that the small industries of Rajnandgaon district may adopt this system because of its lower costs. Here a worker is recruited as an apprentice for an allowance under another experienced worker. He is supposed to learn from the skilled worker by observing him at work and attempting the job under the surveillance of his mentor. As he learns gradually more independence is given to him and constant supervision from his mentor is withdrawn. This training is suitable for entirely new jobs also.

**Job Rotation :** Job rotation is aimed at improving the skills of the workers by reducing the monotony of his work as also encouraging the workers to learn new skills. This is helpful in the development of the workmen through their deployment when there is high pressure on one job center. Also it helps in times of high absenteeism.

**Training workshops:** The existing skills of the workmen can also be improved by their exposure to training workshops in which invited outside faculty, their supervisors & other experienced workers demonstrate to them on how to perform a job efficiently without wasting resources. But such workshops are normally not preferred by the management because it means loss in terms of production time of the participating workers. If the instructors are hired from outside then it means paying them too. This kind of training is specially recommended for those industrial units which are ancillary units to a bigger industry and have to produce jobs as per the required process and design specifications. It is helpful in learning new technological developments where instructors from the suppliers of the new technology demonstrate on the working of a new tool or equipment and invite the workers to work on those lines in the workshop. *Training personnel from Bhilai Steel plant can be associated with such workshops in the region.*

**Sponsoring a candidate to a technical institution or to a parent industry for training:** Although it is one of the most expensive ways of skill development, yet it certainly is one of the most effective tools of training because of the inherent advantages of outside training. The biggest advantage is the better preparedness of the trainees in the new environment away from the routine work place. Such deputations may also be helpful when a new production venture is planned so that the worker becomes conversant with the production methods required for a new product. *Bhilai Steel Plant can be a good training ground for the workmen from small scale industries of the region.*

### **Better Wage Administration**

Most industries in Chhattisgarh make payments to the workers on daily or weekly basis. A daily rate of workers is fixed and deductions for absence are made while making payments. Very few industries offered incentives for better productivity. The pay scale is low as compared to the developed states. Some industries also employ the piece rate system and performance of these industries is better than those of the daily rate system. Most of the workers are temporary and other allowances are not provided to them. Very few industries offered a festival bonus to the workers .

*Productivity based incentive system of wage administration* can help to motivate the workers to produce more number of jobs. A standard number of jobs per day can be fixed after consulting analyzing each job. For each job produced above the standard number an incentive should be offered over and above the fixed rate of wage. Also cash rewards can be offered for the lowest absenteeism and lowest defectives and material wastage. These rewards will also act as incentives for the workers and they will be motivated to improve their skill pattern resulting in higher productivity.

## **The general atmosphere of the organization**

Most organizations have not brought in any changes regarding the organizational methods in functional areas. In this age of modernization where there is a revolutionary change in almost all the concepts of industrialization this complacency has brought about a careless attitude at every level of the organization. Since improvement of skill pattern involves not only training of the workers but also a change in their attitude, this type of a climate becomes a serious drawback in attempting anything for skill development. Improvement in skill pattern means a change in the organizational climate so as to make everyone in the unit aware of the true position of the unit, the change in policies to realize a growth and the plans for it. This needs an openness from the owners that invites involvement from the supervisors and workers.

**Suggestions to improve the organizational climate:** Annual reports containing statements about the performance of the unit in terms of turnover and profits made should be made available to all the employees of the unit. The report should also contain the annual planning of the unit that underlines its intentions of bringing in new developments such as expanding its market or introducing new technology. This will generate a confidence in the management's intentions as well as make the employees feel more responsible. Unless the goal is specified, the path for reaching there cannot be determined.

**Working conditions:** Working conditions in the small industries of a backward state play a very important role in the skill pattern of the workers. The survey of many industries revealed that the working conditions of the units were terrible especially in agro based industries i.e solvent extraction plants, tobacco processing units and fertilizer producing units. The workplaces did not have proper ventilation or lighting. Fumes and intoxicating agents polluted the atmosphere which was detrimental to health. Lack of lighting, space and air made the working conditions of the workers very uncomfortable and this reflected on their skills poorly. In many factories the workers were seen crouching in an uncomfortable position bending on their jobs in poorly lighted and humid environment. No wonder the workers were demotivated, and showed a half hearted attitude towards their work. In agricultural units, chaff covered the area to such an extent that it was difficult to breathe.

In fabrication and rolling mills noise pollution from the machines was too much for a normal person to bear. In many units workers were seen to work on welding machines without using masks and gloves. Often, work-in-process goods were seen lying on the floor which made movement difficult. This made the flow of material more time consuming than necessary. Owners although seemed very reluctant to accept this fact, they implied that their limited funds restricted them from investing in improving the working conditions of a unit.

**Suggestions for improving working conditions:** Since working place conditions contribute a lot in the state of productivity and skill pattern, care should be taken to improve them. A little investment and concern from the owners will go a long way in enhancing both productivity and skill pattern of the organization. The working environment can be made more hygienic by attending to small details like proper ventilation, installation of chimneys and keeping the workplace pollution free and well lighted and airy so that the worker feels more comfortable working. This will add to their efficiency. Safety appliances like gloves, shoes, masks and cotton wool should be provided to them so that injuries to the workers are prevented.

They should be provided better seating arrangement and the height of the work table should be such that one does not have to bend too low or strain oneself unnecessarily. Discomfort or cramped muscles will affect the performance. Wires spread over an area or objects littered on the floor restrict movements. Care should be taken to neatly stack the semi finished and finished

goods on one side and the wires should be laid on the walls near the machines. If attention is paid to these factors and the owners show a little more concern they will surely be rewarded in the form of improved performance.

### **Opening Of New Technical Institutes.**

There are only two technical institutes in the whole of Rajnandgaon district viz, a government women polytechnic (providing diploma in office management, electronics engineering, costume design and dress making) and one government industrial training institute (providing certificate programs in surveyor, instrumentation, mechanic, welder, electrician, fitter, plumber, cutting & tailoring). The students passing out from the polytechnic and the industrial training institute are firstly very little in number and secondly like to try for better jobs outside the district. It is, therefore, suggested that efforts by the industries owners should be made for opening more private technical institutes as well as for getting more government technical institutes opened in the district.

### **NEED FOR COLLECTIVE EFFORTS**

The owners of small business houses in Rajnandgaon district are not so well off that they would be able to take most of the above mentioned initiatives for improving the productivity of their units individually. It is therefore strongly recommended that these initiatives should be tried jointly by the owners particularly in the areas of organizing training workshops, sponsoring for outside training and getting technical institutes opened in the area.

### **ROLE OF BIG INDUSTRIES AROUND, PARTICULARLY THE BHILAI STEEL PLANT of STEEL AUTHORITY OF INDIA LTD**

There are a few big industries in the region including the all-powerful and self-sufficient Bhilai Steel Plant, the flagship plant of Steel Authority of India Limited, which is the largest Public Sector & ISO 9001:2000 certified Steel Plant of India producing more than four million tons of steel every year and employing about thirty seven thousand employees. The plant has been giving profits to the nation continuously for the last seventeen years and has earned during 2003-`04 the highest ever profit by any Indian steel plant so far. *It is one of the best acknowledged socially responsible corporate citizens which can be compared to any responsible society around the globe.* The Plant has spent colossal amounts of US\$ 31.48 millions, 41.35 millions & 44.12 millions on Social Amenities like township, education, medical, sports & cultural etc during the fiscals 2001-02, 02-03 & 03-04 respectively.

The Plant already supports 170 ancillary industries in the small scale sector in the districts of Rajnandgaon, Durg & Raipur. The Plant had placed about three thousand orders on these industries in 2003-`04 valuing about US\$ 20 millions. The Plant provides all necessary technical guidance to them including selection of product & raw material, preparation of project report, stage inspections etc. Therefore, it would be easy by the Plant to increase its area of operation a little in respect of the small scale businesses in the state and help their owners in acquiring necessary awareness on industrial development & its need in Chhattisgarh through programs at its Management Training Center, in providing institutional training to the workmen from these industries in its all-developed Training Institute, providing on the job training in a large number of jobs, providing necessary guidance to them on house keeping & safety and above all keeping their morale high by playing the role of their 'big brother' in a limited manner.

## INFERENCES

This study reveals the state of small scale industries in an industrially backward area with reference to its skills and productivity and has tried to show a relation between the two. It can be surmised that productivity is a function of the skill pattern and any change in the former has to be brought about by introducing a change in the latter. Changes in skill pattern can be brought about through the attitudes towards work, training and the general work environment. Only then will the skill pattern of the workers improve and result in higher productivity.

Industrially, Rajnandgaon is a representative district of Chhattisgarh with the exception of only two-three districts which are very well developed because of the presence of big public sector industries & their ancillaries. There are also a few districts in the tribal belt where even minimum industrialization has not reached. The findings of this study are, therefore, reasonably extendable to the entire state of Chhattisgarh.

To the best knowledge of the authors of this paper, no professional study clearly relating the skills of the existing workmen in small business units in Chhattisgarh state and their productivity has so far been made. In the absence of such a study, the employers cannot take any concrete steps. If a study is made available to the industrialists specifying the extent to which improvement in one parameter affects the other, they could certainly use the results of such a study to their benefit. This kind of a study will enable the owners to deploy their human resources more profitably. Also the results of the study will inspire the workers to perform better especially the ones working on piece-rate system. The paper should be helpful in human resource development in an industrially backward state of India which in turn would improve the performance of the industries based there enabling them to find a wider market for their goods and face the increasing competition even globally.

Analogically, this kind of a study should also be equally useful for other developing nations with similar circumstances.

**TABLES CONTAINING PRIMARY DATA.**

TABLE : I : TYPES OF SMALL BUSINESSES IN RAJNANDGAON DISTRICT. (4)

| Industry Type | No. | Agro based | Fabricat-<br>-ion | Rolling<br>mills | Foundry &<br>castings | Tobacco<br>processing | others | Total |
|---------------|-----|------------|-------------------|------------------|-----------------------|-----------------------|--------|-------|
|               |     | 25         | 24                | 6                | 13                    | 11                    | 40     | 119   |

TABLE : II : DETAILS OF MANPOWER IN SMALL BUSINESSES OF RAJNANDGAON (4)

| SIZE         | EXECUTI<br>LEVEL | CLERICAL<br>STAFF | SUPERVI<br>STAFF | WORKER      | TOTAL       |
|--------------|------------------|-------------------|------------------|-------------|-------------|
| MEDIUM       | 90               | 225               | 150              | 1500        | 1965        |
| SMALL        | 120              | 290               | 160              | 1300        | 1870        |
| TINY         | 180              | 90                | 90               | 380         | 740         |
| <b>TOTAL</b> | <b>390</b>       | <b>605</b>        | <b>400</b>       | <b>3180</b> | <b>4575</b> |

TABLE : III : OBSERVATION CHART :RELATION BETWEEN SKILLS AND PRODUCTIVITY (4).

| Skills<br>+<br>No<br>Of<br>Workers | Number of jobs completed/day |              |         |         |          |          |                |             |         |           |               |          |             |                 |           |  |
|------------------------------------|------------------------------|--------------|---------|---------|----------|----------|----------------|-------------|---------|-----------|---------------|----------|-------------|-----------------|-----------|--|
|                                    | Type of industry             |              |         |         |          |          |                |             |         |           |               |          |             |                 |           |  |
|                                    | fabrication                  |              |         |         |          |          | Agro based     |             |         |           | Rolling mills |          | others      |                 |           |  |
|                                    | Measuring                    | M/c Shearing | Bending | Welding | Grinding | Drilling | Oil Extraction | Filteration | Canning | Threshing | pressing      | anealing | Die casting | Armature making | bottling  |  |
| Illiterate + upto V 1941           | 8                            | -            | -       | -       | -        | -        | -              | -           | -       | 28        | -             | -        | -           | -               | 5         |  |
| Bet V & VIII 468                   | 13                           | -            | -       | -       | -        | -        | -              | -           | -       | 30        | -             | -        | -           | -               | 11        |  |
| VIII & 3mths training 103          | <b>36</b>                    | 12           | 12      | 6       | 7        | 5        | 11sacks        | 16cans      | 24 cans | 33        | -             | -        | -           | -               | <b>38</b> |  |
| VIII & 6 mths. Training 124        | 36                           | 27           | 28      | 10      | 10       | 7        | 15 sacks       | 21          | 24      | 33        | -             | -        | 8           | -               | 38        |  |

|                              |    |           |           |           |           |           |                            |               |           |    |           |           |           |           |    |
|------------------------------|----|-----------|-----------|-----------|-----------|-----------|----------------------------|---------------|-----------|----|-----------|-----------|-----------|-----------|----|
| H.S.& 3<br>mths tr<br>036    | 36 | <b>30</b> | 28        | 30        | 21        | 22        | 18sacks                    | 21cans        | <b>27</b> | 30 | 12        | 11        | 12        | 12        | 38 |
| H.S.& 6<br>mths tr<br>048    | 36 | 30        | <b>30</b> | 30        | 24        | 24        | 30sacks                    | <b>24cans</b> | 27        | -  | 15        | 36        | 18        | 21        | 40 |
| H.S<br>040                   | 36 | 20        | 21        | 6         | 6         | 6         | 9 sacks                    | 12cans        | 12ca      | 30 | -         | -         | -         | -         | 18 |
| ITI<br>357                   | 36 | 27        | 28        | <b>32</b> | <b>24</b> | <b>24</b> | 10sacks                    | 18cans        | 20        | -  | <b>44</b> | <b>40</b> | <b>30</b> | <b>42</b> | 36 |
| Dip. In<br>agri/engg<br>063. | 36 | 30        | 30        | 32        | 25        | 25        | <b>30sacks<br/>of50kgs</b> | 24cans        | 27        | 29 | 43        | 40        | 31        | 42        | 38 |
| Total<br>3180<br>Workers     |    |           |           |           |           |           |                            |               |           |    |           |           |           |           |    |

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### ENDNOTES

This Paper is basically based on an actual field research and relies heavily on the primary data collected during the study.

**DETERMINANTS OF REGIONAL VARIATIONS  
IN THE START-UP RATIO: EVIDENCE FROM JAPAN**

(reduced length version)

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Abstract:

Since the 1990s, new firm formation rate in Japan has been quite low, even lower than the closure rate. Therefore, promotion of business start-ups is one of the most important policy issues. However, despite distinct regional variations in the start-up ratio, there exist few econometric studies on the determinants of these regional variations in Japan. Thus, this paper analyzes the regional determinants of the start-up ratio in the latter half of the 1990s using two datasets with different levels of regional segmentation. The explanatory variables represent demand, cost, human resource, financial, industry agglomeration and industrial structure, and other factors. The empirical results obtained using WLS and OLS analyses demonstrate that while all the above factors significantly affect the start-up ratio at the municipality level, some of these factors are not significant at a larger economic area level. In particular, we obtained evidence that human resource factors together with the average wage and average size of establishments are important determinants of the regional start-up ratio in both the samples. These results suggest that the accumulation of human resources is essential to vitalize regional economies through start-up activities.

## **1. Introduction**

Since the early 1990s, the new firm start-up rate has been lower than the closures rate in Japan. Several public-supported measures were taken in order to encourage start-up activities and to arrest this continuous decline in the numbers of firms; however, these have not achieved any success to date. Business start-ups make several contributions, which are critical not only from the macroeconomic viewpoint, but also for the regional economy. Therefore, in order to obtain policy implications, it is very important to explain the regional factors that impact the business start-up ratio.

Despite of remarkable regional differences in the start-up ratio, the factors affecting these differences have not yet been sufficiently explored in Japan. Instead, early studies have focused on macroeconomic or industrial factors, or the personal profiles of entrepreneurs (Yamawaki [1991], Odagiri and Honjo [1995], Genda *et al.* [1998]). Analysis of regional factors has commenced recently, and is based on prefecture-level data. However, we consider that prefectures in Japan are too large to facilitate an effective analysis of the regional variations. Therefore, the main purpose of this paper is to analyze the regional factors affecting the start-up ratio in the latter half of the 1990s using regional data from different levels, namely the municipality (cities, towns, and villages) and the economic area levels.

## **2. Previous Studies**

Previous studies on the factors affecting start-up activities have been carried out mainly in the U.S. and European countries. These studies can be classified into the following categories: i) analysis of industry factors, ii) analysis of regional factors, and iii) analysis of personal profiles of entrepreneurs. In this section, we review the results of these studies, focusing on the analysis of regional factors.

The analysis of regional determinants of the number or rate of business start-ups became popular in Western countries in the 1990s. Most studies divide the entire country into dozens or hundreds of regions and use pooled data from several time periods. Regional factors can be categorized into demand, cost, human resource, financial, industry agglomeration and structural factors, and other factors. We now present a brief discussion of these factors.

First, several studies indicate that demand factors, such as population growth, are the most direct determinants of the start-up ratio (Moyes and Westhead [1990], Audretsch and Fritsch [1994], Davidsson *et al.* [1994], Guesnier [1994], Keeble and Walker [1994], Reynolds *et al.* [1994], Reynolds *et al.* [1995], Small and Medium Enterprise Agency [2002], [2003], Armington and Acs [2002], Acs and Armington [2004]).

Second, the effects of regional cost disparities on the start-up ratio have been analyzed using labor costs and land prices or office rents. Several previous studies demonstrate that the regional wage level negatively affects the start-up ratio (Ashcroft *et al.* [1991], Gerlach and Wagner [1994], Santarelli and Piergiovanni [1995], Audretsch and Vivarelli [1996], Kobayashi [2004]). With regard to the land prices or office rents, previous studies observe both positive and negative impacts on the start-up ratio.

Third, with regard to human resource factors, several studies focus on the effect of the qualitative and quantitative composition of regional population and labor forces as well as the effect of the employment situation on the start-up ratio. With regard to the effects of the composition of population and labor forces, several studies have demonstrated that the proportion of highly skilled labor (Audretsch and Fritsch [1994], Fotopoulos and Spence [1999]), proportion of university graduates (Guesnier [1994], Armington and Acs [2002], Acs and Armington [2004]), and proportion of the workforce in professional and administrative occupations (Guesnier [1994], Hart and Gudgin [1994], Keeble and Walker [1994]) have a positive impact on the start-up ratio.

With regard to the employment situation, there are conflicting views on the effect of the unemployment rate on the start-up ratio. On the one hand, it is considered that a high unemployment ratio increases the start-up ratio as several unemployed persons set up businesses in order to secure employment for themselves (Evans and Leighton [1990], Storey [1991], Small and Medium Enterprise Agency [2002]). On the other hand, several studies show that a high unemployment ratio reflects a sluggish regional economic situation and thus hampers business start-ups (Carree *et al.* [2002], Reynolds *et al.* [1995], Nerlinger [1998], Steil [1999]).

Fourth, with regard to the financial factors, several studies indicate that difficulties in financing start-ups have a high negative impact on the start-up ratio. A remarkable aspect in this regard is the relationship between the start-up ratio and the householder ratio, since the ownership of housing can act as a collateral and a safety net for the founders. However, the empirical results carried out in the Western countries and Japan differ in this aspect (Moyes and Westhead [1990], Ashcroft *et al.* [1991], Guesnier [1994], Kobayashi [2004]).

Fifth, with regard to industry agglomeration and industry structure, several studies indicate that the start-up ratio is positively affected by agglomeration (Papke [1991], Audretsch and Fritsch [1994], Davidsson *et al.* [1994], Guesnier [1994], Keeble and Walker [1994], Reynolds *et al.* [1994], Armington and Acs [2002], Small and Medium Enterprise Agency [2002], Acs and Armington [2004], Kobayashi [2004]). With regard to the influence of industry structure on business start-ups, previous studies concur that a smaller proportion of the manufacturing sector has a positive effect on the start-up ratio (Evans and Leighton [1989], Reynolds *et al.* [1995], Egelin *et al.* [1997]).

Sixth, with regard to the other factors that affect the regional start-up ratio, previous studies focus on the average business size, traffic access, and the role of the public sector. Several studies report that the smaller the average business size or the higher the share of small businesses, the higher is the start-up ratio (Moyes and Westhead [1990],

Ashcroft *et al.* [1991], Fritsch [1992], Audretsch and Fritsch [1994], Gerlach and Wagner [1994], Guesnier [1994], Hart and Gudgin [1994], Keeble and Walker [1994], Reynolds [1994], Santarelli and Piergiovanni [1995], Audretsch and Vivarelli [1996], Egelin *et al.* [1997], Nerlinger [1998], Fotopoulos and Spence [1999], Steil [1999], Armington and Acs [2002], Acs and Armington [2004]).

Only German studies have investigated the impact of traffic access, reporting that the start-up ratio, particularly in the high-tech sector, is higher in regions that have convenient access to express trains (ICE) or highways (Berger and Nerlinger [1997], Felder *et al.* [1997], Nerlinger [1998], Steil [1999]).

Previous studies on the role of the public sector have focused on tax rates, whereas Papke (1991) and Reynolds (1994) examined the effect of public expenditure on the start-up ratio and observed a positive and negative effect, respectively.

Almost all the studies reviewed in this section pertain to Western countries. Few empirical studies have been carried out on the regional factors affecting the start-up ratio in Japan. In addition, while the U.S. and German studies divide the entire country into hundreds of regions, no detailed studies have been carried out in Japan that use data of areas smaller than the prefectures. Therefore, it is difficult to derive any implications regarding the methods to promote business start-ups at the regional level in Japan. In order to overcome this difficulty, we analyze the regional determinants of the start-up ratio on the basis of previous studies, using regional data of units smaller than the prefectures, namely, the municipality and economic area.

### **3. Analytical Models, Hypotheses, and Data**

#### **3-1. Models, Variables, and Hypotheses**

In this paper, we employ the weighted least square (WLS) and the ordinary least square (OLS) analyses, using a linear multiple regression model with the start-up ratio as the dependent variable. For the same start-up ratio, a highly urbanized region records hundreds or thousands of times more start-ups than a rural region does. From the viewpoint of policy implications, regions with a large number of new start-ups should be assigned a higher weight. Therefore, we consider that the WLS analysis is more preferable to the OLS model in the context of this paper. We utilize the initial number of establishments (those in 1996) as the weight for the WLS analysis.

On the basis of previous literature considered in Section 2, we propose the basic model as follows:

Start-up ratio = f (demand factors, cost factors, human resource factors, financial factors, factors of industry agglomeration and industry structure, other factors)

Table 1 about here

Table 1 lists the definitions of the variables. The growth rate of the total number of private establishments during 1996-99 is the dependent variable. This variable is calculated by dividing the number of start-ups during this period by the total number of establishments in 1996.

As a variable of the demand factors, we utilize the population growth rate (GRPOP), which is the most widely employed measure in previous studies. We utilize the data of the preceding period as a proxy for the expected demand growth.

H 1: The start-up ratio is higher in regions where a higher demand growth is expected (GRPOP +).

The primary cost factors for a business start-up are capital costs, labor costs, and rents for land and office spaces. By classifying capital costs as a financial factor, we focus on labor costs along with various cost factors, using the average wage level in the manufacturing sector (WAGE) in 1998 as a variable. On the basis of the reasoning that start-up firms tend to select locations that have lower labor costs, we expect that the level of labor costs affect the start-up ratio negatively (Ashcroft *et al.* [1991], Gerlach and Wagner [1994], Santarelli and Piergiovanni [1995], Audretsch and Vivarelli [1996], Kobayashi [2004]).

H 2: The start-up ratio is lower in regions where the average wage is higher (WAGE -).

For start-up firms, human capital factors are related to the availability of both entrepreneurs and a labor force. Both aspects involve several quantitative and qualitative measures. Among the quantitative measures, the unemployment ratio is the most commonly used factor in the previous studies. There are two conflicting views regarding the effect of the unemployment ratio (“push hypothesis” and “pull hypothesis”). Therefore, we present the following two conflicting hypotheses:

H 3a: The start-up ratio increases with increase in the unemployment rate (UNEMPL +).

H 3b: The start-up ratio decreases with decrease in the unemployment rate (UNEMPL -).

As qualitative measures of human resource factors, we use the ratio of the number of university graduates to the population over 15 years of age (UNIV) and the ratio of the employment in professional and technical occupations to the total employment (EXPERT). As in previous literature (Guesnier [1994], Hart and Gudgin [1994], Keeble and Walker [1994], Armington and Acs [2002], Acs and Armington [2004]), we hypothesize that these variables have positive effects on the start-up ratio because of the accumulation of qualified human capital.

H 4a: The start-up ratio increases with the ratio of the number of university graduates to the population over 15 years of age (UNIV +).

H 4b: The start-up ratio increases with the ratio of the employment in professional and technical occupations to the total employment (EXPERT +).

It is considerably difficult to measure the regional characteristics of financial factors. In accordance with the previous literature (Moyes and Westhead [1990], Ashcroft *et al.* [1991], Guesnier [1994]), we use the ratio of the number of householders (households with their own houses) to the total number of households (MYHOME) as a proxy for the possibility of financing the start-up. We hypothesize that the higher this ratio, the easier it is to start a new business because the householders can raise funds more easily by using their houses as collaterals.

H 5: The start-up ratio increases with the ratio of householders to the total number of households (MYHOME +).

We use the business density (the number of establishments per square kilometer) (DENS) and the proportion of manufacturing plants among all establishments (MRATIO) as the indicators of industry agglomeration and industry structure, respectively. With regard to industry agglomeration, we assume that the higher the business density, the higher is the start-up ratio. This is because of positive agglomeration effects such as the accumulation of production factors, availability of information, and technology spillovers. With regard to industry structure, several studies suggest that regions characterized by a high proportion of the manufacturing sector tend to have a lower start-up ratio. Therefore, we present the hypothesis that a larger proportion of manufacturing plants affects the start-up ratio negatively.

H 6: The start-up ratio is higher in regions with higher level of industry agglomeration (DENS +).

H 7: The start-up ratio is lower in regions with a high share of the manufacturing sector in the total number of establishments (MRATIO -).

Among other factors, we focus on the average size of establishments, traffic access, and public services. The average size of establishments is supposed to be a measure of the barriers to entry. Moreover, regions characterized by a high proportion of small businesses are expected to have business environments favorable for small businesses. For these reasons, we expect that a large average business size affects the start-up ratio negatively. In this paper, we define the average business size (AVESIZE) as the average number of employees in all establishments in all sectors.

H 8: The start-up ratio is higher in regions with smaller average size of establishments (AVESIZE -).

Traffic access is expected to affect the start-up ratio, because regions with better traffic access are favorable to secure essential production factors and supply goods and services. In this paper, we use the variables for the railway (Shinkansen Express stations) and the roadway (highway interchanges) traffic access. See the full paper for more detail.

H 9: The start-up ratio is higher in regions with better traffic access (SHINK +, HIWAY +).

In this paper, we use the log of the amount of per capita public expenditure (PUBEXP) and the number of local civil servants per hundred residents (CIVSERV) as the variables to represent the weight of the public sector. Public services are expected to affect the start-up ratio positively (Papke [1991]) or negatively (Reynolds [1994]). Therefore, we present two conflicting hypotheses.

H 10a: The start-up ratio is higher in regions with a higher weight of the public sector (PUBEXP +, CIVSERV +).

H 10b: The start-up ratio is lower in region with a higher weight of the public sector (PUBEXP -, CIVSERV -).

### 3-2. Data

Table 1 lists the original data sources of the variables. The dependent variable, i.e., the gross start-up ratio during 1996-99 was calculated from the aggregated regional data of the “Establishment and Enterprise Census 1999.” The data for all the independent variables, except for those of traffic access, are obtained from the “Regional Economy Database,” April 2004 version, published by Toyo Keizai. This database provides regional data from several official and other statistical sources for each municipality, as

of April 2004. The original sources of these data are official statistics such as “Population Census,” “Establishment and Enterprise Census,” and “Census of Manufacturers.”

The data samples used in the analysis presented in this paper are from 3,123 municipalities and 185 economic areas, as of April 2004. Economic areas, which divide each prefecture into 4 regions and contain 17 municipalities on an average, are defined in accordance with the regional segmentation presented in the “2002 National Survey of Prices.” Based on this definition, economic area data were calculated by aggregating the municipality data. We expect the economic area defined in this manner to be an adequate proxy for the local market area.

Table 2 about here

Basic statistics regarding the municipality and economic area samples are presented in Table 2. The mean and the median of the regional gross start-up ratio for the 3 years from 1996 to 1999 are 8.2% and 7.5% at the municipality level and 9.8% and 9.5% at the economic area level, respectively. The maximum gross start-up ratio among the municipalities is 62.8% and that among the economic areas is 18.9%. The disparities in the start-up ratio among municipalities are very large.

#### **4. Analytical Results and Discussion**

##### 4-1. Municipality Sample

Table 3 about here

Table 3 lists the regression results of the municipality sample. With regard to the results of the WLS analysis, except for the householder ratio (MYHOME) and the average size of establishments (AVESIZE), the signs of the coefficients of all the variables are as expected and most of these coefficients are statistically significant. These results support Hypotheses 1, 2, 3a, 4a, 4b, 6, 7, 9, and 10b, but do not support Hypotheses 3b, 5, 8, and 10a.

The results of OLS regressions reveal trends similar to those observed in WLS analyses; however, the coefficients and their levels of significance are reduced, and the coefficient of CIVSERV loses significance. Both the WLS and OLS models presented here have sufficiently high explanatory power.

##### 4-2. Economic Area Sample

Table 4 about here

Table 4 presents the estimation results of the economic area sample. With regard to the results of the WLS analysis, the coefficients of average wage (WAGE), unemployment ratio (UNEMPL), ratio of university graduates (UNIV), the ratio of employment in professional and technical occupations (EXPERT), and relative number of local civil servants (CIVSERV) have the expected signs and are statistically significant. The coefficient of the average size of establishments (AVESIZE) is also significant but its sign is contrary to our expectation. The coefficients of householder ratio (MYHOME), business density (DENS), and proportion of manufacturing plants (MRATIO) are significant in half of the equations, while the signs of the coefficients of MYHOME and DENS are contrary to our hypothesis. The coefficients of remaining variables are not statistically significant. These results support Hypotheses 2, 3a, 4 a, 4b, 7, and 10b, but do not support Hypotheses 1, 3b, 5, 6, 8, 9, and 10a.

The results of the OLS regressions reveal trends that are essentially identical. The coefficients and levels of significance of some variables are lower but the coefficients of MYHOME and MRATIO are now significant in all equations. Both the WLS and OLS models presented here have sufficiently high explanatory power.

#### 4-3. Discussion

The results of the economic area level analysis differ from those of the municipality level analysis in the following aspects:

- 1) The effect of population growth is not significant,
- 2) The effects of the householder ratio and proportion of manufacturing plants are significant only in some regression equations,
- 3) The effect of business density is negative (significant only in certain equations),
- 4) The effect of traffic access is positive but not significant,

The observation that the estimated coefficients of some variables become insignificant may be interpreted to imply that these variables have location-specific characteristics and do not affect start-up activities in a larger region. In the full paper, we present a detailed discussion about the negative effect of business density on the start-up ratio in the economic area analysis.

The results presented in this paper support those obtained in the previous literature with respect to the positive effect of demand factors, the negative effect of cost factors, the positive effect of the unemployment rate (“push hypothesis”), the positive effects of

other human resource factors, the effects of industry agglomeration and industry structure, and the positive effects of traffic access. However, the negative effect of the householder ratio and the positive effect of the average business size, which are contrary to our hypotheses, are not in line with the results of almost all the previous studies. We present some interpretations of these unexpected effects in the full paper.

## **5. Concluding Remarks**

This paper is the first detailed analysis on the regional factors affecting the start-up ratio using segmented regional data, at the municipality and economic area levels in Japan. In this paper, we hypothesized that the regional gross start-up ratio is affected by demand, cost, human resources, financial, industry agglomeration and structure, and other factors (average business size, traffic access, and weight of the public sector).

The results reveal that the factors that cause an increase in the start-up ratio are high population growth, low wages, high unemployment ratio, low householder ratio, high ratio of university graduates, high ratio of employment in professional and technical occupations, high business density, low proportion of manufacturing plants, large average business size, good traffic access, and low weight of the public sector.

These results imply that cost factors are not significant obstacles to business start-ups and that the accumulation of qualified human resources is an important factor for start-ups. In other words, in order to promote business start-ups at the regional level, it is more important to accumulate qualified human resources than reduce the costs of start-up and operation and provide loans.

Despite of some contributions to the understanding of the regional factors of the start-up ratio, this paper has certain limitations. The first limitation is related to the difficulty of definition of a region as an analytical unit. The second limitation is that we could not differentiate among industries due to the limited availability of data.

## **Endnotes**

- 1) The definition of economic areas is based on that stated in the “2002 National Survey of Prices,” wherein each prefecture was divided into 4 economic areas on an average, and 185 economic areas were defined for the entire country.
- 2) According to the Standard Occupation Classification of Japan, “professional and technical occupations” include the occupations of various types of scientists and engineers; occupations in medical and health care services, such as the professions of

doctors, pharmacists, and nurses; occupations in social welfare services; occupations in legal services, such as the profession of lawyers; occupations in business support services, such as the professions of accountants and management consultants; and occupation of teachers and artists.

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Table 1: Definitions of Variables and Original Data Sources

| Variables | Definitions (units / years)   | Original Data Sources                                  |
|-----------|---|--|
| STARTR    | gross start-up ratio (1996-99): # of business openings (1996-99) / total # of establishments in 1996 (private businesses in the non-primary sector) | Establishment and Enterprise Census                    |
| GRPOP     | Rate of Population Growth (1990-95)   | Population Census                                      |
| WAGE      | average wage in manufacturing (thousand yen) (1998)   | Census of Manufactures                                 |
| UNEMPL    | Unemployment ratio (1996)   | Population Census                                      |
| UNIV      | Ratio of university graduates to the population (older than 15 years old) (2000)  | Population Census                                      |
| EXPERT    | Ratio of employment in professional and technical occupations to the total # of employment (1995)   | Population Census                                      |
| MYHOME    | Ratio of households with own housings (1995)  | Population Census                                      |
| DENS      | Business density: # of establishments per km <sup>2</sup> (1995 / 96)   | Population Census, Establishment and Enterprise Census |
| MRATIO    | Share of manufacturing plants to total number of establishments (1996)  | Establishment and Enterprise Census                    |
| AVESIZE   | average establishment size: average # of employees of private establishments in the non-primary sector (1996)                                       | Establishment and Enterprise Census                    |
| SHINK     | Dummy for railway access, taking on the value of 1 if there is a station of Shinkansen Express and 0 otherwise                                      |  |
| HIWAY     | Dummy for highway access, taking on the value of 1 if these is a highway interchange and 0 otherwise  |  |
| PUBEXP    | Public services: log of public expenditures per capita (1996)   | Survey of Public Account in Municipalities             |
| CIVSERV   | Public services: # of local civil servants per 100 inhabitants (1996)   | Survey of Wages of Local Civil Servants                |

Notes:

- 1) Regional data for the empirical analysis except for STARTR, SHINK and HIWAY were obtained from "Regional Economy Data CD-ROM", Version April 2004 (Toyo Keizai). SHINK and HIWAY were prepared from a Japanese Map.
- 2) With regard to the analysis using economic area data, SHINK and HIWAY are the share of the number of inhabitants in the municipalities with a Shinkansen station or a highway interchange to the total number of inhabitants in the economic area, respectively.

Table 2: Basic Statistics

## A. Municipality Data

| Variables | Mean   | Median | St.Dev. | Min.   | Max.    | Observations |
|-----------|--------|--------|---------|--------|---------|--------------|
| STARTR    | 0.082  | 0.075  | 0.052   | 0      | 0.628   | 3,123        |
| GRPOP     | -0.005 | -0.014 | 0.064   | -0.253 | 0.592   | 3,123        |
| WAGE      | 3,467  | 3,346  | 1,069   | 190    | 9,890   | 3,038        |
| UNEMPL    | 0.033  | 0.030  | 0.016   | 0      | 0.178   | 3,123        |
| UNIV      | 0.076  | 0.065  | 0.044   | 0.011  | 0.335   | 3,122        |
| EXPERT    | 0.099  | 0.096  | 0.029   | 0.031  | 0.253   | 3,123        |
| MYHOME    | 0.799  | 0.836  | 0.135   | 0.127  | 0.998   | 3,123        |
| DENS      | 39.0   | 9.5    | 160.2   | 0.2    | 4,403.6 | 3,123        |
| MRATIO    | 0.121  | 0.102  | 0.076   | 0      | 0.660   | 3,123        |
| AVESIZE   | 7.7    | 7.3    | 2.2     | 2.0    | 26.1    | 3,123        |
| SHINK     | 0.024  | 0      | 0.152   | 0      | 1       | 3,123        |
| HIWAY     | 0.210  | 0      | 0.407   | 0      | 1       | 3,123        |
| PUBEXP    | 6.312  | 6.202  | 0.537   | 5.382  | 8.966   | 3,123        |
| CIVSERV   | 1.7    | 1.4    | 1.1     | 0.1    | 22.6    | 3,123        |

## B. Economic Area Data

| Variables | Mean  | Median | St.Dev. | Min.   | Max.  | Observations |
|-----------|-------|--------|---------|--------|-------|--------------|
| STARTR    | 0.098 | 0.095  | 0.024   | 0.040  | 0.189 | 185          |
| GRPOP1    | 0.007 | 0.007  | 0.031   | -0.079 | 0.096 | 185          |
| WAGE      | 3,994 | 3,936  | 869     | 2,093  | 6,417 | 185          |
| UNEMPL    | 0.038 | 0.038  | 0.012   | 0.018  | 0.111 | 185          |
| UNIV      | 0.103 | 0.097  | 0.042   | 0.042  | 0.264 | 185          |
| EXPERT    | 0.116 | 0.112  | 0.018   | 0.080  | 0.189 | 185          |
| MYHOME    | 0.698 | 0.718  | 0.107   | 0.378  | 0.904 | 185          |
| DENS      | 54.9  | 14.3   | 180.9   | 1.9    | 1,884 | 185          |
| MRATIO    | 0.110 | 0.097  | 0.050   | 0.039  | 0.306 | 185          |
| AVESIZE   | 8.3   | 8.3    | 1.5     | 5.3    | 15.0  | 185          |
| SHINK     | 0.114 | 0.000  | 0.232   | 0.000  | 1.000 | 185          |
| HIWAY     | 0.459 | 0.502  | 0.306   | 0.000  | 1.000 | 185          |
| PUBEXP    | 6.091 | 6.084  | 0.274   | 5.503  | 7.167 | 185          |
| CIVSERV   | 1.273 | 1.222  | 0.341   | 0.773  | 3.065 | 185          |

Table 3: Estimation Results using Municipality Level Data

Dependent variable = STARTR

WLS estimation (weight = number of establishments in 1996)

| variables/models | 1                    | 2                    | 3                    | 4                    |
|------------------|----------------------|----------------------|----------------------|----------------------|
| constant         | 0.0604 (8.64) a      | 0.0388 (5.04) a      | 0.0572 (8.12) a      | 0.0387 (5.04) a      |
| GRPOP            | 0.130 (10.1) a       | 0.129 (10.1) a       | 0.136 (10.7) a       | 0.137 (10.8) a       |
| WAGE             | -0.609E-05 (-7.82) a | -0.499E-05 (-6.67) a | -0.610E-05 (-7.92) a | -0.489E-05 (-6.59) a |
| UNEMPL           | 0.542 (12.0) a       | 0.432 (10.0) a       | 0.562 (12.4) a       | 0.455 (10.5) a       |
| UNIV             | 0.174 (12.1) a       |                      | 0.168 (11.8) a       |                      |
| EXPERT           |                      | 0.343 (13.2) a       |                      | 0.322 (12.6) a       |
| MYHOME           | -0.126E-03 (-2.17) b | -0.170E-03 (-3.08) a | -0.110E-03 (-1.92) c | -0.173E-03 (-3.18) a |
| DENS             | 0.116E-04 (8.72) a   | 0.173E-04 (13.6) a   | 0.123E-04 (9.26) a   | 0.178E-04 (13.9) a   |
| MRATIO           | -0.131 (-16.9) a     | -0.0988 (-11.8) a    | -0.129 (-16.7) a     | -0.0997 (-12.0) a    |
| AVESIZE          | 0.600E-02 (17.7) a   | 0.591E-02 (17.5) a   | 0.582E-02 (17.2) a   | 0.571E-02 (17.0) a   |
| SHINK            | 0.284E-02 (2.21) b   | 0.420E-02 (3.25) a   |                      |                      |
| HIWAY            |                      |                      | 0.475E-02 (4.08) a   | 0.454E-02 (3.91) a   |
| CIVSERV          | -0.435E-02 (-3.49) a | -0.419E-02 (-3.38) a | -0.321E-02 (-2.59) a | -0.296E-02 (-2.39) b |
| adj. R-square    | 0.552                | 0.556                | 0.554                | 0.557                |
| F value          | 375.4                | 381.6                | 378.0                | 382.7                |
| observations     | 3,037                | 3,038                | 3,037                | 3,038                |

OLS estimation

| variables/models | 5                    | 6                    | 7                    | 8                    |
|------------------|----------------------|----------------------|----------------------|----------------------|
| constant         | 0.0751 (5.26) a      | 0.0663 (4.40) a      | 0.0753 (5.29) a      | 0.0664 (4.41) a      |
| GRPOP            | 0.130 (6.30) a       | 0.136 (6.77) a       | 0.130 (6.33) a       | 0.136 (6.78) a       |
| WAGE             | -0.328E-05 (-2.19) b | -0.203E-05 (-1.49)   | -0.327E-05 (-2.20) b | -0.204E-05 (-1.51)   |
| UNEMPL           | 0.227 (2.93) a       | 0.154 (2.04) b       | 0.226 (2.92) a       | 0.153 (2.03) b       |
| UNIV             | 0.177 (5.40) a       |                      | 0.175 (5.31) a       |                      |
| EXPERT           |                      | 0.226 (5.25) a       |                      | 0.223 (5.19) a       |
| MYHOME           | -0.348E-03 (-3.26) b | -0.373E-03 (-3.59) a | -0.350E-03 (-3.28) a | -0.372E-03 (-3.58) a |
| DENS             | 0.125E-04 (3.00) a   | 0.230E-04 (5.36) a   | 0.129E-04 (3.10) a   | 0.232E-04 (5.57) a   |
| MRATIO           | -0.0776 (-7.98) a    | -0.0673 (-6.71) a    | -0.0774 (-7.95) a    | -0.0672 (-6.69) a    |
| AVESIZE          | 0.444E-02 (6.33) a   | 0.433E-02 (6.25) a   | 0.441E-02 (6.25) a   | 0.429E-02 (6.17) a   |
| SHINK            | 0.554E-02 (1.95) c   | 0.585E-02 (1.96) b   |                      |                      |
| HIWAY            |                      |                      | 0.185E-02 (0.981)    | 0.224E-02 (1.19)     |
| CIVSERV          | 0.567E-03 (0.420)    | 0.105E-03 (0.0790)   | 0.630E-03 (0.468)    | 0.195E-03 (0.147)    |
| adj. R-square    | 0.209                | 0.208                | 0.209                | 0.208                |
| F value          | 81.1                 | 80.8                 | 81.1                 | 80.8                 |
| observations     | 3,037                | 3,038                | 3,037                | 3,038                |

Notes: t-values in parentheses. Levels of significance: a 1%, b 5%, c 10%.

The results on PUBEXP (not significant) were omitted from the table.

Table 4: Estimation Results using Economic Area Data

Dependent variable = STARTR

WLS estimation (weight = number of establishments in 1996)

| variables/models | 1                    | 2                    | 3                    | 4                    |
|------------------|----------------------|----------------------|----------------------|----------------------|
| constant         | 0.0303 (1.57)        | 0.0163 (0.775)       | 0.0306 (1.55)        | 0.0173 (0.800)       |
| GRPOP            | -0.0604 (-1.32)      | -0.0377 (-0.822)     | -0.0589 (-1.29)      | -0.0362 (-0.788)     |
| WAGE             | -0.119E-04 (-5.48) a | -0.113E-04 (-5.37) a | -0.115E-04 (-5.47) a | -0.106E-04 (-5.26) a |
| UNEMPL           | 0.816 (7.92) a       | 0.695 (6.95) a       | 0.819 (7.95) a       | 0.704 (7.05) a       |
| UNIV             | 0.153 (4.20) a       |                      | 0.148 (4.11) a       |                      |
| EXPERT           |                      | 0.318 (4.22) a       |                      | 0.299 (4.05) a       |
| MYHOME           | -0.0183 (-1.16)      | -0.0273 (-1.85) c    | -0.0215 (-1.33)      | -0.0313 (-2.07) b    |
| DENS             | -0.124E-04 (-2.44) b | -0.619E-05 (-1.22)   | -0.129E-04 (-2.58) b | -0.732E-05 (-1.47)   |
| MRATIO           | -0.0655 (-2.69) a    | -0.0286 (-1.06)      | -0.0640 (-2.63) a    | -0.0289 (-1.07)      |
| AVESIZE          | 0.0121 (10.5) a      | 0.0119 (10.3) a      | 0.0121 (10.4) a      | 0.0119 (10.3) a      |
| SHINK            | 0.192E-02 (0.554)    | 0.332E-02 (0.941)    |                      |                      |
| HIWAY            |                      |                      | -0.987E-03 (-0.239)  | -0.442E-03 (-0.106)  |
| CIVSERV          | -0.801E-02 (-1.79) c | -0.935E-02 (-2.13) b | -0.715E-02 (-1.70) c | -0.799E-02 (-1.93) c |
| adj. R-squared   | 0.664                | 0.675                | 0.663                | 0.673                |
| F value          | 70.3                 | 70.4                 | 70.2                 | 70.0                 |
| n                | 185                  | 185                  | 185                  | 185                  |

OLS estimation

| variables/models | 5                    | 6                    | 7                    | 8                    |
|------------------|----------------------|----------------------|----------------------|----------------------|
| constant         | 0.0866 (2.74) a      | 0.0660 (1.94) c      | 0.0836 (2.56) a      | 0.0649 (1.87) c      |
| GRPOP            | 0.0513 (0.818)       | 0.0639 (1.05)        | 0.0517 (0.803)       | 0.0630 (1.00)        |
| WAGE             | -0.929E-05 (-4.45) a | -0.910E-05 (-4.83) a | -0.907E-05 (-4.34) a | -0.877E-05 (-4.56) a |
| UNEMPL           | 0.450 (1.98) b       | 0.351 (1.54)         | 0.452 (2.00) b       | 0.362 (1.58)         |
| UNIV             | 0.134 (2.55) b       |                      | 0.125 (2.61) a       |                      |
| EXPERT           |                      | 0.293 (2.99) a       |                      | 0.265 (2.98) a       |
| MYHOME           | -0.0562 (-2.80) a    | -0.0563 (-2.95) a    | -0.0569 (-2.93) a    | -0.0580 (-3.10) a    |
| DENS             | -0.543E-05 (-0.385)  | 0.157E-05 (0.131)    | -0.575E-05 (-0.416)  | 0.509E-06 (0.0431)   |
| MRATIO           | -0.0709 (-2.94) a    | -0.0444 (-1.66) c    | -0.0692 (-2.88) a    | -0.0445 (-1.68) c    |
| AVESIZE          | 0.819E-02 (4.89) a   | 0.834E-02 (5.11) a   | 0.818E-02 (4.60) a   | 0.835E-02 (4.75) a   |
| SHINK            | 0.663E-02 (1.22)     | 0.845E-02 (1.52)     |                      |                      |
| HIWAY            |                      |                      | 0.505E-02 (1.19)     | 0.566E-02 (1.34)     |
| CIVSERV          | -0.303E-02 (-0.736)  | -0.405E-02 (-1.02)   | -0.171E-02 (-0.390)  | -0.238E-02 (-0.559)  |
| adj. R-squared   | 0.697                | 0.703                | 0.696                | 0.701                |
| F value          | 43.3                 | 44.6                 | 43.2                 | 44.2                 |
| n                | 185                  | 185                  | 185                  | 185                  |

Notes: t-values in parentheses. Levels of significance: a 1%, b 5%, c 10%.

The results on PUBEXP (not significant) were omitted from the table.

# **IMPLEMENTATION OF THE SMALL AND MEDIUM INDUSTRIES EQUITY INVESTMENT SCHEME IN NIGERIA**

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## **Abstract**

Many SMIs in Nigeria have become moribund majorly because of poor funding. The CBN established the SMIEIS in 2001 to provide equity finance for the SMIs. The CBN directs all banks to contribute 10% profit after tax to the Scheme. The goal was to relieve the SMIs from borrowing and interest burden. The implementation of the Scheme is below expectation. By the end of 2004, less than 50% of the 89 banks complied with the CBN directive. Only 31% of the Scheme's ₦28.8 billion was invested in the SMIs.

This paper identifies the challenges facing the Scheme. Data were collected using a sample of six banks – headquarters and two private fund operators. Findings reveal that the number of applications approved was on the average 4.3% of the applications received. The reasons given for declining applications, ranked in order of prominence, ranged from bad feasibility studies, poor management skills and lack of proper accounting to poor character checks. Non-full disbursement of approved amounts was due to incomplete/improper documentation and diversification of funds. Some banks lacked interest because project review was demanding, costly and took long and also there was envisaged difficulty at point of disinvestment.

Sectoral distribution of funded projects was more in favour of the productive sector with manufacturing dominating.

This paper recommends that all stakeholders in SMIEIS should develop strategies that will enable entrepreneurs meet the requirements of the banks and the PFMs. The banks should be more responsive and pro-active in implementing the Scheme.

## **Introduction**

Studies of Entrepreneurship and small and medium industries (SMIs) development worldwide have established lack of adequate capital as a basic and major constraint (Bolton 1978; Fatunla 1989, Olutunla (2001), etc. Many of the SMIs in Nigeria have become moribund owing partly and oftentimes largely to poor funding. To solve the financial and related problems

of the SMIs, the Central Bank of Nigeria (CBN) established the Small and Medium Industries Equity Investment Scheme (SMIEIS) as a voluntary initiative of the Bankers' Committee and it was approved on 19<sup>th</sup> June, 2001. The Scheme requires all banks in Nigeria to set aside 10% of their profit before tax for equity investment in small and medium scale industries.

The SMIEIS defines SMI as any industry with an asset base ranging between ₦1.50 million and ₦200million including working capital but excluding cost of land and a workforce of 11 to 300 workers (Report of NCI – 14, 2003). In addition to providing finance, the Scheme requires banks to identify, develop and package viable industries with enterprising customers. The goal of the Scheme is to relieve the SMIs from borrowing and consequently relieve them from interest and other charges. The advantages of the Scheme include provision of risk capital, financial advisory services and entrepreneurial management to SMIs. Initially, only commercial banks participated in the Scheme. Recently in the last one year, private fund managers (PFM) have been incorporated to manage the Scheme, pooling the idle equity funds from several commercial banks to administer and reach out to more SMIs.

Though very laudable in its objectives, the implementation of the Scheme seems to be falling below expectation. In year 2004, out of eighty-nine (89) banks operating in Nigeria, only forty-four (44) had invested in this Scheme. Over 50% of the banks were yet to comply with the CBN directive. Out of the N28.8 billion set aside by the complying banks, only about N9 billion or 31% was invested in SMIs (Business Day, 2004). Obviously, the implementation of the Scheme is facing certain challenges that are increasingly creating problems to the success of the Scheme. This exploratory study identifies some of the challenges and discusses the Scheme's achievements, constraints and prospects for better and higher level of effective implementation.

## **Methodology**

This study is exploratory in scope. Originally conceived as a paper based on the case study of one bank by Ogunleye (2004), it has been expanded to a sample of size 8 i.e. randomly selected six (6) banks and two private fund managers (PFM). The headquarters of the banks were selected and located in Lagos, the commercial nerve-centre of Nigeria. Normally, all applications from branches go to the headquarters for processing and approvals. Time coverage for the study was from the inception of the Scheme (2001) to the time of interview. The data for the case study Bank (labelled A in the Tables) was collected in 2004, while the data from the other five banks (labelled B to F in the Tables) and the two PFMs (labelled G & H) were collected in February 2005.

Preliminary discussions were made with the Corporate Affairs managers in the selected bank headquarters and also with the PFMs. Thereafter, structured questionnaires were completed by them. Seven (7) were self administered, while only one responded by hand mail. Any ambiguity was cleared over telephone calls.

Data were collected on variables such as the number of applications received, the number approved, the reasons for declining applications, the total amount of equity participation requested and the proportion granted. The questionnaire also sought information on sectoral distribution of the beneficiaries as well as the level and type of assistance rendered to the funded SMIs. Suggestions were also sought on how to make the Scheme effective and successful.

## Data Analysis and Findings

The numbers of applications received and approved are as detailed in Table 1. Analysis shows that the number of applications approved ranged between 2% and 17% of the number of applications received with average of 4.3%.

Table 1 here

Surprisingly the proportion in the category of the private fund managers was only 3% despite the large number of applications received by them. It should be noted however that a very large proportion of the applications were still being processed. Others have been declined outright. The numbers of applications declined by the reasons given are as presented in table 2(a). Table 2(b) shows the ranking of the reasons – with score of 5 representing the most common reason and 1 the least common reason. Both tables confirm that the four most prominent reasons given were bad feasibility studies, poor management skills, lack of proper accounting and poor character. The two reasons that were of least importance were business not in strategic focus of the bank and business owners neither wanting to dilute equity nor share control.

Tables 2(a) & 2(b) here

Table 3 presents the data on the amount of equity participation requested, approved and disbursed. There is not much variation between the amount requested by the SMIs and the amount disbursed. Approval was 72% of request while disbursement was 93% of approval. This shows that there was not much frivolity in the application requests. More importantly, it emphasizes the fact that there was adequate supply to meet the demand for equity funds.

Table 3 here

For the few cases of non-disbursement, the most frequently cited reason for incomplete disbursement of the amount approved was incomplete / improper documentation by the applicants. Other reasons were non-fulfillments of conditions precedent to draw down, poor business/project viability, inability of entrepreneurs to demonstrate good understanding of the business and diversification of capital funds.

The sectoral distribution of the equity fund beneficiaries is presented in tables 4(a) and 4(b)

|                       |
|-----------------------|
| Tables 4a and 4b here |
|-----------------------|

The spread of the sample data (table 4a) is at variance with the spread of investment in the population data for the whole country presented in table 4(b). In Lagos (from where the sample was taken), equity investments were more in the services related sector (having 67.35% of the 49 projects funded by the respondents). The reverse was the case in the distribution for the whole country. Both the number of projects (67.85% of the 168 projects) and the value of investments (65.41% of ₦8,531 billion investment) were in favour of the productive sector, with manufacturing dominating. The service related sector had only a third of the equity investment of the Scheme. Incidentally, Lagos State had the highest with its total investments put at ₦5.045 billion in 110 projects representing 80.29% of total equity investments in the country (Business Times, 2005). Caution should be taken to ensure that the Scheme is used to develop SMIs rather than services. SMIs are normally disadvantaged to get funding because of the usually long gestation period and slow rate of returns.

Apart from financial investment in the SMIs, it is encouraging to note that both the participating banks and the PFMs provide other development support such as financial advisory services, entrepreneurial management assistance and board membership. However the PFMs

were more responsive to these needs of the SMIs. While the PFMs provided these 3 types of assistance in all the 34 SMIs in which they had equity interest, the banks gave financial advisory and management assistance to only 55% of the SMIs and had Board membership in 89% of the SMIs where they invested. Furthermore, data reveal that both the banks and the PFMs put in minimum of 5% to 40% and maximum of 33% to 51% as equity while the Board membership was minimum of 5% to 50% and maximum of 40% to 50% of total.

In order to improve the level of effective implementation, it is important to know the requirements that the participating banks and equity fund managers expected the Scheme applicants to meet. The requirements were listed in order of importance. Scoring the most important three (3) and the least important one (1), the analysis of responses revealed that 'feasibility study and project viability' ranked highest with 14 points, 'entrepreneurial managerial competence' with 9 points was second, while 'market analysis' was 3<sup>rd</sup> with 4 points. In the 4<sup>th</sup> rank, with 3 points each, were 'good character', 'corporate governance', 'incorporation papers' and 'business growth'. The requirements that came last, each with 1 point, were 'strategic focus' and 'ability to meet the guidelines'.

To compare the ability of the applicants to meet the requirements expected of them, the banks were to state the number of applicants that met the requirements. Analysis and results show that by and large, the ranking of the ability matched that of the expectations. Satisfactory feasibility study, good accounting procedure, project viability and reliable management skill topped the ranking. The number of applicants meeting the above ranked requirements were 127, 114, 111 and 201 respectively. Satisfactory character check and good community were last with 74 and 39 applicants meeting these two requirements respectively.

There is the widely held view that banks prefer to pay penalties rather than participate in the Scheme. Our sample and findings do not confirm this view. Only two banks responded that, if given the option, banks would prefer to pay penalty. The remaining 5 respondents including the two PFMs felt that banks would not prefer to pay penalty. The banks which felt that penalty option would be preferred to participation gave many reasons for their opinion: project review was demanding and takes long time; associated cost of processing, management and documentation was discouraging; equity investment was risky and income slow, as well as difficulty at point of disinvestment and the insincerity of promoters.

The respondents offered suggestions for future review of the CBN Guidelines for the Scheme. Major among these was that the lower limit of number of employees and/or capital investment should be less or removed to accommodate micro enterprises to qualify for the Scheme; that micro-finance institutions should be included in the eligible sectors so as to create access to small borrowers. Other important suggestions were that the CBN Guidelines should remove the rigidity of sectoral allocation for the Scheme to include more sectors and that the Scheme should include viable start – up projects. Furthermore, aside from finance, the guidelines should address other SMIEIS problems like infrastructure particularly electricity supply; education of promoters on basis of management skills; and emphasis should be based on SMEs with comparative advantage to the nation.

Only 2 of the 8 banks and PFMs agreed that the entrepreneurs were adequately aware and interested in the Scheme. The remaining 6 operators or 75% felt that there was not enough awareness by the entrepreneurs. Generally, 62.5% of the banks/PFMs felt that the Scheme had been successful while the remaining felt the Scheme had only partial or no success.

## **Implications for SMI Development**

An approval rate of 4.3% confirms that the Scheme is failing to achieve the objectives of setting it up. This implies that ailing and moribund SMIs are not being revived. Entrepreneurs and the SMIs are still left to seek financial assistance through borrowing often with high interest rates. Even loan assistance may never be available to them as the reasons given by the banks for rejecting applications remain the same since the 1970s i.e. bad feasibility reports and non-viability of projects, poor management skills and lack of proper accounting procedures.

This study highlights the significant role being played by the private fund managers since they entered the Scheme in the last one year. The PFMs are taking on those challenging roles that the banks have refused over the years. In addition to their financial participation, they have assisted the SMIs in financial as well as management advisory services. These and their major participation in Board membership augur well for the development of the SMIs. Through Boardroom monitoring, the past practices of fund diversification and bad financial management will give way to efficiency, profitability and growth of the SMIs. The PFMs may ultimately be the hope of the entrepreneurs and SMIs in successful implementation of the Scheme in their favour. It is recommended that more private fund managers should be encouraged to incorporate and use the huge funds available in the SMIEIS to develop the SMIs.

The sectoral distribution of the SMIEIS investment is encouraging as about two-thirds are in the productive sector while about one-third are in the services-related sectors of the SMEs (table 4). Investments in the real sector usually have longer gestation period. Unfortunately, the banks traditionally are more interested in financing short-term projects with quick profit returns. The SMIEIS, particularly with the emergency of the PFMs, is addressing this challenge and the trend of participating more in favour of the real sector should continue. This has important

impact for sustainable development and growth of the industrial sector in emerging economies like Nigeria.

Even though the requirements demanded by the banks to approve SMI applications for funding are high and unrelenting over the years, they are very important for the capacity building of the entrepreneurs and SMI managers. The requirements sensitize the awareness that more attention should be focused on the training of entrepreneurs and SMI managers to improve their capability in presenting bankable investment proposals and feasibility study reports, to train entrepreneurs in accounting principles and generally to raise their organizational skill and managerial capacity. To this end, this study recommends the establishment of some Centres and Institutes of Entrepreneurship in selected Nigerian Universities to focus on Entrepreneurship/SME research and training. Such institutions can seek partnerships with relevant government ministries and agencies like Small and Medium Enterprises Development Agency (SMEDAN) and National Directorate of Employment (NDE). The government and corporate bodies can also establish Entrepreneurship Chairs for research professors (Olutunla, 2001)

Hitherto, the micro-enterprises (with less than ₦1.5million capital and employing less than 11 workers) have been excluded from qualifying for the SMIEIS funding. Including micro industries in the CBN Guidelines for the Scheme will imply more growth for the SME sector, reduction of poverty and unemployment. More micro industries funded by the SMIEIS will grow to become the springboards for SMIs and large industries in the country.

While it is recommended that viable start-up projects should be included in the Scheme, the Guidelines should not be broadened to include all sectors of all sizes. That will negate the objective of the Scheme. Widening the Guidelines qualifications to include more services

sectors (particularly trading) and the large firms will stifle out the SMIs from the unique benefits of the Scheme.

The option of penalty payment by non-participating banks may not augur well for SME development. Rather, it will give the opportunity to the reluctant banks not to invest in the Scheme. Already some banks try to make a way out and try to fulfill the righteousness of the CBN directive through inside lending to their own directors or relations having interests in SMIs. In fact some banks participate as preferential shareholders. However, such practices face disqualification and sanctions when discovered by the CBN. The important thing is that the banks should contribute, support their own initiative and faithfully implement the Scheme to achieve the desired set goals.

## **Conclusion**

The SMIEIS is a very well conceived and laudable Scheme. Though the pace of implementation is slow and level of equity investment is extremely low, the Scheme should be encouraged to succeed. Given the chance of time to mature, it will contribute immensely to the development of SMEs in Nigeria. The banks should be more pro-active, fulfil their obligations and use the huge funds available to finance the SMIs. More private fund managers should be established to participate in the Scheme.

Government, Universities, the organized private sectors (like NACCIMA, NASSI and NASME), NGOs in partnership with international development agencies (like UNDP) should all contribute to the training and enhancement of the managerial capacity of entrepreneurs and SMIs. With proper and effective implementation of SMIEIS, the Scheme will play the expected role in SMI development in particular and generally in the employment generation, poverty

alleviation and overall economic development of Nigeria. Indeed, it will become a model for other developing nations of the world.

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**Table 1: The Number of Applications Received and Approved**

|  | <b>Banks/<br/>PFMs</b> | <b>Number of<br/>Application<br/>received</b> | <b>Number<br/>Approved</b> | <b>Proportion<br/>Approved</b> |              |
|--|------------------------|---|----------------------------|--------------------------------|--------------|
|  | A                      | 102   | 9                          | 9 %                            |              |
|  | B                      | 16  | 1                          | 6 %                            |              |
|  | C                      | 60  | 1                          | 2 %                            |              |
|  | D                      | 30  | 5                          | 17 %                           |              |
|  | E                      | >80   | 12                         | 15 %                           |              |
|  | F                      | 100   | 8                          | 8 %                            |              |
|  | G                      | 800   | 20                         | 3 %                            |              |
|  | H                      | >450  | 14                         | 3 %                            |              |
|  | <b>TOTAL</b>           | <b>8</b>                                      | <b>1,638</b>               | <b>70</b>                      | <b>4.3 %</b> |

**Note:** Banks are A – F; PFMs are G & H

**Table 2(a): Number of declined applications by Reasons**

| <b>Reasons</b>            | <b>A</b> | <b>B</b> | <b>C</b> | <b>D</b> | <b>E</b> | <b>F</b> | <b>G</b> | <b>H</b> | <b>TOTAL<br/>NO.</b> | <b>RANKING</b>        |
|---------------------------|----------|----------|----------|----------|----------|----------|----------|----------|----------------------|-----------------------|
| i. Bad feasibility        |          | 4        | 5        |          | 42       | 2        | 300      | 5        | <b>358</b>           | <b>1<sup>st</sup></b> |
| ii. Not in strategic foc. |          | 3        |          |          | 4        |          | 50       |          | <b>57</b>            | <b>5<sup>th</sup></b> |
| iii. Poor Mgt. Skill      |          | 3        | 5        |          | 6        | 4        | 50       | 4        | <b>72</b>            | <b>4<sup>th</sup></b> |
| iv. Lack of proper a/c    |          |          |          |          |          | 3        | 100      |          | <b>103</b>           | <b>3<sup>rd</sup></b> |
| v. Poor Character         |          | 2        | 5        |          |          |          | 150      | 3        | <b>160</b>           | <b>2<sup>nd</sup></b> |
| vi. Not share control     |          |          | 2        |          |          |          | 50       |          | <b>52</b>            | <b>6<sup>th</sup></b> |
| <b>Total no. declined</b> |          |          |          |          |          |          |          |          | <b>802</b>           |                       |

**Table 2(b): Ranking of Reasons for Declining Applications**

| <b>Reasons</b>            | <b>A</b> | <b>B</b> | <b>C</b> | <b>D</b> | <b>E</b> | <b>F</b> | <b>G</b> | <b>H</b> | <b>TOTAL<br/>NO.</b> | <b>RANKING</b>        |
|---------------------------|----------|----------|----------|----------|----------|----------|----------|----------|----------------------|-----------------------|
| i. Bad feasibility        | 3        | 5        | 5        |          | 5        | 2        | 5        |          | <b>25</b>            | <b>1<sup>st</sup></b> |
| ii. Not in strategic foc. | 3        | 2        |          |          | 2        |          |          |          | <b>7</b>             | <b>5<sup>th</sup></b> |
| iii. Poor Mgt. Skill      | 5        | 4        | 5        |          | 3        | 4        |          |          | <b>21</b>            | <b>2<sup>nd</sup></b> |
| iv. Lack of proper a/c    | 4        | 1        |          |          |          | 3        |          |          | <b>8</b>             | <b>4<sup>th</sup></b> |
| v. Poor Character         | 1        | 3        | 5        |          |          |          | 1        |          | <b>10</b>            | <b>3<sup>rd</sup></b> |
| vi. Not share control.    | 2        |          | 2        |          |          |          |          |          | <b>4</b>             | <b>6<sup>th</sup></b> |

**Note:** Most important reason = 5; least important reason = 1

**Table 3: Amount of Equity participation requested, Approved and Disbursed**

| <b>Equity Fund Operator</b> | <b>Amount Requested by Approved Applications<br/>N'm</b> | <b>Amount Approved<br/>N'm</b> | <b>Amount Disbursed<br/>N'm</b> |
|-----------------------------|--|--------------------------------|---------------------------------|
| A                           | 124.1  | 124.1                          | 97.710                          |
| B                           | 400  | 30                             | 30                              |
| C                           | 80   | 80                             | 50                              |
| D                           | 495  | 495                            | 495                             |
| E                           | 87   | 12                             | 12                              |
| F                           | 400  | 400                            | 380                             |
| G                           |  |                                |                                 |
| H                           |  |                                |                                 |
| <b>TOTAL %</b>              | <b>1,586.1</b>   | <b>1,741.1<br/>(72 %)</b>      | <b>1,064.71<br/>(93 %)</b>      |

**Table 4(a): Sectoral distribution of Equity Fund Beneficiaries by numbers**

| <b>Fund Operators</b> | <b>A</b> | <b>B*</b> | <b>C</b> | <b>D</b> | <b>E</b>  | <b>F</b> | <b>G*</b> | <b>H</b>  | <b>TOTAL No. of Beneficiaries</b> | <b>RANKING</b>        |
|-----------------------|----------|-----------|----------|----------|-----------|----------|-----------|-----------|-----------------------------------|-----------------------|
| <b>Sectors</b>        |          |           |          |          |           |          |           |           |                                   |                       |
| Agriculture           | 1        | -         | -        | -        | 3         | -        | -         | -         | <b>4</b>                          | <b>5<sup>th</sup></b> |
| Manufacturing         | -        | -         | -        | 1        | 3         | 6        | -         | 2         | <b>12</b>                         | <b>2<sup>nd</sup></b> |
| Construction          | -        | -         | -        | -        | -         | -        | -         | -         | <b>-</b>                          | <b>7<sup>th</sup></b> |
| Solid Minerals        | -        | -         | -        | -        | -         | -        | -         | -         | <b>-</b>                          | <b>7<sup>th</sup></b> |
| IT & Telecom          | 2        | -         | 1        | 1        | 2         | 1        | -         | 2         | <b>9</b>                          | <b>3<sup>rd</sup></b> |
| Education             | 3        | -         | -        | -        | 2         | -        | -         | -         | <b>5</b>                          | <b>4<sup>th</sup></b> |
| Services              | 2        | -         | -        | 3        | 1         | 1        | -         | 9         | <b>16</b>                         | <b>1<sup>st</sup></b> |
| Hotel & Tourism       | 1        | -         | -        | -        | 1         | -        | -         | 1         | <b>3</b>                          | <b>6<sup>th</sup></b> |
| <b>TOTAL</b>          | <b>9</b> | <b>-</b>  | <b>1</b> | <b>5</b> | <b>12</b> | <b>8</b> | <b>-</b>  | <b>14</b> | <b>49</b>                         |                       |

\* No responses

**Table 4(b): Sectoral Distribution of Total Investments under SMIEIS, 2003 and 2004**

| S/N                          | SECTOR         | ENTERPRISE  | INVESTMENT AS AT<br>31 <sup>ST</sup> DECEMBER, 2003         |  | INVESTMENT AS AT<br>31 <sup>ST</sup> DECEMBER 2004 |                   |
|------------------------------|----------------|---|---|--|--|-------------------|
|                              |                |   | NO OF PROJECT   | AMOUNT<br>N' 000                                 | NO OF<br>PROJECT                                   | AMOUNT<br>N' 000  |
| 1                            | REAL<br>SECTOR | Agro Allied<br>(including wood<br>work & water<br>bottling) | 24  | 664,181  | 21   | 706,684           |
|                              |                | Manufacturing<br>(including printing<br>& publishing)       | 60  | 3,316,263  | 81   | 3,741,869         |
|                              |                | Construction<br>(including<br>quarrying)                    | 9   | 868,884  | 9  | 1,071,288         |
|                              |                | Solid Minerals  | 2   | 29,440   | 3  | 59,440            |
|                              |                | <b>SUB TOTAL</b>  | <b>95</b>   | <b>4,878,768</b>                                 | <b>144</b>   | <b>5,579,281</b>  |
|                              |                | 2   | SERVICE<br>RELATED<br>ENTERPRISES<br>(excluding<br>Trading) | Information<br>Technology &<br>Telecommunication | 12   | 951,119           |
| Educational<br>Establishment | 1              |   |   | 20,000   | 3  | 103,935           |
| Services                     | 25             |   |   | 923,814  | 34   | 1,619,260         |
| Tourism & Leisure            | 4              |   |   | 296,398  | 4  | 203,220           |
| Others                       | 0              |   |   | 0.00   |  | 0.00              |
| <b>SUB TOTAL</b>             | <b>42</b>      |   |   | <b>2,191,331</b>                                 | <b>54</b>  | <b>2,951, 048</b> |
| 3                            | OTHERS         | Micro Enterprises   |   |  |  |                   |
|                              |                | <b>GRAND TOTAL</b>  | <b>137</b>  | <b>7,070,000</b>                                 | <b>168</b>   | <b>8,530,329</b>  |

Source: Central Bank of Nigeria as reported in Business Times: March 7-9, 2005.

**Gender differences in perceived success among business owners and corporate managers**

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## Gender differences in perceived success among business owners and corporate managers <sup>1</sup>

To better understand potential explanations for gender differences in organizational performance, this paper examines how owner-managers and corporate managers define success. The work also documents how perceptions vary systemically by gender. The study draws on a sample of 326 Canadian business owners and 405 Canadian corporate managers. Four factors were evidenced in the two sample groups (personal fulfillment/personal well-being; balance/balanced life; financial outcomes/financial rewards; and market acceptance/organizational performance) and appear to be similar in structure. One factor, *workplace culture*, was significantly different. This factor reflects success criteria that includes a supportive work culture, reputation of organization, competent colleagues, professional autonomy and employment flexibility. The factor speaks to the benefits of being employed in a large organization that affords employment flexibility and opportunities to work with many individuals. Gender differences in perceived success were noted. Female managers were more likely than male managers to value intrinsic criteria in both the personal and professional realms. Women business owners also accord higher values (than men) to success criteria associated with personal fulfillment and balance. Recommendations about the next steps in the research are outlined.

What is success? Previous research has found that individuals define “success” differently. This empirical study compares, across gender, how owners of small firms and senior corporate executives define success. Within the entrepreneurship and small business literature, “success” is often delineated using financial criteria such as revenue, employment, productivity, profit, or return on investment (Newton, 1995, 2001; Freel, 1999; Kalleberg et al., 1991; and Abraham, Karns, and Shaw and Mena, 2001). Organizational theorists have also traditionally taken a narrow perspective on success, with success defined in terms of remuneration and hierarchical level (Jaskolka, Beyer & Trice, 1985; Melamed, 1996; Stroh, Brett & Reilly, 1992). Business owners and employees, however, may not define success in

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<sup>1</sup> This research has been supported with support from Industry Canada and the Social Science Humanities Research Council of Canada (Grant No. 410-99-0824, (PI) B. Orser, (CI) L. Dyke). The authors would also acknowledge the contributions of the Women’s Enterprise Initiative Ginny Devine (Viewpoints Research Ltd.), Marzena Cedzynski,

these terms. The objectives of this research therefore is to examine empirically the dimensions of perceived success, to test explore how success dimensions used by business owners and corporate managers differ, and to identify potential gender differences across the two groups.

Briefly, gaining a better understanding of the cognitive aspects of success is important for several reasons. While pecuniary motives are often assumed to be the driver of organizational decision-making, traditional financial indicators do not consider non-pecuniary outcomes that individuals may value. It is also conceivable that the definition of “success” may vary systemically across gender and across other salient dimensions. These potential differences may help to explain documented differences in small firm performance and career outcomes (Industry Canada, 2005, Conference Board of Canada 2000). The paper therefore begins with a literature review, followed by an overview of the research methodology. The research findings follow. The paper closes with a discussion about next steps in the research.

### **Review of Literature**

Success appears to be complex, multi-dimensional and transitory: perceptions may evolve over time, may be role sensitive, and likely include pecuniary and non-pecuniary outcomes. Several researchers have sought to identify the dimensions of success. In the context of larger firms, Gattiker and Larwood (1986) identified five facets of success; criteria that reflect work role, interpersonal, financial, hierarchical and life success attributes. Schein (1975) defines professionals’ perceptions of success as “career values”, values that include: autonomy/independence; security/stability; technical-functional competence; general managerial competence; entrepreneurial activity; service or dedication to a cause; pure challenge and lifestyle. Similarly, Derr (1986) identifies five career success orientations: getting ahead,

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Allan Riding and Roland Thomas and (Carleton University), and Erwin Dreessen and Don Harrison (Small Business Policy Branch, Industry Canada).

getting secure, getting free, getting high on challenge and adventure, and getting balanced. Parker and Chusmir's (1992) analysis of 42 success criteria led to the identification of six success factors; these include status/wealth, contribution to society, family relationships, personal fulfillment, professional fulfillment, and security.

Employing a women only sample of professionals, Slipowitz (1992) reports on the interface between personal, family, and entrepreneurs' social environments. Success was seen as a process rather than a final outcome. More recently, Sturges (1999) categorized 3 types of success criteria: internal, external and intangible. "Internal" success criteria include attributes such as accomplishment, personal achievement, enjoyment, integrity and balance. "External" success criteria focus on hierarchical position and compensation. "Intangible" criteria of success include personal recognition and influence. Similarly, Nabi (2001) identified two underlying dimensions of subjective success: intrinsic job success, which includes enjoyable work, respect and support and extrinsic job success, which focuses on financial rewards and promotional opportunities.

The above observations are echoed in the small business literature. In a cross-cultural study of business owners, Ray and Trupin (1989) suggest five categories of "entrepreneurial success" including: *financially-orientated entrepreneurs*, typified as young ventures with significant growth in a short period; *craftsman-inventors* described as older, slow-growth firms; entrepreneurs that sought *independence*; those that framed their work as a "*calling*" – young ventures with significant growth; and, entrepreneurs that exhibited a sense of *wonderment that they became entrepreneurs*. More recently, Orser (1997) reports on 6 dimensions of success among Canadian business owners: family, financial security, mobility, personal well-being, emotion and the environment. Employing a female-only sample of women entrepreneurs, Lee-

Gosselin and Grise (1990) identified three types of success criteria: financial aspects of the firm (e.g., increased revenues, profits, earning income); the owner/managers' environment (e.g., people have confidence in the company, being visible and known in the community); and respondents' personal frameworks (i.e. having control of their own business or market).

Taking a broad perspective of the literatures suggest that “success” reflects both external factors (for example, historical period, nationality, sector, employment structure and organizational setting) and factors internal to the individual (e.g., life cycle or life stage, experience, education, occupation, employment level, wealth, and gender). In addition, the literature also records definitions of success that encompass personal (e.g., self-fulfillment, freedom and work flexibility) and commercial dimensions (e.g., business growth, profit) (Ray and Trupin, 1989; Fagenson, 1993). These relationships are illustrated in Figure 1. These observations suggest the first set of propositions:

*H1: Multiple success criteria are important to small business owners and corporate managers. Success reflects personal and professional attributes and intrinsic and extrinsic attributes.*

## **The Effect of Gender on Perceived Success**

Empirical studies that examine gender differences in definitions of success report inconsistent results, results that may reflect a methodological bias. Those studies that have used global measures of success (e.g., “*How would you rate your overall success*”) have found no gender differences (Judge, Cable, Boudreau & Bretz, 1995; Nabi, 2001; Peluchette, 1993). Conversely, studies that have examined specific dimensions of success have documented a number of significant gender differences (Duxbury, Dyke & Lam, 1999, 2000; Dyke & Murphy, 1998; Kagan, 1993; Parker & Chusmir, 1992; Sturges, 1999). For example, Parker and Chusmir (1992) examined both gender and organizational level. Their results indicated that *personal*

*fulfillment* was more important to women than to men, amongst both managers and non-managers. *Security* was also more important to women managers than to male managers. Similarly, in a study of women and men nominated by others as successful, Dyke and Murphy (1998) found that women placed more emphasis on balance while material success was important to more men. In two large surveys of public service and high technology employees, Duxbury, Dyke and Lam (1999, 2000) found that women rated several success criteria as more important than men. These included balance, relationships on the job and moving through positions of increasing responsibility. In both studies, men rated being able to influence organizational direction as more important than did women. Similarly, Sturges (1999) found that women were more likely to emphasize internal criteria of success such as accomplishment and intangible criteria like recognition while hierarchical position was more important to men. Sturges (1999) argues that women focus on less tangible markers of success because traditional successes such as hierarchical advancement and high salaries are not readily available to them.

It is not clear if perceptions of success differ between small business owners and corporate managers. The literature does, however, hint that both workplace and gender influence perceived success. For example, in an investigation of perceptions of success among managers and non-managers, Parker and Chusmir (1992) noted that male and female managers differed significantly on two dimensions. Personal fulfillment and security were more important to women managers than to male managers. Among non-managers, no gender differences in the perceived value of security, professional fulfillment, and social contribution were found; however, women were more likely than men to value personal fulfillment and importance of family relationship. Men valued status and wealth more highly than women did. Women managers viewed status/health and professional fulfillment as more important than non-

managerial women. A broad perspective of this literature suggests that women are relatively more concerned about personal aspects of success while men are relatively more concerned with financial rewards. These observations are reflected in the following propositions:

*H2a: Women business owners place a higher value than male business owners on intrinsic personal success criteria.*

*H2b: Women managers place a higher value than male business managers on intrinsic personal success criteria.*

*H3a: Male business owners place a higher value than women business owners on extrinsic professional success criteria.*

*H3b: Male managers place a higher value than women business managers do on extrinsic success criteria.*

## **Research Methodology**

### **Sample Selection**

To test these propositions, complementary questionnaires were used to solicit the views of a sample of SME owners and a separate sample of corporate executives and managers. The development and design of the small business and corporate surveys are reported in Orser and Riding, 2004 and Dyke and Orser, 2005.

*Small business owners:* The sampling frame consisted of 1,002 SME owners drawn from a commercial database. The sampling was undertaken in two phases. Phase one entailed fax-back survey administered in spring 2001. Phase 2 entailed a telephone survey in winter 2003.<sup>2</sup> A total of 326 telephone surveys were completed in the 2003 fieldwork, a response rate of 46.2 percent of eligible respondents.<sup>3</sup>

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<sup>2</sup> A comparison between the 2001 and 2003 samples was undertaken to investigate survivorship and non-response biases. Using standard Chi-square tests to examine the distributions of salient attributes, there were no statistically significant differences (p-value of less than 0.05) in owner or firm characteristics between the baseline data available in the sampling frame and the corresponding attributes of respondents.

<sup>3</sup> Of the 1,002 respondents in the 2001 WEI sampling frame, interviewers were unable to contact 234 respondents; 60 potential respondents were no longer in business. Of the remaining 707 eligible respondents, 223 refused to

*Corporate managers:* Two databases were used as a sample frame from which 5,924 names of corporate executives and managers were purchased from a data management firm. All held mid-level management to executive positions in private or government organizations that employed at least 500 people. The sample included all Canadian provinces, except Quebec. Since women are less likely to hold executive positions, the sample was augmented with the names of 76 women business leaders from Canada's Top 100 Most Powerful Women. The analysis is based on 545 respondents including 281 men and 261 women reflecting a 9 percent response rate; 24 responses were received from Canada's Top 100 Most Powerful Women, a 32 percent response rate.

### **Sample profiles**

Respondents' attributes are summarized in Table 1. Male business owners accounted for two-thirds of the sample (67.3 percent). Most small business owners were well educated, a finding that appears to be consistent among self-employed Canadians across the four Western provinces surveyed. Approximately half of the business owners surveyed were less than 50 years of age with the majority falling into the 30 to 49 year age group. Only 2 percent of respondents were less than 30 years of age. Three-quarters of those surveyed created or participated in the creation of the business. The sectoral breakdown is not representative of the population of SMEs as a whole: respondent firms are relatively highly concentrated in the services and trade sectors, with few establishments in the goods-producing sector. Sixty-five percent of the respondent

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participate, 142 failed to return any of more than three calls and another 16 were eliminated for miscellaneous reasons. This reflects a 46.2% response rate among eligible respondents or 32.6 percent response rate within the sampling frame

firms employed 5 or fewer full-time equivalents (FTE); 28 percent of the firms employed 5 to 20 employees or FTEs; while 7 percent employed more than 20 FTEs.<sup>4</sup>

*Corporate managers:* Similar to the sample of small business owners, corporate respondents were well educated; the majority (59 percent of females and 42 percent of males) had university degrees. On average, respondents had over a quarter of 25 years work experience, worked with their current employer for over 13 years and earned in excess of \$110,000. On average, respondents were responsible for 23 employees. Six in ten respondents were employed in executive roles.

### **Measuring perceived success**

*Small business owners:* To test the above propositions, the questionnaire asked business owners to rate on 5 point scales the importance of each of 18 criteria that they might conceivably use to evaluate success. To explore the construction and value of the success criteria, factor analysis using principal components with varimax rotation was applied to 14 success criteria scales.<sup>5 6</sup> The results drawn from the small business owner sample are shown in Table 2. The analysis suggested four factors that together explained 56.7% of the variation. In summary, the four-dimensional construct reflected aspects of success associated with market acceptance, self-fulfillment, balance, and financial outcomes.

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4 The proportion of firms with less than 5 employees is likely less than in the general SME population if one considers the profile of employer businesses and self-employed. For example, 35 percent of the firms in the sample used here reported more than five employees. Industry Canada (2003) reports that 42 percent of the 1.0 million Canadian business establishments (or employer firms) employ more than 5 people. This does not, however, take into account approximately 2.3 million self-employed individuals, 64 percent of which have no paid help.

5 Only 14 of the 18 criteria were entered into the principal component analysis. The three variables pertaining to employees (e.g., employee relations, employee productivity, creating employment) and one variable pertaining to external investment (e.g., investor relations) were not used as they were not relevant to non-employer firms. This is because most owners of non-employer firms responded that these scales were “not applicable”.

6 No additional factors with Eigenvalues in excess of 1.0 were identified; examination of the Scree plot also suggested that a four factor solution was reasonable. In addition, each of the four factors included scales that loaded on the factor with loads near or above 0.8. According to Stevens (2002), this is a desirable property in principal component analysis.

F1: *market acceptance* is commercial and incorporates five variables that correlate with the extent to which the business' products or services have gained acceptance including product or service quality, market acceptance, customer relations, environmental impact and operating performance.

F2: *personal-fulfillment* is associated with intangible, intellectual scales of spiritual well-being, pursuit of intellectual activities, etc. and is inherently personal. Variables included pursuing intellectual activities, spiritual well-being, maintaining professional autonomy, environmental impact and community relations. The scales that most closely relate to this factor pertain to the owners' personal, inner, feelings.

F3: *balance* differs from the second in that it reflects relationships in the business and household environments. The variables include maintaining personal relationships, work life balance, personal goods acquisition and customer relations.

F4: *financial outcomes* are again commercial. The variables that load highly on this factor included profitability, generating income, operating performance and personal goods acquisition.

These four factors appear to be intuitively sound and support the argument advanced by Sekaran and Hall (1989) regarding "multiple-role relationships" in determining criteria of success. Indeed, it appears that Canadian business owners perceive success as multi-dimensional. Statistically significant gender differences were also noted in the values that owners accord the various dimensions of success. Women business owners indicated statistically significant (at p-values of 0.063 and 0.022, respectively) and higher values (than men) to success criteria associated with *personal fulfillment* and *balance*. Whereas the weightings of these two factor scores were positive for women, the average factor scores for male business owners were negative. These findings are consistent with the previous results that suggests women business owners accord higher value to maintaining customer and personal relationships, spiritual well being and work life balance. These results also support arguments that women business owners are more likely than their male counterparts to value success criteria associated with the personal dimension. In addition, gender differences were noted in *market acceptance* (e.g., product or service quality, market acceptance, customer relations, environmental impact and operating performance) at a p-value of 0.102. Finally, no significant

gender differences were noted regarding success criteria pertaining to *financial outcomes* (e.g., profitability, generating income, operating performance and personal goods acquisition). These results support the argument that most business owners are concerned about their firm's operational results.

**Corporate managers:** Principal components analysis was also used to examine the underlying structure of 24 success criteria associated with corporate employment.<sup>7</sup> Two analyses were undertaken. The first employed a forced 4-factor solution. The 4-factor solution explained 48 percent of the variance in scores.<sup>8</sup> A second analysis used the traditional test for factor inclusion of an Eigenvalue greater than one. This analysis produced a 6-factor solution that explained 57 percent of the variance in scores. Since the six-factor solution captured more of the variance in success criteria, it was used in subsequent analyses. The factor loadings for both solutions can be found in Table 3. The 6-factor solution provides support for the hypothesis that success reflects personal and professional attributes and intrinsic and extrinsic attributes. Although some quadrants contain more than one factor, each factor maps onto one of the typology's quadrants. The items included in each factor are described below along with the quadrant in the proposed success typology that they represent.

**F1: organizational performance** includes employee relations, customer relations and image, product or service quality, employee productivity, organizational profitability, and investor relations (extrinsic — professional).

**F2: workplace culture** includes supportive work culture, reputation of organization, competent colleagues, professional autonomy, and employment flexibility (intrinsic — professional).

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<sup>7</sup> The corporate and small business surveys differ in several ways. The corporate survey included success criteria related to “employment flexibility”, “working with competent people”, “supportive workplace culture”, “financial security”, and “opportunities to participate in community activities”. The small business survey included questions related to “firm profitability”, “product or service quality”, “market acceptance” and “operating performance”.

<sup>8</sup> The 4-factor solution did not precisely map the proposed success typology. Two factors appear to measure extrinsic professional criteria (F1 reflects aspects of organizational performance and F4 reflects financial rewards). Factor 3 reflects rewarding work and captures intrinsic professional criteria. The final factor (F2) reflects both extrinsic and intrinsic personal criteria (see Table 2).

F3: **balanced life** includes personal relationships, managing work/life demands, intellectual activities, dependent care/parenting, and spiritual well-being (intrinsic — personal).

F4: **financial rewards** include income, employee benefits, and stability of income (extrinsic — professional).

F5: **community impact** includes environmental impact, professional recognition (“e.g., industry reputation, respect”), and creating employment (extrinsic — professional).

F6: **personal well-being** includes personal health and being active in the community (extrinsic — personal).

To test for gender differences on the six factors, scales comprised of mean importance scores for the items loading highest on each factor were utilized.<sup>9</sup> T-tests on the mean values of the six scales were conducted to examine potential gender differences in the importance accorded to each. The results suggested no significant gender differences in the importance of organizational performance, community impact, personal well-being or financial rewards. There were, however, significant gender differences for two factors. Women placed greater importance than men on rewarding work (mean = 4.31 versus 4.19,  $p = .005$ ) and a balanced life (mean = 3.95 versus 3.80,  $p = .004$ ). Thus the findings suggest that women place a higher value than men on personal success criteria (intrinsic) but not extrinsic personal criteria. Interestingly, both of the factors which women rated as more important than men reflect intrinsic criteria – in both the personal and professional domains.

## **Discussion and Conclusions**

The above results indicate that multiple success criteria are important to small business owners and corporate managers. Both personal and professional and both extrinsic and intrinsic criteria were rated as highly important. A comparison of the small business and corporate factor solutions is informative. Four of the factors described in both samples groups (personal

fulfillment/personal well-being; balance/balanced life; financial outcomes/financial rewards; and market acceptance/organizational performance) appear to be similar in structure. These factors are also consistent with the conceptual model illustrated in Figure 1. Between the two samples, only one factor, *workplace culture*, was significantly different. This factor includes success criteria of supportive work culture, reputation of organization, competent colleagues, professional autonomy and employment flexibility. The factor speaks to the benefits of being employed in a large organization that affords employment flexibility and opportunities to work with many individuals. As such, the success criteria that load on this particular factor are generally not applicable to most small businesses, given the majority of respondents in this survey (68 percent) employ less than 5 employees. The next step in the research is to examine the relative importance of this factor, particularly among those managers and executives that are considering leaving their employer for self-employment or business ownership. Also, the findings regarding organizational performance are interesting. While research on entrepreneurs has found that the entrepreneur's evaluation of his or her success is related to firm performance (Lee-Gosselin & Grise, 1990; Ray and Trupin, 1989), research on corporate managers has not previously identified organizational performance as important criteria of success. The data also indicates that overall success, for both male and female managers, is strongly influenced by financial rewards. Finally, the research found some gender differences in perceived success. Female managers were more likely than male managers to value intrinsic criteria in both the personal and professional realms. Women business owners accord higher values (than men) to success criteria associated with personal fulfillment and balance. Important questions remain to be examined. It is not clear about the influence on perceptions on business owners' growth

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<sup>9</sup> Several of the Cronbach's alphas were below .7. This reflects, in part, the small number of items in two of the scales. These low reliabilities may attenuate results.

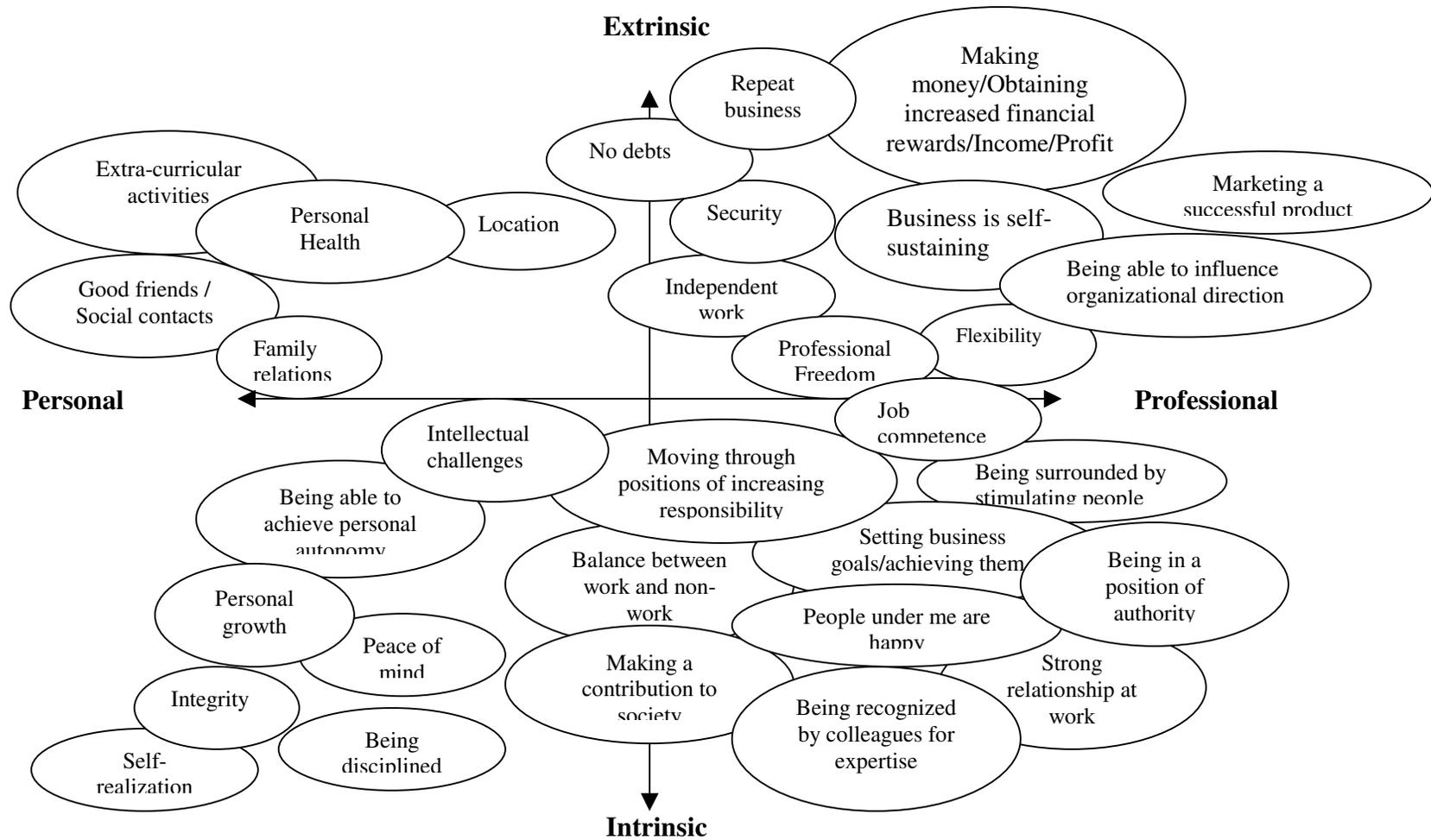
intentions and corporate managers' career aspirations. Work also remains to examine potential differences in perceived success across other personal attributes (e.g., age and business aspirations) and professional attributes (e.g., size and stage of firm, level within the organization). Finally, the research calls for further examination of the underlying structures of the factor solutions. As such, confirmatory factor analysis will be undertaken to further investigate the structure of the factor solutions between the male and female, small business owners and corporate managers. The next phase of the research will examine these associations.

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**Figure 1**  
**A Typology of Success Criteria**



**Table 1: Sample Profile by Gender of Respondent**

| Attributes   | Owners        |                 |                | Corporate Managers |                 |                |
|--|---------------|-----------------|----------------|--------------------|-----------------|----------------|
|  | Male<br>N=219 | Female<br>N=107 | Total<br>N=326 | Male<br>N=281      | Female<br>N=261 | Total<br>N=542 |
| <b>Age:</b>  |               |                 |                |                    |                 |                |
| Less than 30   | 2.3           | 1.9             | 2.1            | 0.4                | 0               | 0.2            |
| 30 to 39   | 11.4          | 13.1            | 12.0           | 8.0                | 5.9             | 7.0            |
| 40 to 49   | 33.3          | 32.7            | 33.1           | 39.8               | 42.5            | 41.1           |
| 50 to 59   | 40.2          | 43.9            | 41.4           | 44.2               | 43.3            | 43.8           |
| More than 59   | 12.8          | 8.4             | 11.3           | 7.7                | 8.3             | 8.0            |
| <b>Education:</b>  |               |                 |                |                    |                 |                |
| No Tertiary  | 54.4          | 43.3            | 50.6           | 28.8               | 25.3            | 27.1           |
| College Graduate   | 17.2          | 17.3            | 17.2           | 10.7               | 10.9            | 10.8           |
| University or University Grad                                  | 28.4          | 39.4            | 32.1           | 23.5               | 50.6            | 36.4           |
| Other  |               |                 |                | 37.0               | 13.2            | 25.7           |
| <b>Total years of work experience:</b>                         |               |                 |                |                    |                 |                |
| Less than 5  | 2.7           | 10.3            | 5.2            | 0.4                | 0.8             | 0.6            |
| 5 to 9.9   | 8.2           | 19.6            | 12.0           | 0.4                | 0.4             | 0.4            |
| 10 to 14.5   | 15.1          | 21.5            | 17.2           | 2.1                | 4.7             | 3.3            |
| 15 to 19.9   | 15.1          | 15.0            | 15.0           | 6.1                | 7.8             | 6.9            |
| 20 to 24.9   | 16.4          | 15.9            | 16.3           | 18.2               | 19.8            | 19.0           |
| More than 25   | 42.5          | 17.8            | 34.4           | 72.9               | 66.7            | 69.9           |
| <b>Work experience<br/>(current firm or current employer):</b> |               |                 |                |                    |                 |                |
| Less than 5  | 15.5          | 18.7            | 16.6           | 17.6               | 17.9            | 17.7           |
| 5 to 9.9   | 14.6          | 36.4            | 21.8           | 22.2               | 25.1            | 23.6           |
| 10 to 14.5   | 22.8          | 18.7            | 21.5           | 16.5               | 13.9            | 15.3           |
| 15 to 19.9   | 14.6          | 13.1            | 14.1           | 15.4               | 15.5            | 15.5           |
| 20 to 24.9   | 14.6          | 6.5             | 12.0           | 14.0               | 12.7            | 13.4           |
| More than 25   | 17.8          | 6.5             | 14.1           | 14.3               | 14.7            | 14.5           |

**Table 1: Sample Profile by Gender of Respondent (Continued)**

| <b>Attributes</b>   | <b>Owners</b> |      |      | <b>Corporate Managers</b> |      |      |
|---|---------------|------|------|---------------------------|------|------|
| <b>Owner is manager</b>   | 97.3          | 97.0 | 97.2 |                           |      |      |
| <b>Owner is founder</b>   | 80.4          | 73.7 | 78.3 |                           |      |      |
| <b>Intends to expand 2001</b>                                   | 48.8          | 49.4 | 49.0 |                           |      |      |
| <b>Intends to expand 2003</b>                                   | 42.8          | 38.5 | 41.5 |                           |      |      |
| <b>Employees (only) - Reporting Levels Below President/CEO:</b> |               |      |      |                           |      |      |
| I am the President or CEO                                       |               |      |      | 25.0                      | 36.5 | 30.5 |
| Report to the President or CEO                                  |               |      |      | 38.8                      | 31.3 | 35.2 |
| 2-3   |               |      |      | 27.9                      | 25.0 | 26.5 |
| 3-4   |               |      |      | 4.7                       | 5.2  | 4.9  |
| 4-6   |               |      |      | 2.2                       | 1.6  | 1.9  |
| More than 5   |               |      |      | 1.4                       | 0.4  | 0.9  |
| <b># of Employees (FTE) Reports:</b>                            |               |      |      |                           |      |      |
| No Employees  | 16.7          | 29.0 | 20.5 | 1.1                       | 8.2  | 4.5  |
| 1 to 4.9 Employees  | 44.1          | 45.0 | 44.4 | 13.6                      | 30.0 | 21.4 |
| 5 to 19.9 Employees   | 30.2          | 22.0 | 27.6 | 56.7                      | 45.5 | 51.4 |
| More than 20 FTE  | 9.0           | 4.0  | 7.5  | 28.6                      | 16.3 | 22.7 |
| <b>Annual Revenue/Salary:</b>                                   |               |      |      |                           |      |      |
| Less than \$100,000   | 21.7          | 34.0 | 24.6 | 35.5                      | 60.1 | 47.5 |
| \$100,000 to \$499,999  | 31.4          | 41.5 | 33.8 | 64.1                      | 38.9 | 51.8 |
| \$500,000 to \$1,000,000  | 19.4          | 9.4  | 17.1 | 0.5                       | 1.0  | 0.7  |
| More than \$1,000,000   | 27.4          | 15.1 | 24.6 |                           |      |      |
| <b>Sector:</b>  |               |      |      |                           |      |      |
| Service Industry  | 80.4          | 86.0 | 82.2 | 66.5                      | 85.9 | 75.8 |
| Goods Industry  | 2.3           | 1.9  | 2.1  | 14.3                      | 7.3  | 11.0 |
| Manufacturing   | 17.4          | 12.1 | 15.6 | 19.1                      | 6.9  | 13.3 |

**Table 2: Small Business Owners' Perceptions of Success Criteria Importance and Principal Component Analysis**

| Success Criteria Scales  | Mean Importance |                 |              |                | 4 Factor Solution |       |       |       |
|--|-----------------|-----------------|--------------|----------------|-------------------|-------|-------|-------|
|  | Male<br>N=219   | Female<br>N=107 | p-<br>value  | Total<br>N=326 | F1                | F2    | F3    | F4    |
| Product or service quality (for example on-time delivery).                       | 4.51            | 4.69            | 0.051        | 4.57           | 0.718             |       |       |       |
| Market acceptance (for example, recognition or product quality).                 | 4.28            | 4.35            | 0.582        | 4.30           | 0.682             |       |       |       |
| Customer relations (for example, corporate image or good will.)                  | <b>4.69</b>     | <b>4.88</b>     | 0.001        | 4.75           | 0.591             |       | 0.446 |       |
| Environmental impact, for instance recycling or emission standards.              | 3.58            | 3.59            | 0.909        | 3.58           | 0.516             | 0.490 |       |       |
| Pursuing intellectual activities, such as acquiring new knowledge.               | 3.97            | 4.09            | 0.293        | 4.01           |                   | 0.787 |       |       |
| Spiritual well-being for instance faith and spiritual needs.                     | <b>3.27</b>     | <b>3.74</b>     | 0.003        | 3.42           |                   | 0.681 |       |       |
| Maintaining professional autonomy  | 4.35            | 4.52            | 0.079        | 4.41           |                   | 0.518 |       |       |
| Community relations, community recognition                                       | 3.91            | 4.01            | 0.460        | 3.94           |                   | 0.421 |       |       |
| Maintaining relationships with friends, family and/or partner                    | <b>4.53</b>     | <b>4.76</b>     | <b>0.004</b> | <b>4.61</b>    |                   |       | 0.803 |       |
| Managing work / life demands   | <b>4.25</b>     | <b>4.53</b>     | <b>0.004</b> | <b>4.34</b>    |                   |       | 0.661 |       |
| Ability to acquire personal goods such as a house, car or the ability to travel. | 3.79            | 3.86            | 0.580        | 3.81           |                   |       | 0.492 | 0.466 |
| Organizational profitability (return on capital invested and net profit).        | 4.24            | 4.38            | 0.251        | 4.29           |                   |       |       | 0.856 |
| Generating income (for example, salary and financial security).                  | 4.27            | 4.47            | 0.057        | 4.34           |                   |       |       | 0.599 |
| Operating performance (for example inventory turnover or financial ratios).      | 3.80            | 4.06            | 0.064        | 3.89           | 0.433             |       |       | 0.561 |
| Percent of Variance Explained  |                 |                 |              |                | 15.41             | 14.90 | 13.44 | 12.96 |

**Table 3 Corporate Managers' Perceptions of Success Criteria Importance and Principal Component**

| Success Criteria Scales   | Mean Importance |                 |                | 6 Factor Solution |        |      |      |      |        |
|---|-----------------|-----------------|----------------|-------------------|--------|------|------|------|--------|
|   | Male<br>N=281   | Female<br>N=261 | Total<br>N=542 | F1                | F2     | F3   | F4   | F5   | F6     |
| Employee relations (employee retention, satisfaction)                     | 4.44            | 4.49            | 4.46           | .565              |        |      |      |      |        |
| Supportive work culture (values and attitudes)                            | 4.34            | 4.57            | 4.45           |                   | .675   |      |      |      |        |
| Customer relations / image  | 4.38            | 4.48            | 4.43           | .711              |        |      |      |      |        |
| Product or service quality (on-time delivery).                            | 4.41            | 4.41            | 4.41           | .727              |        |      |      |      |        |
| Reputation of organization  | 4.35            | 4.46            | 4.40           |                   | .734   |      |      |      |        |
| Competent colleagues  | 4.30            | 4.41            | 4.35           |                   | .729   |      |      |      |        |
| Generating income (for example, salary and financial security).           | 4.32            | 4.33            | 4.33           |                   |        |      | .749 |      |        |
| Maintaining relationships with friends, family and/or partner             | 4.30            | 4.37            | 4.33           |                   |        | .736 |      |      |        |
| Maintaining professional autonomy   | 4.18            | 4.31            | 4.24           |                   | .406   |      |      |      |        |
| Managing work / life demands  | 4.14            | 4.25            | 4.20           |                   |        | .700 |      |      |        |
| Income (remuneration)   | 4.15            | 4.13            | 4.14           |                   |        |      | .810 |      |        |
| Personal health (e.g. fitness, weight)                                    | 4.08            | 4.12            | 4.10           |                   |        |      |      |      | .607   |
| Employee productivity (revenue per employee)                              | 4.09            | 4.05            | 4.07           | .631              |        |      |      |      |        |
| Organizational profitability (return on capital invested and net profit). | 4.06            | 4.01            | 4.04           | .690              |        |      |      |      |        |
| Pursuing intellectual activities, such as acquiring new knowledge.        | 3.92            | 4.09            | 4.01           |                   |        | .567 |      |      |        |
| Employee benefits (health care, employee assistance)                      | 3.87            | 4.04            | 3.95           |                   |        |      | .607 |      |        |
| Professional recognition (industry recognition, respect)                  | 3.77            | 4.00            | 3.88           |                   | (.403) |      |      | .510 |        |
| Employment flexibility (location, hours of work)                          | 3.78            | 3.83            | 3.81           |                   |        |      |      |      |        |
| Parenting or caring for dependents  | 3.66            | 3.82            | 3.74           |                   |        | .613 |      |      |        |
| Creating employment for others  | 3.51            | 3.60            | 3.56           |                   |        |      |      | .599 |        |
| Environmental impact, for instance recycling or emission standards.       | 3.52            | 3.54            | 3.53           |                   |        |      |      | .674 |        |
| Investor relations (shareholders, banking relationships)                  | 3.38            | 3.47            | 3.42           | .598              |        |      |      |      |        |
| Spiritual well-being for instance faith and spiritual needs.              | 3.23            | 3.56            | 3.39           |                   |        | .514 |      |      | (.431) |
| Community relations, community recognition                                | 3.27            | 3.44            | 3.35           |                   | 3.35   |      |      |      | .669   |
| Percent Variance Accounted for by Factor                                  |                 |                 |                |                   | 16.0   | 12.3 | 11.2 | 8.2% | 13.1   |

# INDIVIDUAL PATHS TOWARDS ENTREPRENEURSHIP

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## ABSTRACT

The purpose of the study is to recognise and describe university graduates' individual paths towards entrepreneurship. The focus is on individual's personal demographics and work history and their association with entrepreneurship. Our findings suggest that there are contingencies and distinct factors that have made or may make entrepreneurship an option to be considered regarding one's career and that various combinations of these factors form individual paths towards entrepreneurship. From personal demographics relevant are, in order of importance, age, type of education, number of degrees, gender and role models. Work history, however, outweighs personal demographics in significance. Several aspects emerge, which all are related to entrepreneurship: amount of working experience, variety of work, type of employment, quality and amount of work tasks, career advancement, experience on small firms and labor market status.

## INTRODUCTION

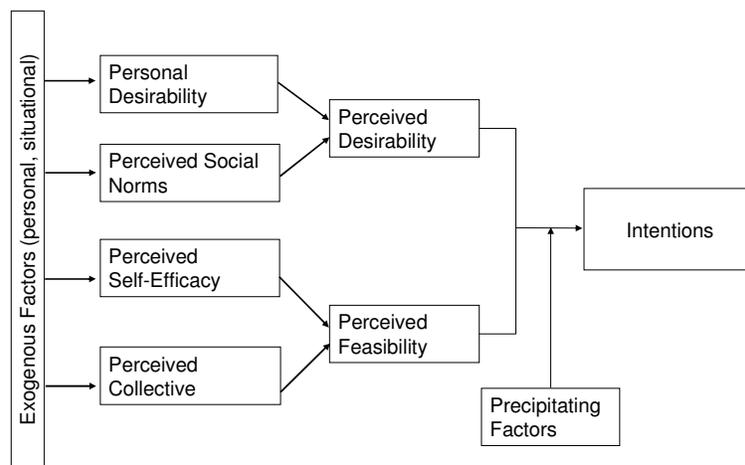
University graduates have traditionally not favored entrepreneurship as a career option. More obvious choices have been public sector tenure or managerial careers in large companies. Both public sector cutbacks, and the transformation of large companies into leaner, meaner machines with fewer layers, have diminished the attractiveness and significance of these paths to those with university degrees. Trends towards outsourcing, and also offshoring – moving facilities to lower cost countries – are increasing the amount of academic applicants in the job market. Entrepreneurship has been presented as one possible substitute career option. At present, of those with a university degree and employed outside the home, less than a tenth work as entrepreneurs in Finland. Conversely, of those with only obligatory basic level education, one fifth is self-employed. (Statistics Finland 2004) Entrepreneurial activity has long been seen to correlate inversely with level of education in Finland. Finnish university degree holders are less active in entrepreneurship terms than Europeans on average. In a recent survey of ten European countries Finland shared seventh place along with Sweden (3 % of respondents defined as entrepreneurs) leaving behind only France and Norway, whereas Italy and Germany scored best with a 10 % and 16 % entrepreneur share respectively (Kivinen – Nurmi – Kanervo 2002). From the economical or public policy makers point of view the advancement of entrepreneurship among academically educated is seen to be of particular interest, as it has been stated that highest potential for growth and survival is among entrepreneurs with university level degree (Arenius et al 2001; Arenius – Autio 2000; Ristimäki 1998).

The study sheds light on transfer from salaried employment towards entrepreneurship among academically educated individuals. It aims at analysing certain exogenous factors and their association with entrepreneurship. First, we examine personal demographics and their role in becoming an entrepreneur. Work history is then analysed to find out whether it differentiates between entrepreneurs and other academically educated people in paid work. Finally, we try to explore how these pieces of work history constitute individual paths toward entrepreneurship.

### ENTREPRENEURIAL INTENTIONS – SOME THEORETICAL INSIGHTS

The theoretical background of the study lies in the assumption that becoming an entrepreneur is intentional, planned behavior. Within the entrepreneurship domain of research the implicit idea originates from Shapero’s and Sokol’s (1982) model of entrepreneurial events, which has been revised by different researchers (for example Bird 1988; Boyd – Vozikis 1994). Another important theory in this respect is Ajzen’s (1991) social psychology based theory of planned behavior. These two approaches have been paralleled by Krueger and others (2000) and Krueger (2000), who has introduced yet another revised model of entrepreneurial intentions. Also Dyer (1994), in building a theory of entrepreneurial careers, has suggested in his model that there are a number of antecedents influencing career choice. They are labeled as individual, social and economic factors.

This study does not try to test those theories but rather builds on them, particularly the one introduced by Krueger (2000). According to this model, entrepreneurial intentions are based on an individual’s perceptions on different exogenous variables, which can further be divided into personal and situational factors (Figure 1). Exogenous variables can affect four types of perceptions related to entrepreneurship as a possible career choice: personal desirability of the event, social desirability (norms), self-efficacy and collective efficacy (see Krueger 2000).



**Figure 1 Intentions model (Krueger 2000)**

In this study, we concentrate only on certain exogenous factors. In addition, we focus on examining whether these variables are in association with entrepreneurship or not, thus the mechanisms of how they may affect on one’s perceptions, intentions and, finally, action are excluded from the study at this point. Moreover, we use the exogenous attributes as building blocks for different paths towards entrepreneurship. For this, exogenous variables have been divided into two groups, personal demographics and career history, which are further divided into a number of subgroups. The study is grounded in data, in a sense that the different

possible dependencies or paths have not been hypothesized in advance, but rather will be based on the results of the data analysis.

In earlier studies it has been noted that from personal demographics male and younger people tend to involve in or consider entrepreneurship as a career option more often than others. These findings have been rather unanimous across different countries (GEM 2005; European Commission 2004). As to the educational level it has been reported that there are country-specific variations in entrepreneurial activity (GEM 2005). In Finland education has a negative impact, i.e. the higher the education the lower is entrepreneurial activity (Statistics Finland 2004). At general (EU-)level, however, the differences may be rather low (European Commission 2004). In particular case of academically educated individuals, it has been discovered that the following attributes are related to entrepreneurs: male gender, older age and early personal interaction with entrepreneur family members (Korvela – Mäki 2002; Harju et al. 2004). The line (business, engineering, etc.) of education also plays a role. It has been found that entrepreneurial activity is higher among those faculties, which are – in a traditional way – providing, in effect, professional or vocational training (e.g. medicine and law) (Tonttila 2001).

Concerning the career history, the total number of years in paid work (Statistics Finland 2004; Harju et al. 2004) and the diversity of working experience (Hyytinen – Ilmakunnas 2004) as hypothesized by Lazear (2002) are related to entrepreneurial intentions in general. In addition, unemployment has been attached to entrepreneurship (GEM 2005) and this applies also in case of academically educated (Statistics Finland 2004). Earlier studies have also concluded that there may not be any association between wage level and entrepreneurial aspirations. On the other hand, unpaid over time has been reported to have a positive impact on these aspirations. (Hyytinen – Ilmakunnas 2004)

## **STUDY DESIGN**

### **Data Collection**

The study is based on literature review, analysis of statistics on entrepreneurial activity and a survey conducted among academics. The research population was defined as employees and entrepreneurs with academic background in either business economics or engineering. The sampling frame included the central, professional organizations for graduates in the aforementioned two fields. We used two types of sampling methods: total sample in case of entrepreneurs and stratified sampling for employees. The latter was based on four strata according to graduation decade, i.e. 1970's, 1980's, 1990's and 2000's.

The survey was conducted among approximately 4.000 academically educated employees and approximately 1.000 entrepreneurs. The data was gathered via email and Internet in February and March in 2005. We sent to each respondent an e-mail invitation with a link to a questionnaire. We worked jointly with the central corresponding member organizations and got a list of their members with an e-mail address. Entrepreneurs and employees were separated beforehand and both groups received respective questionnaires. The response rate was approximately 30 % among employees and approximately 35 % among entrepreneurs.

### **Measure development and data analysis**

As discussed earlier, individual paths towards entrepreneurship are examined here through two building blocks: personal demographics, education and career history. We operationalized *personal demographics* as: gender, age and social role models in terms of entrepreneurial parents or close friends as well as educational background i.e. business economics or engineering, and number of various degrees.

Career history, in turn, was first divided into seven topics based on typical categorizations used in career literature (see e.g. Haapakorpi 1994; Kivinen et al. 2002; Suutari 2002) and then a set of measures were designed to each of them. We measured the *amount of working experience* as total number of years in paid work. We decided to measure *variety of work* in terms of total number of employers, experience of different organization types (private, public government, public community and third sector, e.g. foundations and associations), work history in different industry types (seven categories ranging from manufacturing to services) and total number of employments in different industries.

The *type of employment* was operationalised into employment continuity (temporary or ongoing) and work-time (full-time or part-time). We chose the following items for measuring individual's *work tasks*: type and total number of different tasks (seven categories from secretarial to international tasks), experience in project work (yes/no), overtime work (none/compensated/non-compensated) and, finally, work tasks equivalence to one's education (subjective opinion in 1–5 scale). To capture *career advancement*, we measured different position types during one's work history (manager, expert, official, other), superior experience (yes/no) and salary (at the time of survey or immediately before entrepreneurship). *Experience on small firms* were measured in terms of organization size (four size categories), working in one's family-owned business (yes/no/no such business in family) and possible minority partnership in a (other than stock exchange) company (yes/no). Finally, we measured individual's *labor market status* at the time of survey or immediately before entrepreneurship in terms of ongoing or temporary paid work, full-time studying, unemployed and family or other leave.

For analyzing the data, we decided to use SPSS's binary logistic regression. Entrepreneurs were encoded into one group (value=1) and employees to another (value=0). In addition, we decided to exclude the part time-entrepreneurs from the analysis. This was due to the questionnaire design, which did not allow us to unambiguously measure the career history in paid work *before* becoming a part-time entrepreneur.

## **RESULTS / PATHS TOWARDS ENTREPRENEURSHIP**

The purpose of the study was to recognize and describe academically educated people's individual paths towards entrepreneurship. In the analysis we concentrated first on personal demographics and then on career history in paid work.

The results of the stepwise logistic regression indicate that personal demographics separate entrepreneurs from employees (also) in case of academically educated individuals. All of the examined measures played a role, while the highest prediction power was associated with age. However, the relationship was not linear. The likelihood for becoming an entrepreneur increases up to 45 years of age and declines after that. Entrepreneurial activity seems to be especially low among senior workers. The reasons behind this curvilinear relationship may lie in starting a family and lacking of work experience in one end and forthcoming retirement in the other end of the career path. The second most important demographic feature was found to

be the type of education. Odd ratio is three to one in favor of entrepreneurship if you have a degree in business management in comparison to engineering. Moreover, entrepreneurs possess more often multiple degrees than those in paid work. Gender (male) is also rather important, but comes only fifth in order. Finally, the results suggest that entrepreneurial role models are a pull factor towards entrepreneurship. The example of close friends is almost as important as that of parents. (Table 1)

**Table 1 Logistic regression on significance of individual's demographics in becoming an entrepreneur**

| <b>Variable</b>  | <b>Exp (B)</b> | <b>Sig.</b> |
|--|----------------|-------------|
| Male   | 2,057          | 0,000       |
| Age: up to 35 years  | 9,885          | ,000        |
| 36–45  | 18,869         | ,000        |
| 45–55  | 11,017         | ,000        |
| over 55 (ref. group)   |                | ,000        |
| Education: business management   | 3,167          | ,000        |
| More than one degree   | 2,347          | ,000        |
| Entrepreneurial parents  | 1,579          | ,005        |
| Entrepreneurial close friends  | 1,449          | ,023        |
| Constant   | ,005           | ,000        |
| <b>Model summary:</b>  |                |             |
| N=1006; Model Sig. < 0,001; Nagelkerke R Square = 0,226; Hosmer and Lemeshow Test, Sig. > 0,05 |                |             |
| <b>Method of Analysis:</b>   |                |             |
| Binary Logistic Regression: Forward Wald   |                |             |

Next, we carried out a stepwise logistic regression on career history and its significance in becoming an entrepreneur. The results are introduced in the table below, including information on the model summary. The model is statistically significant and suggests that the relation between previous work experience and entrepreneurship is rather strong. It can be argued that if all the events, which are presented in the model, have occurred in one's career history there is approximately 50 % chance of one becoming an entrepreneur (see Nagelkerke's R square). The results indicate that all of the examined seven aspects of career history are of relevance for academically educated individuals. The amount of working experience is in curvilinear association to entrepreneurship, odds ratio being highest between 11 and 20 years of paid work. The finding is quite similar to that of age and entrepreneurship, discussed earlier. The natural interpretation is that at the age of 40 (plus/minus 5 years) one has already a certain number of years of paid work behind during which s/he has acquired skills and knowledge needed in running an own business and yet, there are many more years left before retirement.

The variety of work is significant in terms of the industry in a sense that becoming an entrepreneur is more probable for those academically educated who have been working in service sector. There are several possible explanations for this one industry standing out. The capital requirement for establishing one's own business is rather low in contrast to many other sectors, which reduces the financial risks. It may also be that while working in a service sector it is easier to discern a possible business idea than in some other branches. In addition, there may be good chances in service sector to be able to learn useful customer service skills or to establish potential customer contacts. Taken all these issues together, in services the threshold for discovering and realizing potential business ideas may be lower than elsewhere.

**Table 2 Logistic regression on significance of career history in becoming an entrepreneur**

| <b>Variable</b>  | <b>Exp (B)</b> | <b>Sig.</b> |
|--|----------------|-------------|
| Years in paid work: up to 10   | 3,307          | ,001        |
| 11–20  | 4,478          | ,000        |
| 21–30  | 2,768          | ,004        |
| over 30 (ref. group)   |                | ,000        |
| Industry type: services  | 2,183          | ,000        |
| Employment continuity: temporary   | ,560           | ,019        |
| Work time: part-time   | ,535           | ,050        |
| Work equivalence to education (1–5, descending)  | ,550           | ,000        |
| Overtime work: no (ref. group)   |                | ,000        |
| yes, but no compensation   | 12,266         | ,000        |
| yes, and compensated   | 5,604          | ,003        |
| Work tasks: data administration  | ,572           | ,075        |
| sales and marketing  | 1,819          | ,004        |
| Career advancement: management   | 2,176          | ,005        |
| expert   | ,504           | ,005        |
| official   | ,472           | ,001        |
| Superior experience: yes   | 1,943          | ,037        |
| Salary (1–6, ascending)  | ,517           | ,000        |
| Organisation size: less than 10 employees  | 1,614          | ,031        |
| 10–49 employees  | 1,620          | ,020        |
| Work status: ongoing paid work   |                | ,000        |
| temporary paid work  | 1,601          | ,202        |
| studying full-time   | 1,0E+10        | ,999        |
| unemployed   | 200,463        | ,000        |
| parental leave   | 2,959          | ,133        |
| other  | 35,533         | ,001        |
| Constant   | ,258           | ,086        |
| <b>Model summary:</b>  |                |             |
| N=1012; Model Sig. < 0,001; Nagelkerke R Square = 0,512; Hosmer and Lemeshow Test, Sig. > 0,05 |                |             |
| <b>Method of Analysis:</b>   |                |             |
| Binary Logistic Regression: Forward Wald   |                |             |

Type of employment is present in the model both in terms of continuity and work time. Contrary to expectations, perhaps, it seems that temporary and part-time work decrease probability of entrepreneurship. The possible reasoning is manifold: a person who has experienced such employment(s) may long for security, which s/he considers is easier to reach through paid work, or one's skills and know-how may not accumulate in atypical employments as effectively as in others. Also personal financial situation for investing to one's own business may be weaker if there are many periods of for example part-time work in the career. Or it simply may be that the type of employment is not an effect at all but a cause of a life style choice, for example a decision to concentrate on family care and work only part-time or temporarily.

Yet another aspect of career history that has significance in relation to entrepreneurship is work tasks (type, quality and amount). Probability of becoming an entrepreneur is highest among those academically educated, who have been working in sales and marketing during their career. Straightforward interpretation is that in this type of work tasks one will automatically learn beneficiary social skills and may also get access to potential customer contacts, learn to understand market demand and customer preferences and may thus recognize business opportunities perhaps easier than those in other tasks. Also, it could be that marketing tasks and entrepreneurial activity require similar characteristics, for example optimism or propensity to act. From this point of view, marketing tasks are not a prerequisite

or stepping stone for entrepreneurship, but a parallel act. Another issue, equivalence of work tasks to one's education, also stands out from the analysis. Again here, as in case of the type of employment, the association is negative in that inappropriate tasks decrease odds ratio for entrepreneurship. This, in a way, surprising finding suggests that know-how and skills needed in academic entrepreneurship accumulate only in work tasks, which quality corresponds the type and level of education. Concerning the amount of work tasks, overtime work is in association with entrepreneurial activity. If you have been working overtime, odds ratio is 5 to 1 in favor of entrepreneurship for compensated working and 12 to 1 in case of non-compensation. The direction appears to be reasonable: one may start thinking that instead of doing extra hours for some else, even without compensation, there might be higher chances for better earnings when working on one's own account. Transition to entrepreneurship can also be easier in a sense that the two may become alike in one's perception as to the length of work days i.e. paid work begins to be suggestive of entrepreneurship or at least the image of entrepreneurship. Concerning the project tasks, they do not seem to be in association with entrepreneurship. It may be that working in projects is so elementary to nearly every academic task that it alone does not differentiate between entrepreneurs and others. Or perhaps the question set up was a bit too loose, since we asked whether one has been involved in project type of work during her/his career. The situation might be different if we had concentrated specifically on project management tasks or on participating projects from beginning to the end and not allowing one to report other type project involvement. Fortunately, we are able to get back to this and narrow the definition in later analysis of the data, since we have also asked the respondents to describe in their own words the content of the project tasks in more detail.

From the examined aspects of work history, also career advancement is attached to entrepreneurship. Management and superior experience both increase the probability of being an entrepreneur. The explanation could be that managerial position develops many of the same skills that are also important in managing your own business, e.g. (strategic) planning, organizing, budgeting and understanding the business logic as a whole. Superior experience, in turn, probably enhances partly the same skills and also those of people management and delegation. Income level and being an entrepreneur are inversely related. The better incomes are the more probably one stays in paid work. One way of interpretation is the risk or uncertainty aspect i.e. if you give up above the average level earnings and start your own business, which does not pay off, in a way you loose more than in such case where your earnings are lower. Put it in another way, the better one's incomes are in paid work, the more successful the business (idea) has to be to receive the same financial status as in paid work. Slightly different perspective is to consider incomes as a pull factor towards entrepreneurship. If the main motive in becoming an entrepreneur is potentially high incomes, this factor is of less relevance for those, who already earn rather well in paid work.

Furthermore, our findings suggest that experiences on small firms during the career may be important for academically educated individuals in becoming an entrepreneur. Probability for entrepreneurship is higher for those, who have been working in micro (less than ten employees) or small companies (10–49 employees). The effects of organization size can be diverse: in smaller companies the work tasks may be more versatile than in others thus improving multiple skills, less hierarchical and specialized organization may also allow better chances for understanding the business logic. In addition, working in a small company may dispel prejudices or negative images attached to entrepreneurship, bringing out what is good in it or knowing the entrepreneur personally may act as a positive role model towards establishing an own business.

Finally, the logistic regression model indicates that academically educated individual's present status on the labor market is of importance. Entrepreneurship is more probable for those who are currently unemployed in comparison to those being in ongoing employment. It may, of course, be as a case, where entrepreneurship is foremost a matter of necessity rather than opportunity based act. On the other hand, one could argue the opposite, if we recall what has been discussed in the theoretical chapter above. In Finland as in many other western countries, the level of academic unemployment is rather low, which means that finding a new job is relatively easy. On these grounds, unemployment might be interpreted as a critical event, where there is an opportunity to break the inertia and to fulfill one's own dream of starting a business one day.

So far we have discussed about the different aspects of career history and their possible role in becoming an entrepreneur. We have been able to find out certain dependent variables that seem to increase the odds ratio for entrepreneurship. The question then arouses that are these findings individual paths towards entrepreneurship as indicated in the paper title or are they merely a description of one typical path? Our answer is 'partial yes' to both of these two viewpoints. On one hand, the statistical significances found in the analysis are generalizations and when they all exist in one's career history the entrepreneurial probability is in its highest. On the other hand, all of these dependencies rarely exist together. In the data there was only one entrepreneur who had undergone all but one of them. Thus, in our opinion each of the examined issues are pieces of career paths, and there are altogether 12 of these pieces or sub-paths, which can be combined in a numerous ways thus making each path somewhat unique. The individuality is present both in number and type of career path pieces. For some individuals there may be only two or three events that have occurred in their career in paid work before establishing own business while in some other cases s/he has undergone eight or nine of these 'entrepreneurially predictive' career sub-paths. Yet, there are other individuals with also eight or nine milestones behind them and they are still in paid work. This is introduced in the table below (Table 3).

**Table 3 Number of critical pieces of career paths, which increase the probability of being an entrepreneur**

| <b>Number of critical pieces of career paths</b> | <b>Share of entrepreneurs</b> | <b>Share of employees</b> |
|--|-------------------------------|---------------------------|
| Less than 3                                      | 3,8 %                         | 8,4 %                     |
| 3-4  | 6,6 %                         | 28,5 %                    |
| 5-6  | 29,1 %                        | 35,9 %                    |
| 7-8  | 46,0 %                        | 25,1 %                    |
| 9-10   | 14,2 %                        | 1,9 %                     |
| 11-12  | 0,3 %                         | 0,1 %                     |
| Total  | 100 % (n= 880)                | 100 % (n=289)             |

Thus, we do not believe that the career history is solely affecting the entrepreneurial choice, although we have been examining the topic in isolation from some other theoretically important insights. Also, different steps are important to different individuals. For one, working in a small company may be that crucial one piece in career path, while for the other this is not important or not enough, but needs to be combined with the managerial experience, before entrepreneurial intentions realize. Yet for someone else, other pieces of career path, like working in service sector, are critical from the point of view of entrepreneurship.

## DISCUSSION

The aim of the study was to examine and describe individual paths towards entrepreneurship among academically educated. We decided to focus on exogenous factors, specifically personal demographics and previous work history and their association with entrepreneurship as a career choice. The study was exploratory in nature, thus no preliminary hypothesis or proposition were set in advance.

To begin with, our findings suggest that personal demographics differentiate between entrepreneurs and others also among academically educated individuals. Significant factors are, in order of importance, age, type of education, number of degrees, gender and role models. The probability for entrepreneurship is highest if you are 36–45 years, have educational background in business administration, possess multiple degrees and are male with entrepreneurial parents and close friends. These demographics draw a picture of qualified, vital entrepreneurs indicating that entrepreneurship is not considered as a necessity in lack of other choices or a cooling of period among academically educated.

There is also a rather strong association between career history and entrepreneurship according to our data, suggesting that by understanding previous work experience we can learn a great deal of entrepreneurship. All of the examined aspects seem to be relevant in case of academically educated individuals. Typically they end up choosing entrepreneurship as a career choice after being in paid work for more than 10 but less than 20 years. The variety of work is significant in that those who have been working in service sector establish their own business more often than others. Atypical (temporary or part-time) employments, in turn, seem to decrease the probability of entrepreneurship. Also type, quality and amount of work tasks are of relevance. Experience in sales and marketing, equivalence between work and education and over-time work all increase likelihood for entrepreneurship. As to the career advancement, experience of managerial position and superior role both act in favor of entrepreneurship, whereas higher salary levels have the opposite linkage. Work experience in a small company during career also associates positively with the choice of entrepreneurship as does the present labor market status in terms of unemployment.

We are also suggesting that each of the above-mentioned elements of career history can be seen as a piece of path toward entrepreneurship. Different types or number of pieces exist or are relevant for each academically educated, thus there are numerous combinations of these pieces making every path unique. Some of the paths are probably more common than others, an issue of clustering which we will probably get back to later on in analyzing the data. Also, these elements of work history do not exist only among those who have chosen entrepreneurship, but also among those who are (still) in paid work. This indicates that work history does not solely determine one's path toward entrepreneurship. Instead, it seems to matter to some extent, but there are also many other important antecedents of intentions such as personal values and various situational factors (see e.g. Shapero 1982).

At this point, we would also like to discuss briefly about the impression of academically educated individuals' entrepreneurship, which comes across by examining their work history. Firstly, our interpretation is that, opportunity based entrepreneurship is emphasized instead of necessity among academically educated in Finnish context. Neither is entrepreneurship considered as some kind of casual work or hobby, but a serious career choice, which is heavily based on skills and know-how gained in paid work. Furthermore, the findings indicate

that the threshold towards entrepreneurship becomes lower, when there are features in paid work that are typically attached to entrepreneurship, such as longer working hours, multiple as well as managerial skills and experience in sales and marketing and customer service. Also, it seems that academic, all-around education does not provide for or individual's does not perceive it providing for enough skills and know-how to establish an own business soon after graduation. Instead, a number of years in paid work are considered necessary in order to gather more human, social and financial capital needed in entrepreneurship. Moreover, it shows that academically educated are often not interested in starting their own business unless they are pretty sure that there is enough grounds for successful execution of it. On the other hand, it could be argued that it is not always a matter of capability shortage as such, but newly graduated individuals may not recognize, how their university qualification can be turned into a profitable business idea. An implication for the public policy could be that it is possible to promote entrepreneurship by familiarizing individuals earlier, while still studying, with entrepreneurship and in this manner raise it to same level with other employment forms as a career choice. In practice this could mean, for example, that at university level, teaching methods would be organized in such a manner that they develop more entrepreneurial way of thinking. Education could also be organized so that it would give a more comprehensive idea of business logic, instead of teaching only narrow and separate aspects of it. Also, small business owners could be utilized in educational cases as speakers etc. in order to offer role models of how to turn academic know-how into business idea.

Finally, our analysis arouses at least as many new research questions as it has been able to answer so far. To capture a more thorough picture of the phenomenon, the examination should probably be enlarged to cover also other types of academic education in addition to business administration and engineering presented here. It would also be useful to compare the role of work history in becoming an entrepreneur between academically educated and those with other educational level. Also individual paths or pieces of such paths need to be studied further, since certain combinations or clusters are probably more common than others. Moreover, it would be of interest to make cross-national comparisons in order to examine, whether there are any national features or peculiarities between work history and the choice of entrepreneurship. In addition, it would probably be valuable to explore whether the work history is in association not only with the choice of entrepreneurship, but also with the success/growth or failure. Foremost, it would be of great importance to explore more thoroughly the mechanisms through which the work history and individual intentions and actions toward entrepreneurship converge – an issue, also we will try to shed some more light in further study of the data by analyzing how work history affects individuals' perceptions of desirability and feasibility (see Krueger et al. 2000) of executing entrepreneurial career.

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**PART-TIME ENTREPRENEURSHIP AND WEALTH EFFECTS  
NEW EVIDENCE FROM THE PANEL STUDY OF ENTREPRENEURIAL DYNAMICS**

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Abstract

Do people have to be wealthy to become entrepreneurs? I reexamine the effect of initial wealth on the propensity to participate in a business start-up. Previous studies address this question using self-employment data. Self-employment surveys, however, treat respondents as either self-employed or wage workers and thus provide a poor measure of firm creation. In contrast, a recent survey of the establishment of new businesses reports that 50 percent of entrepreneurs engage in full-time and 20 percent in part-time wage and salary work. In this study, I develop a model of entrepreneurial choice where individuals can both hold outside paid jobs and be involved in start-ups. To evaluate wealth effects, I use a new data set that follows both entrepreneurs and start-ups. I instrument wealth with month-to-month changes in S&P and find that wealth does not affect the propensity to become an entrepreneur. Start-up owners devote a portion of their outside wage income to investments in their firms. Thus, wealth becomes less relevant for starting new businesses. This result suggests that people do not have to be wealthy before they can start a business.

Extended Abstract Paper

New businesses often rely on individual and household wealth as a source of start-up capital, financial security, or insurance for acquiring funds (Gartner et al. 2004). This seems to suggest that assets have a crucial effect on the level of entrepreneurial activity; but the literature offers mixed evidence. The seminal studies of Evans and Jovanovic (1989) and Dunn and Holtz-Eakin (1994) argue that entrepreneurs are liquidity constrained, and that wealthy people, who are better able to obtain substantial amounts of initial capital, are more likely to be involved in entrepreneurial activities. In a recent paper, however, Hurst and Lusardi (2004) show that wealth effects are significant only for the top 5 percent of the wealth distribution. In this paper, I reexamine the effect of wealth on the tendency to participate in a business start-up and argue that initial wealth does not significantly affect the propensity to become an entrepreneur.

The existing literature suffers from two major problems. First, previous studies address the question of wealth effects using self-employment data. Self-employment surveys, however, treat respondents as either self-employed or wage workers and thus provide a poor measure of firm creation. In contrast, a recent cross-national study on the level of entrepreneurial activity of

40 countries (Global Entrepreneurship Monitor, GEM, 2003 Executive Report) has established that 80 percent of those who implement a start-up also hold outside jobs. Thus, to answer the question of wealth effects, we need to use data that reflects the complexity of entrepreneurial activity.

The second major problem in the existing literature is that wealth is likely to be endogenous: what helps people become wealthy might actually be the same quality responsible for their unobservable entrepreneurial talent. Hence, one has to correct for this potential endogeneity. Blanchflower and Oswald (1990), Holtz-Eakin et al. (1994), and Hurst and Lusardi (2004) recognize this problem and propose a set of instrumental variables; however, the literature still does not seem to agree on whether wealth engenders self-employment. To deal with this problem, I instrument wealth with month-to-month changes in Standard & Poor, a source of assets variation that is exogenous to entrepreneurial decisions.

In this study, I propose a part-time entrepreneurship model, where new business owners can hold outside paid jobs. Start-up owners devote a portion of the outside wage income to investments in their firms. Individuals who spend relatively more time in outside jobs have more wage income, and respectively more savings and capital to invest in a start-up. Therefore, the opportunity cost of time spent in a start-up is not just the outside wage, but also the potential savings and investments that come with this wage. Thus, entrepreneurs will continue spending time in their new business until what could be produced for one more hour in the start-up is equal to the outside hourly wage plus the savings that this wage would have brought.

To evaluate wealth effects, I use a new data set that allows me to confront the two major problems discussed above. The Panel Study of Entrepreneurial Dynamics (PSED) is an extensive nationally representative survey of the establishment of new businesses that follows both entrepreneurs and start-ups. The PSED covers business creation from a start-up to the full development of an operating firm. The survey reports that 50 percent of entrepreneurs have full-time work and 20 percent have part-time wage and salary work outside the start-ups.

The PSED provides several innovations over previous empirical research. The data were specifically created to follow both nascent entrepreneurs and start-ups. Nascent entrepreneurs are selected based on three criteria: being involved in a start-up for the past 12 months, expecting to be at least partial owners of the business, and functioning in a gestation phase of the business. The third criterion determines whether "the start-up has a positive cash-flow that covers expenses and the owner-manager salaries for more than three months." Respondents with a positive cash-flow for more than three months are excluded. Start-ups are followed for a period of four years. In this way we can observe the effect of wealth and initial capital on the start-ups' performance and the rate of entrepreneurial survival.

I instrument wealth with month-to-month changes in S&P and find that wealth does not affect the propensity to become an entrepreneur and that people who already have jobs are more likely to become involved in entrepreneurial activities. Start-up owners devote a portion of their outside wage income to investments in their firms. Thus, wealth is shown to be not significantly relevant for starting new businesses. This result suggests that people do not have to be wealthy before they can start a business.

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# **FACTORS INFLUENCING THE SUCCESSFUL PERFORMANCE OF SME IN THE CZECH REPUBLIC.**

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## **ABSTRACT**

This paper discusses the conclusions of some research projects undertaken at the University of Economics in Prague, aimed at the measurement of performance of SME. The aim of the initial project was to test some recommended methods and models and its practicality for SME. For this purpose, a small sample of just two companies was chosen. It has revealed that even companies certified according to ISO EN have the weakest point in marketing expertise and strategy creation.

The next stage started with the formulation of a new hypothesis. Which factors should be included in the evaluation of the future successfulness of a firm? How to define the development potential? To answer these questions, a much larger sample has been analyzed. Fifty companies were analyzed according to six components- strategy and planning, marketing, production processes and technology, quality and environment, logistics and human resource management. Several statistical methods were used to analyze the interdependencies between the main group factors and the six remaining determinants. The conclusions of the self assessment approach were used by placing the companies into four groups A, B, AB, and C, which express the development potential.

In the third stage the same questionnaire was used to examine 95 SMEs (heterogeneous group). The conclusions have proven that more than 50 % of companies do not have any mission and corresponding strategy. More than 30% do not perform marketing activities and do not practice CRM. Almost 50% of the sample companies' produce using licenses or by copying products. Only 50% of companies make use of their own R&D for the product innovations. Just 28 % underwent certification processes, 70% do not create integrated supply chains and logistic and almost 50% of companies do not have their MIS integrated. Motivational systems are not innovatively created.

## **INTRODUCTION**

The business environment can be characterized by permanent and quick changes. These changes are caused by increased global competition, increased intensity of changes in technology and better communication networks using the Internet. These factors influence the activities of all kinds of firms. But there are special problems that affect SMEs more than larger businesses:

- they have more difficult access to capital and conclusively they can't invest in technological advancement
- they have weaker position in acquiring state contracts
- they don't have enough financial means to have top experts on their payrolls
- the system approach to a product development is not generally practised
- they have to compete very often with dumping prices of multinational corporations

- they do not possess enough expertise to follow and interpret the impact of a steady inflow of new laws, regulations and prescriptions which create a difficult business environment in the Czech Republic. (They often have to hire a specialized consulting agency in order to obtain funding from the EU, because of complexities of the application procedure).

Regardless of these barriers, SMEs represent a formidable economic force, creating 37 % GDP of the CR and providing employment for 60% of the labour force. Some selected indicators can be seen from the (Table 1.)

*Table 1 here*

The critical role of managers consists in **continuous** assessment of the firms performance aimed at seeking steady improvement – **potential development**. Standard procedures of performance assessment, which have been used in the past, do not reflect new entrepreneurship approaches. The most frequent questions that address the evaluation of company's performance of contemporary management are the following: [1].

- **How well is the main company's process organized?**
- **How well is the innovation process managed and what is the position of the company's product, compared to the product trend? Does the company set the trend? Or is it falling behind?**
- **How good is the company's financial performance? Can it stand to the benchmarked values? Is the shareholders value increasing?**
- **How well does it stand in the eye of the customer? Does it satisfy the customer's needs?**

- **How intensive and well defined is its corporate social responsibility?**

The traditional methods of rating the company's performance have concentrated on measuring the benefits of cash inflows rather than providing an answer to the above mentioned questions. The professionals have reacted with the development and proposal of new models such as the **Balanced Scorecard** [2], and also proposing the European model of **EFQM - European Foundation for Quality Management** [3] and have therefore created a new paradigm for the measurement of performance. See - Figure 1 [4].

*Figure 1 here*

The faculty at the University of Economics in Prague have been considering this paradigm as a great challenge and have been working on the implementation of these new models for a considerable period of time. The research work follows a traditional financial analysis track and contemporary approaches (BSC, EFQM) with the aim of supplying the managers (especially those of SMEs) with effective methods for measuring performance and giving them the tools for future strategic decisions.

First of all, the research hypothesis has been formulated:

**“WHICH FACTORS SHOULD BE INCLUDED IN THE EVALUATION OF FUTURE SUCCESSFULNESS OF THE SME-HOW TO DEFINE THE DEVELOPMENT POTENTIAL OF A FIRM”?**

Shall we proceed according to BSC or EFQM model, or shall we develop our own model? The decision in favour of EFQM was partly influenced by the prospective entry of the Czech Republic into the EU and by expected support and subsidies for SME.

## **THE FIRST EXPERIMENTAL RESEARCH [5], USING EFQM - SMALL SAMPLE**

For the first pilot study project the EFQM model was used and a sample of two companies was acquired for implementation. The short description of the EFQM:

1. **Leadership (100 points)** - mission, ethical code of behaviour, delegation of authority, structure, relationship with customers, performance appraisal.
2. **Policies & Strategy (90 points)** – how the strategy was implemented. The overall work for supporting the information system. Effectiveness of market research and its use for market prognosis and consumer behaviour. Internal reporting system and its organization.
3. **Human Resources (90 points)** – planning, recruiting and skills development of employees.
4. **Partnership & Resources (90 points)** - partnership with suppliers and community. Effective use of financial resources, financial strategy, investment in technology, R&D.
5. **Processes (140 points)** - how well are the main processes organized? The detailed description of processes, parameterization of processes and its outputs. ISO 9001. Services and customers.
6. **Customer Satisfaction (200 points)** - quality, safety and reliability of a firm's product, customer loyalty, CRM.
7. **Results Concerning Employees (90 points)** - motivation and transparent options for promotion. Performance appraisal of individual's effort. Working environment
8. **Results Concerning Social Responsibility (60 points)** - *image* in the public, corporate social responsibility, environmental protection.
9. **Performance and Results ( 150 points )** - summarization of key results covering:

- Financial performance i.e., cash flow, liquidity, EPS, sales, revenues, net profit,
- Intangibles, expertise, knowledge - based progress etc.

### **TARGET COMPANY: AXIS LTD.**

Axis Ltd. is a company well established on the Czech market, belonging to the SME group, producing a broad spectrum of steel products - production of steel constructions, technological facilities, high pressure pots, reconstruction of machinery equipment, assembly of gas equipment, machine tool shaping etc.

The company was subject to a certification process in 1999 according to ISO 9001 norm, and gained the corresponding certificate. This research study has made use of a standardized questionnaire of EFQM, recommended by National Centre for Quality. The questionnaire consisted of fifty questions which were to be answered using a self assessment procedure. The answers had to follow four grade evaluations:

- A. Fully accomplished - excellent process or result, fully implemented.
- B. Considerable progress- giving enough space for improvement.
- C. Moderate progress - needs further research. Bringing good results if implemented.
- D. There are no measurable results. There are some good ideas which were not seriously reviewed or practiced.

The self assessment process has been implemented at the top and middle management levels of the company. The results of the overall evaluation can be seen on figures 2 and 3.

*Figure 2 here*

*Figure 3 here*

### **Conclusions:**

Managers of AXIS have to direct their attention to the improvement of customer satisfaction or to implement a system of CRM. The next recommendation would be to pay more attention to create a clear and effective strategy concerning main firm processes.

### **DEVELOPMENT POTENTIAL OF A COMPANY [6]**

In our paper, we define development potential as a set of tangible and intangible factors directly influencing contemporary and the future success of a company. Development potential in our interpretation is a vector of six components describing basic areas of a company's activities. Within each component, six characteristics follow. The model has been originally developed at the University of West Bohemia in the U-SME innovation project, supported by the Leonardo da Vinci programme of the EU [7]. It uses the following components:

- **Strategy and Planning:** strategic control system, mission and vision of a company. Awareness and sharing a vision by employees.
- **Marketing:** marketing costs can be today as high as 50% of total expenses. It is traditionally the weakest point of many Czech companies. The following factors were subject to analysis: market research, market positioning, competitor's analysis, and advertising.
- **Production Processes and Technology:** does the company follow its competitors or does it set up a trend? Is there an internal innovation centre, or does the firm make use of licences? How is the innovation process organized? How is the technological

development and its applications in products and production processes implemented?  
Although innovation is a central issue discussed in connection with the development potential, innovation itself is not a goal, but only a tool in achieving company goals.

- **Quality and Environment:** these are assessed in relation to EN ISO standards. Quality goals are measurable and consistent with the quality strategy. From a microeconomic point of view, the environment is treated as a public good or negative externality.
- **Logistics:** (Supply Chain Management) - complete system of planning, organising, realising and controlling the flow of goods. The role of outsourcing and its impact on lowering (increasing) costs.
- **Managing Human Resources. Support of MIS for Integration of All Informational Activities i.e.** approaches to information processing and use of internet technologies. Motivational systems, learning processes, company culture and knowledgeable management.

The contents of the components are based on a practice of benchmarking in leading Czech companies. Their structure corresponds to empirical findings published in professional readings.

The definition of the development potential and its measurement is difficult. It is not easy to generalise a procedure assigning it a universal quantitative value. Self-evaluation is once again an important aspect of the process and it reflects the maturity of the company management and its interest in improving their company performance. It follows the structure of the first above mentioned case, using EFQM.

The development potential assessment was performed in three steps. In the first step, the development potential of individual components was evaluated. In the second step, the overall assessment was determined and in the third step the classification of the company was done according to its overall assessment and put into one of the four categories (**C**, **AB**, **B**, **A**).

The classification of companies into the corresponding categories was done according to a set of European Standards – EN ISO 9000:2000, which specifies the rules and system terminologies and on the British norm BS 7000-1:1999, providing a manual for management of development processes and innovations in long time periods. The classifications of companies according to their development potential are shown in the following (Table 2.)

*Table 2 here*

Companies classified as **C** are not ready to implement development activities, to improve their performance and to better satisfy their customers. If they want to develop, they should first implement fundamental changes in their organization and other basic company processes.

Companies classified as **AB** are prepared to complete changes necessary for improving their performance, but must consistently improve their basic processes. Management training can help to achieve long-term goals. Companies classified as **B** can employ and further develop their potential and they are prepared to undergo a certification process according to corresponding ISO standards. Class **A** includes companies with the highest development potential, highly competitive, high performers successful in mid- and long-term horizon.

The definition of development potential and its components was followed by field research using the structured questionnaire. A sample used in the research consisted of fifty companies active in different industries in North Moravia and five companies from the Pilsen region. Field research in North Moravia was performed by the Faculty of Management of Tomáš Baťa University in Zlín in the second quarter of 2002 [7] and it was continued by the collection of data from more companies in both regions. Conclusions presented in this paper are based on data acquired from fifty companies from the following industries:

- 13 - rubber and plastics;
- 20 - machinery;
- 12 - steel and steel product;
- 5 - mechanical engineering;

Nine of these companies were classified as AB, twenty seven as B, fourteen as A. There was no company classified as C. The total average achieved in the four-point scale was 3.06.

The results were processed using one- and multi-dimensional statistical analysis. Financial performance was determined using data published in authorised databases. The following parts of the paper describe conclusions of statistical analyses.

#### Multidimensional regression analysis

In multidimensional regression analysis, the development potential was treated as a dependent variable, while its components were treated as independent variables. The resulting regression model is:

$$DP = - 0.0037 + 0.1809 * \text{Quality and environment}$$

- + 0.1683 \* Logistics
- + 0.1938 \* Marketing
- + 0.1488 \* Information systems and human resources
- + 0.1775 \* Strategy and planning
- + 0.1305 \* Production processes and technology

The analysis results can be interpreted as follows:

- None of the six components could be eliminated from the model.
- The relationship between variables is statistically significant
- The total development potential in the six component model is the most sensitive to the *Marketing* component.
- No correlation coefficient in the model has a value higher than 0.5. Mutual correlation of components was not found.
- Explaining power of the model is 99.5%.
- It is possible to use the following simplified models, which have the following explaining powers:

1 component – 79%

2 components – 89%

3 components – 95%

4 components – 98%

5 components – 99%

- The strategy component significantly influences classification of the development potential into classes.
- For the sample used in this paper it was not necessary to use weighting factors of components.
- The questionnaire has a high explaining power.

### **Conclusions:**

The development potential includes factors which can be influenced by the company owners and managers. They had a considerable effect on the financial performance and correlate with value creation. The relevancy of the selection of the development potential components was demonstrated by statistical methods.

Although **marketing** is the most sensitive factor, its values in our sample were the lowest. It confirms the general experience, that **Czech companies generally have a lack of marketing expertise and do not collect information about customer's behaviour.** (Confirmed also the by conclusions of the AXIS case).

**Production processes and the technologies** components achieve the highest values. For firms in our sample this component is of the highest importance. It was demonstrated that this component provides the best one-component estimate of the total development potential and its correlation with ROE is the strongest. **Companies having leading positions in technology and having high quality products, attract employees and satisfy their customer's needs.**

**Strategy and planning** component significantly influences classification of the companies according to their development potential, but its explaining power is low. It confirms that the **dependence between the performance measurement and the strategy is rather weak.**

Correlation analysis has proven to be a both-sided statistical dependence between the development potential and ROE. It indicates that, when DP is growing, the value of the invested capital by company owners is also growing. It was demonstrated that the company with a higher DP has the potential to satisfy its customers, owners and other stakeholders.

The process of the development potential assessment can be used by the management as a manifold tool in analysing ways that would lead to efficient implementation of the company goals and objectives. Firstly, the two-sided correlation between development potential and financial performance enables the creation of strategic plans aimed at developing all DP components. Secondly, the DP together with selected financial indicators can be a valuable tool in evaluating the company owner's ambitions and shareholders expectations. Its application could be productive also in benchmarking in the present case of a sufficient database for a specific industry.

Finally, we have to stress that; an important precondition for implementation of the DP assessment procedure is the understanding, learning and willingness of companies' management to practise it.

## **THE DEVELOPMENT POTENTIAL OF CZECH SME - ENLARGED SAMPLE.**

Enlarged Sample of SMEs and their characteristics:

The sample consists of 95 SMEs [8], which are described by following characteristics:

**Number of Employees:**

- a) 1 - 9
- b) 10 - 49
- c) 50 - 250
- d) N/A

*Figure 4 here*

**Sales in 2002:**

- a) < 250 mil. Czech crowns
- b) 250 - 1.450 mil
- c) more
- d) N/A

*Figure 5 here*

**SME by Industry:**

- a) Retailing
- b) Services
- c) Building
- d) Machinery
- e) Electronics
- f) Metal industry

- g) Chemical and pharmaceutical
- h) Food and beverages
- i) Agriculture
- j) Power engineering
- k) Wood processing
- l) Textile and clothing industry
- m) Transportation
- n) Insurance
- o) Other
- p) N/A- not filled in ( or performing more different activities )

*Figure 6 here*

**Production Is Aimed at:**

- a) Domestic market
- b) International market
- c) Both
- d) N/A

*Figure 7 here*

**THE EVALUATION OF DEVELOPMENT POTENTIAL OF SME USING THE SAME SIX COMPONENTS AS IN SAMPLE 2.**

In the third stage the same questionnaire was used to examine 95 SMEs (heterogeneous group). The same six characteristics correspond with categories used in the second research study were chosen.

**Mission and Vision, Strategy and Planning:**

- a) The firm concentrates on present situation and day to day activities
- b) The firm possesses written documents about future development for 1 to 2 years
- c) The firm possesses written documents about future development for 3 to 5 years
- d) N/A

*Figure 8 here*

**Marketing Activities:**

- a) Not performed at all
- b) Occasionally – only ( in case) if they are threats to our position
- c) Systematic market positioning

d) N/A

*Figure 9 here*

**Processes and Innovations (described by two characteristics):**

1. Product development

- a) Internal R&D
- b) Licensing
- c) Copying
- d) N/A

*Figure 10 here*

2. The initialization for product change:

- a) No initiative being undertaken
- b) Mainly from internal sources
- c) From external environment
- d) N/A

*Figure 11 here*

**Quality and Corporate Social Responsibility:**

- a) Quality monitoring – not performed systematically
- b) Quality regularly monitored, but analysis of corresponding incurred costs will not be performed
- c) Results of quality monitoring and incurred costs being subject of strict control and evaluation
- d) Firm gained certification and works according to its requirements

*Figure 12 here*

**Supply Chain Management and Logistics:**

- a) Firm keeps a steady and reliable set of suppliers
- b) A supplier will be chosen case by case
- c) Firm developed data base of suppliers with intensive interchange of information
- d) N/A

*Figure 13 here*

**HR and MIS (described by two characteristics):**

1. Motivational factors of employees

- a) The basic duty of an employee is to perform efficiently and obey orders
- b) There exists a sophisticated motivational system for employees
- c) The company management develops ( except of the existence of a structured motivational system ) a distinctive effort for creating a friendly working environment
- d) Team work is broadly practiced

*Figure 14 here*

## 2. Information system:

- a) The formalized and centralized IS does not exist
- b) The formalized IS for operational purposes exists, but does not provide pragmatic information for strategic management
- c) The well structured and integrated IS exists for all levels of management
- d) N/A

*Figure 15 here*

## **Conclusions**

The last phase of research is still taking place, so we can make some preliminary conclusions.

The same questionnaire has been used as in the previous stages as well as the same self

assessment technique, so the conclusions are fully comparable. It gives us a sample of 145 SMEs covering a broad spectrum of companies. The latest evaluation has brought evidence that more than **50%** of the companies do not create any vision and corresponding strategy (though we have proven that the dependence between performance measurement and the strategy is rather weak). More than **30%** do not perform marketing activities and do not practice CRM. Almost **50%** of sample companies produce using licenses or copying products. Only **50%** of companies make use of their own R&D for the products innovations. Just **28%** underwent certification processes, **70%** do not create integrated supply chains and logistic processes and almost **50%** of the companies do not have MIS integrated. The motivational systems are not satisfactorily composed. This set of preliminary conclusions gives us a clear direction of how can we proceed with further research in order to help SME in the Czech Republic to increase its competitiveness within an enlarged EU.

### **CHALLENGES FOR FUTURE RESEARCH:**

- **HOW TO IMPROVE PRODUCT DEVELOPMENT?**

The interviews and research conclusions have proven that the majority of SMEs need to learn a new method for product development.

- **THE PSYCHOLOGICAL FACTORS AND PERSONAL ATTRIBUTES NECESSARY FOR SUCCESSFUL MANAGEMENT OF SME.**

The Czech Business Schools will have to focus on the development of more courses, focused on entrepreneurs.

- **WHAT IS THE EXPERIENCE OF SUCCESSFUL SMEs WITHIN THE MOST DEVELOPED COUNTRIES? IS IT TRANSFERABLE?**

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ISBN 80-245-0739-0.

### Figures & Tables

| Year 2003             | Number of Employees<br>0 - 249 | Self-employment | Total SME<br>+Self | The Share of Employees<br>of SME +Self-<br>employment on the Total<br>Employed Workers |
|-----------------------|--------------------------------|-----------------|--------------------|--|
|                       | Number of<br>Businesses        | Number          | Total              | %  |
| Manufacturing         | 25 641                         | 131 608         | 157 249            | 49,70  |
| Construction          | 6 517                          | 88 756          | 95 273             | 80,18  |
| Wholesale & Retail    | 55 250                         | 194 857         | 250 107            | 80,40  |
| Groceries/Restaurants | 4 689                          | 47 639          | 52 328             | 89,34  |
| Transportation        | 5 173                          | 40 531          | 45 704             | 29,93  |
| Financial             | 901                            | 28 998          | 29 899             | 21,74  |
| Services              | 46 691                         | 268 791         | 315 482            | 81,45  |
| Agriculture           | 3 578                          | 39 167          | 42 745             | 85,00  |
| Total                 | 148 440                        | 840 347         | 988 787            | 62,21  |

Table 1 – Number of Employees of SMEs in the Czech Republic. (The data put together from the statistics of the Czech Ministry of Industry and Trade.), [www.mpo.cz](http://www.mpo.cz)

| 1920  | 1970                   | 1980   | 1990→   |
|---|------------------------|--|---|
| Dupont Pyramid<br>ROI- Return on Investment | EPS Earnings per Share | M/B Market to Book Value per Share<br>ROE Return on Equity<br>RONA Return on Net Assets<br>CF- Cash Flow | EVA Economic Value Added<br>Gross Margin<br>MVA Market Value Added<br>BSC Balanced Scorecard<br>CFROI<br>EFQM<br>TSR Total Revenue For the Owners |

Figure 1 - The Change in Paradigm in Evaluating the Company's Performance.

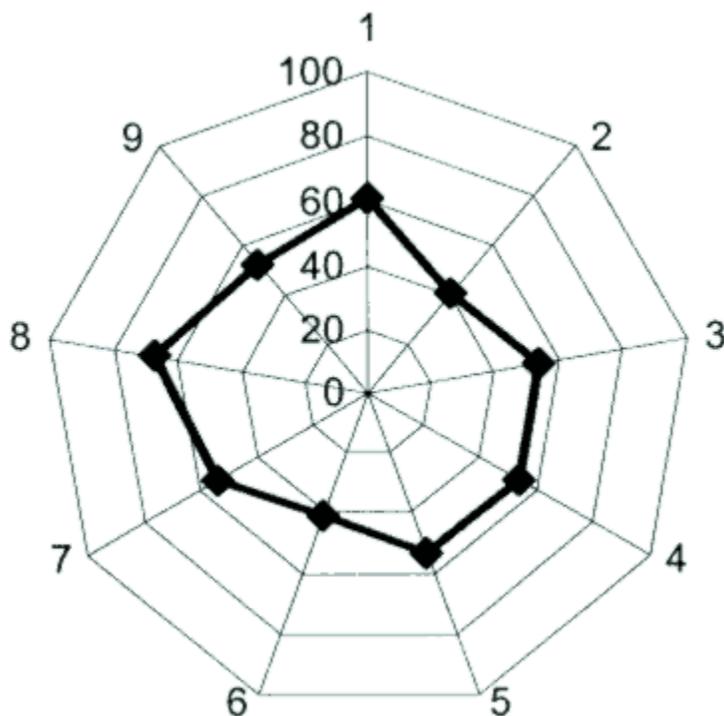


Figure 2 - AXIS – Assessment According 9 Criteria of EFQM

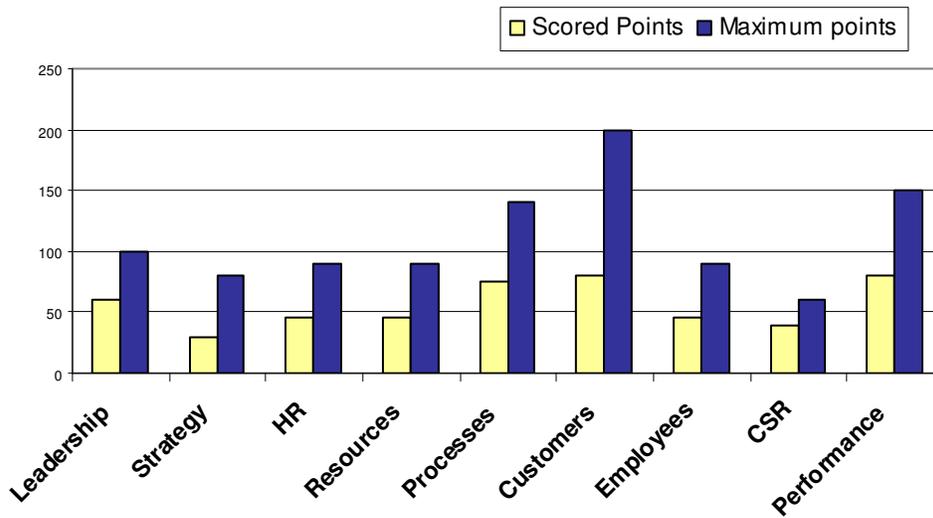


Figure 3 - AXIS - Assessment of Performance According to EFQM

| Evaluation of Development Potential | Type of Company according to its Development Potential |
|-------------------------------------|--|
| 1.00 – 1.49                         | <b>C</b>   |
| 1.50 - 2.49                         | <b>AB</b>  |
| 2.50 - 3.49                         | <b>B</b>   |
| 3.50 - 4.00                         | <b>A</b>   |

Table 2 -The Classification of Companies According to their Development Potential

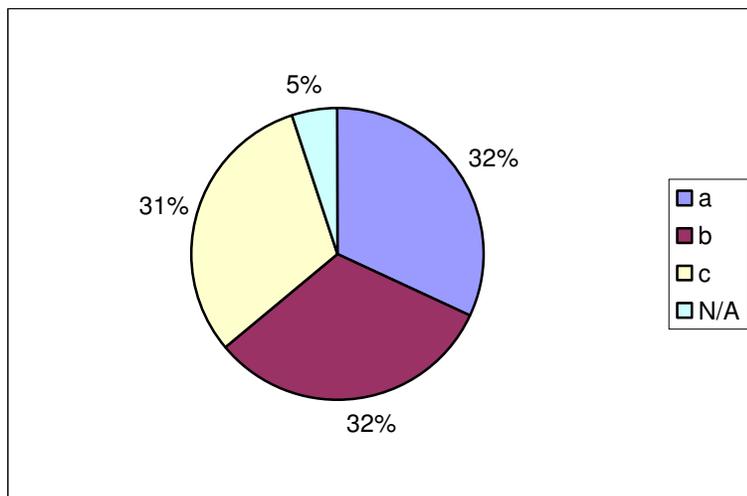


Figure 4 - Number of Employees

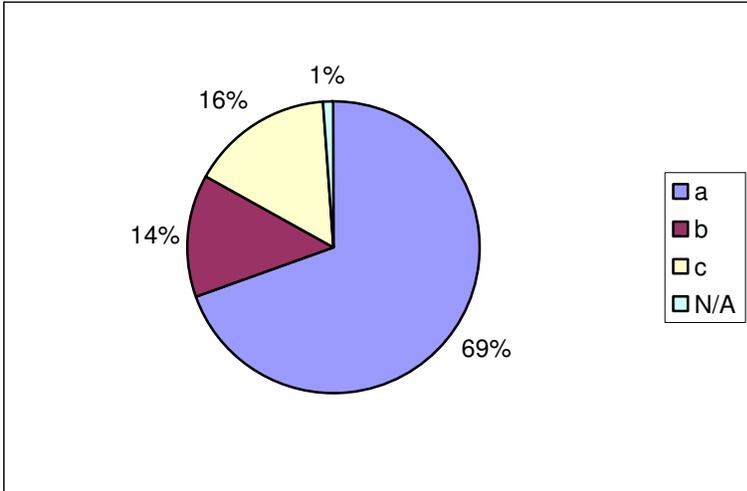


Figure 5 - Sales in 2002

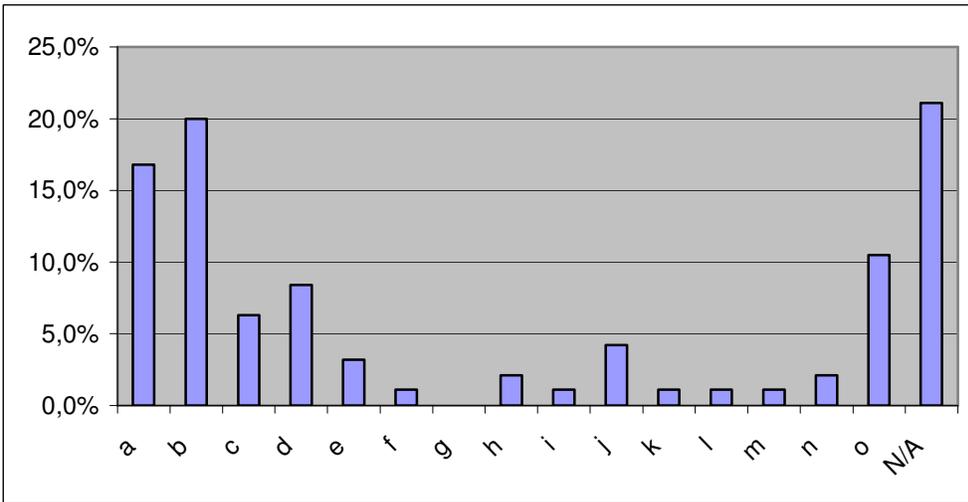


Figure 6 - SME by Industry

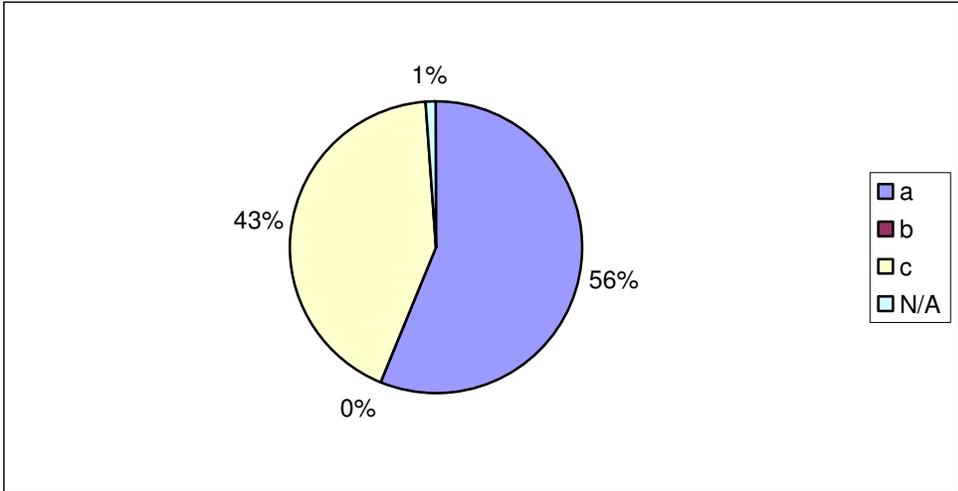


Figure 7 - Production

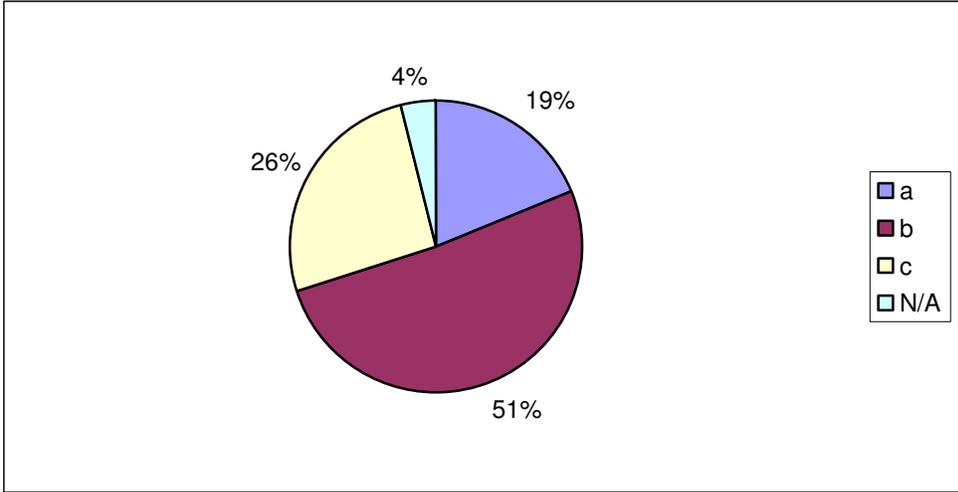


Figure 8 - Mission and Vision, Strategy and Planning

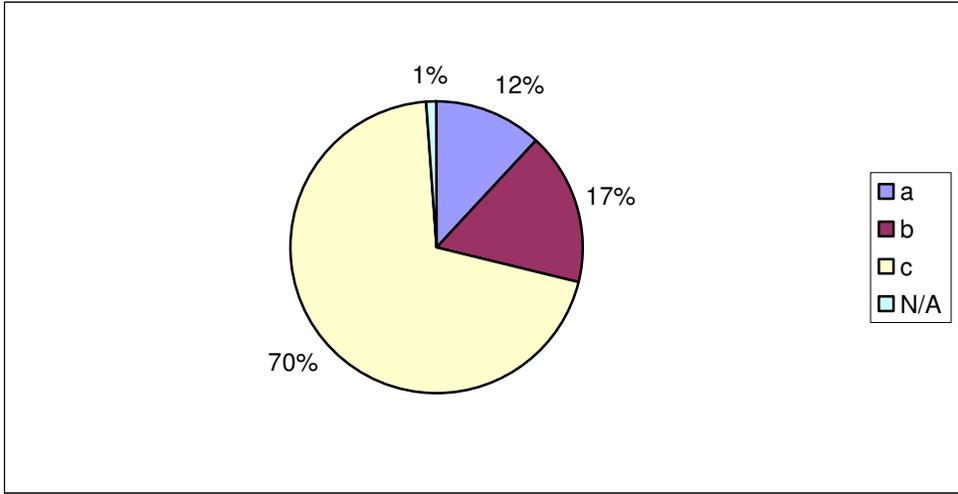


Figure 9 - Marketing Activities

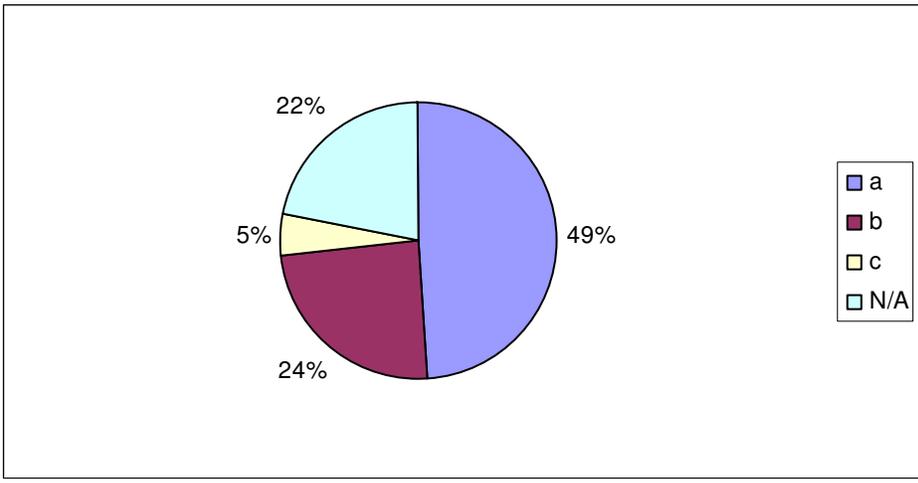


Figure 10 - Product Development

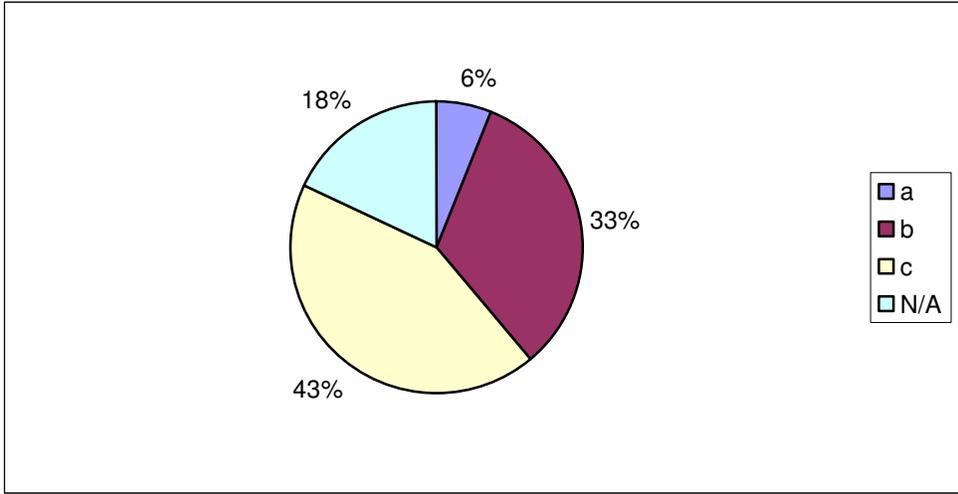


Figure 11 - The Initialization for Product Change

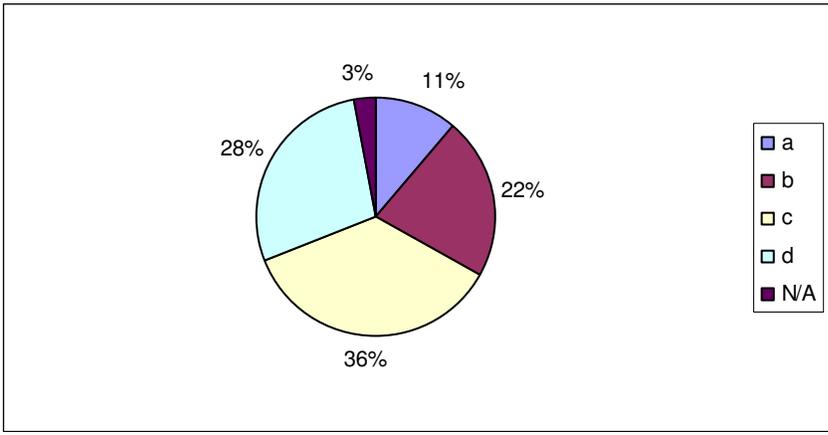


Figure 12 - Quality and Corporate Social Responsibility

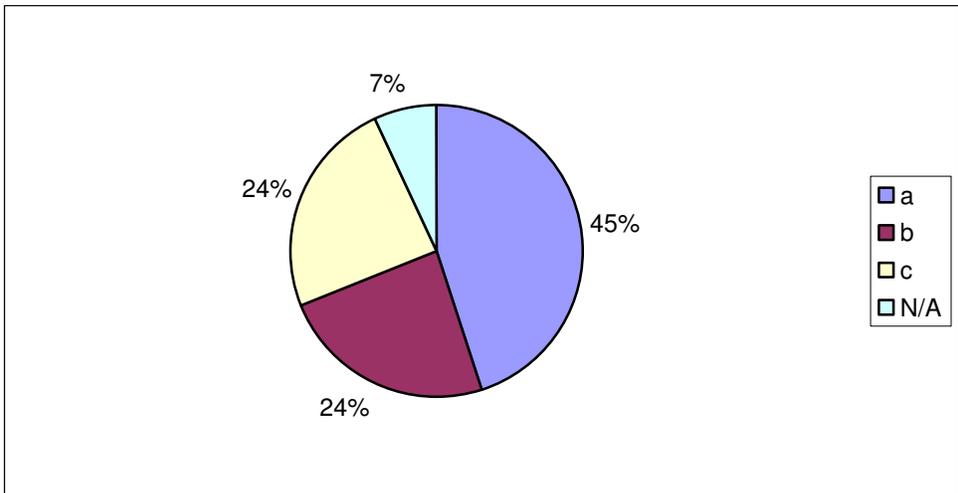


Figure 13 - Supply Chain Management and Logistics

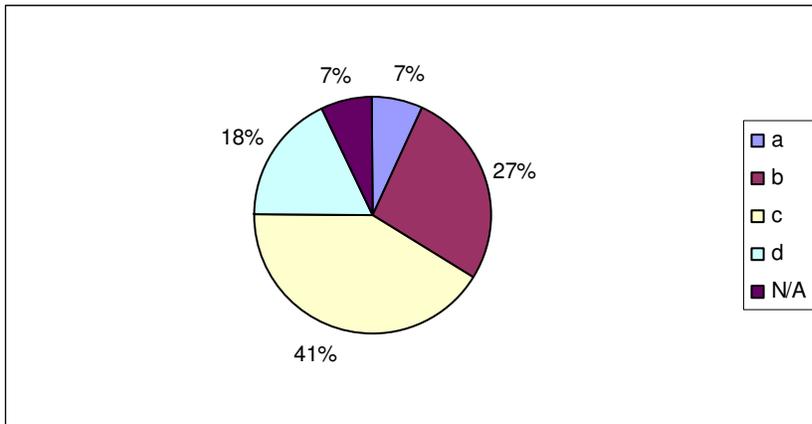


Figure 14 - Motivational Factors of Employees

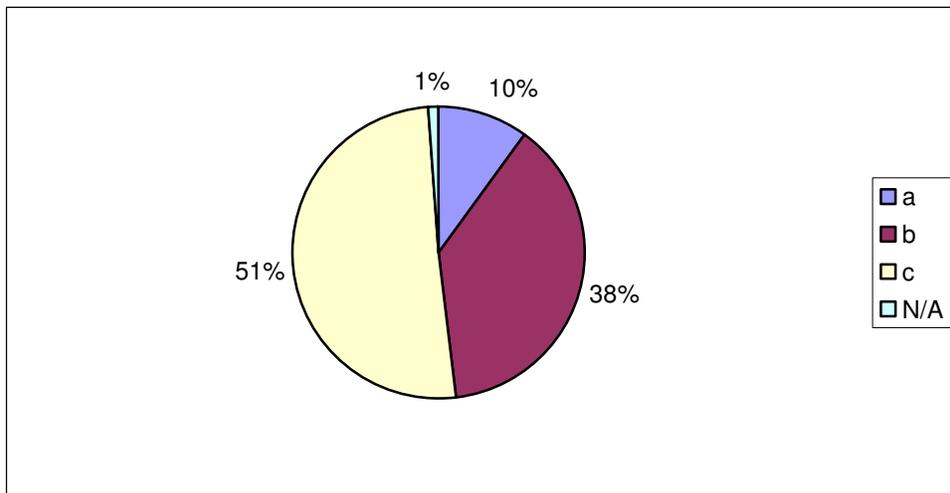


Figure 15 - Information System

**MANAGING FAMILY BUSINESS ETHICS:  
CURRENT PRACTICE & REGULATORY CONTEXT**

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June 2005  
ICSB 2005 World Conference

# **MANAGING FAMILY BUSINESS ETHICS: CURRENT PRACTICE & REGULATORY CONTEXT**

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## **ABSTRACT**

Increasing pressures are beginning to be placed on privately-held businesses to meet stringent regulatory requirements of Sarbanes-Oxley (SOX) and Federal Sentencing Guidelines for Organizations (FSGO) regarding board use and ethical compliance processes. We studied 167 family businesses in two states to determine how extensive “best” governance practices were being actually utilized, particularly those related to boards of directors and ethical compliance processes.

Survey analyses indicate very mixed results, although a significant pattern exists, as expected, that larger family businesses were more actively using boards with independent directors, had formal written codes, and utilized more formalized ethical compliance processes. Given the critical importance of not only developing codes but also having effective compliance processes in place, the overall survey results suggest widely varying practices that may not yield desired results and may also expose the family business to unnecessary legal liability. Compliance processes need more active attention and this paper outlines the specific operational elements of effective compliance processes that will improve their application.

## **Introduction**

There are good business and family reasons for codes of ethics, conduct, and values. Codes can help define and preserve the family’s core values across generations (Aronoff and Ward 1996) and help build bottom-line performance when operationally expressed within the business (Aronoff, Astrachan, and Ward 1998; Ferrell, Maignan and Loe 2004; Miller 2002; Moran 2004; Sharma 2004). Continuing corporate scandals have, however, raised the importance of codes and other forms of corporate governance even further, and there is growing evidence that Sarbanes-Oxley (SOX) Section 406 regulations will increasingly be applied to privately-held businesses (Alford 2005; McDonagh 2005; Plant, Pratt, and McCann 2004). Among several provisions that already apply are calls for more independent and knowledgeable boards of directors with formal committees, particularly an audit committee, and formal ethical compliance policies and practices (Lander 2004).

As Alford (2005) and McDonagh (2005) note, there are several reasons why private companies must become more aware and compliant with SOX regulations. Large suppliers, insurance companies, and lenders are, for example, increasingly expressing expectations that their private company customers comply with such practices to get the best terms (Smoot 2004). Large public companies seeking to acquire private companies must also certify that the entire combined company after a deal is compliant with SOX within a limited time period, and any private company seeking to be acquired should have those practices well in place if a timely closure is

desired. Acquirers may be more willing to pay higher premiums for private businesses that demonstrated effective governance practices (Moscetello 1990) and meet SOX requirements. Whether this is the case or not may be an important emerging research question for family business researchers.

Private business owners also recognize that ethical codes and formal corporate governance processes make sound sense for growing businesses, and SOX, while arduous to comply with, provides a well-recognized, universal standard. Adopting such standards becomes important as family businesses move toward greater professionalism in management and systems (Dyer 1989; Flamholtz 1990; Sharma, Chrisman, and Chua 1997).

SOX regulations are relatively new and controversial in terms of their impact, but we have found much less attention given to the 1984 Federal Sentencing Guidelines for Organizations (FSGO). FSGO has been requiring privately-held businesses to develop and implement ethical compliance systems for nearly two decades (Desio 2004; Murphy, Castillo, Sessions, Steer, Hinojosa, Horowitz, O'Neill, Jaso, and Reilly 2003; United States Sentencing Commission 2004). The U. S. Sentencing Commission was created by Congress in 1984 to establish sentencing policies and practices for federal courts, including recommendations of the form and severity of punishment for offenders convicted of federal crimes. The most common offense for which organizations are sentenced under FSGO is fraud, followed by environmental pollution, money laundering, antitrust, and food and drug violations.

Of primary interest to family business owners is that the 1991 organizational sentencing guidelines apply to all organizations – publicly or privately held, corporations or partnerships (LeClair, Ferrell and Fraedrich 1998). In fact, according to research posted on the Sentencing Commission's internet website, 92.7 percent of convicted organizations in 1988, and 88.2 percent in 1989 (the most recent figures based upon ownership) were closely-held organizations – higher by far than publicly-traded organizations (5.8 percent) and non-profit institutions (0.6 percent) (<http://www.usc.gov/training/corpq&a.pdf>).

As Desio (2004) notes, "Criminal liability can attach to an organization whenever an employee of the organization commits an act within the apparent scope of his or her employment, even if the employee acted directly contrary to company policy and instructions." The organization can be fined, placed under probation, ordered to make restitution, and to publicly apologize for the offense.

Two factors that can mitigate the punishment of a company are the existence of an effective ethics program and the business's efforts to self-report the offense and cooperate with the authorities. Fines can be reduced up to 95 percent if the company can show it had an effective ethics and compliance program in place and that the violation was an unusual occurrence in an otherwise ethical business. On the other hand, the absence of an effective ethics program may cause the court to put the organization on probation. The Commission strengthened the criteria for an effective program in 2004 to reflect its experiences with organizations over the past ten years and to align with the Sarbanes-Oxley Act and other governmental initiatives (Desio 2004).

Given the importance accredited to family-supported ethical cultures and governance practices, we have found few recent large surveys of family businesses about their actual governance practices, including their operational use of ethical and behavioral codes (Gallo 2004; Hornsby, Kuratko, Naffziger, LaFollette, and Hodgetts 1994; McCann, Leon-Guerrero, and Haley 2001). It is not clear how family businesses are actually engaging in “best” governance practices such as the use of formal boards of directors, regular board meetings, use of outside directors, and formally developed and applied codes (Aronoff, Astrachan and Ward 2002; Sharma 2004). While advocated, do such prescriptions match the reality of family business in today’s increasingly stringent regulatory context?

## **SURVEY DESIGN & METHODOLOGY**

To explore these questions, two family business centers in Florida and Washington State surveyed 1497 family businesses in their states which yielded a usable sample of 167 family owned and managed businesses for an 11.2 percent overall response rate. Two closely-timed waves of requests for responses were made to yield this sample. These family businesses had been identified through several years of various contacts due to the two centers’ programs and periodic surveys. Respondents were identified as either the founder or the current leader of the business. Respondents were asked to complete a written survey to explore three broad research questions:

- What is the current state of practice regarding the development and application of codes of ethics, conduct, and values?
- Have these practices been influenced by SOX and FSGO requirements?
- Are other governance practices also associated with the use of codes, specifically regarding the use of boards of directors?

The survey contained 19 mixed scale questions. Categorical and scaled questions asked about the existence of a formal board of directors, current number of independent non-family board members, and whether the board meets regularly. Two open-ended questions encouraged respondents to list specific written or unwritten ethical values or beliefs that were important to their businesses and to relate specific instances where their codes had been operationally applied. Participants were invited to attach a copy of their own company’s codes of ethics if desired. Sixteen respondents did return documents such as mission/vision statements, guidelines, codes, or policy handbooks. Finally, we asked to what extent they had made changes in their business in response to SOX and FSGO. The full survey is in Appendix 1.

Demographic variables included the age of the business, number of employees, ownership and management structure, revenues, number of generations actively involved, and the primary nature of the business to test whether there were significant demographic relationships with ethical and board practices (See Table 1). Two-thirds of the sample was Washington State family businesses, but no significant demographic differences were found between states. Over one-half of the total sample had more than 25 employees and over five million dollars in annual revenues, 60 percent were over 25 years old, and 90 percent were family owned and privately held. 80 percent had two or more generations involved, and the sample represented a broad array of industries.

-- Insert Table 1 Here --

## **ANALYSES & RESULTS**

Summary statistics were first developed for all items and content analyses performed on the open-ended responses to identify patterns and themes among the values/beliefs listed, and among the situations or instances where codes had been operationally applied. We were particularly interested in the characteristics of those family businesses that were most likely to adopt board and code practices. It would be reasonable to hypothesize that larger, more established family businesses were most likely to have adopted such practices, and this relationship was tested.

Table 2 provides a descriptive summary of the overall responses obtained. The following results can be summarized:

- 57 percent had formal boards of directors with 63 percent of those with boards holding regularly scheduled meetings.
- 69 percent had no independent directors, and only 22 percent had two or more independent directors.
- 54 percent had written codes with 59 percent of those with codes having them apply to both the family and the business.
- 40 percent of those with codes had them written by the founder or family leader alone, and 39 percent had help from outside professionals.
- 94 percent of those without written codes still believe that there are clearly understood and accepted unwritten ethical values and behavior standards in their organizations.
- In terms of their code's application, 27 percent are only verbally communicated, 25 percent are communicated both verbally and in writing, 12 percent are expressed in formal policy/procedure manuals, and 34 percent are introduced in training programs and employee orientations.
- Importantly, only six percent were aware of or had changed their codes and their use in response to FSGO, and only two percent in response to SOX.

-- Insert Table 2 Here --

### **Boards, Codes and Demographic Relationships**

Standard parametric statistical analyses appropriate for mixed scale and categorical response data were then performed (Pearson correlations, ANOVA tests). Tables 3 and 4 summarize some of the statistically significant relationships among the variables that were found.

-- Insert Tables 3 & 4 Here --

As readily expected, there were significant correlations between gross revenues and: (a) business age, with older businesses having greater revenues; (b) type of ownership structure, where smaller revenue businesses were most associated with a family owned and managed structure; and (c) the number of generations active in the business, with predominantly first generation firms having smaller gross revenues. While some additional relationships among the demographic variables were suggestive, none were statistically significant.

Notably few significant relationships between the use of a formal board of directors and the demographic variables were found. The presence of a formal board and size of the business in terms of both number of employees and in terms of gross revenues were positively correlated ( $p \leq .01$  respectively). No other significant relationships were found between the presence of a formal board and business age, ownership/management structure, and number of generations involved. This finding suggests that at least in this sample the utilization or relative lack of utilization, of formal boards and associated practices effectively spans the gamut of firms.

### **The Use of Written and Unwritten Codes**

We found no significant correlation between the presence of a written code and business age, size in terms of employees, or number of generations. Business revenues and written codes were positively correlated ( $p \leq .05$ ). With this single exception, codes, like boards, were generally either absent or present across a broad array of businesses in this sample. There was a strong but not significant correlation between whether a family business had a written code of ethics and whether it also had a formal board of directors ( $p \leq .12$ ). However, there was a significant relationship between whether a business had a code of ethics and whether its board meets regularly ( $p \leq 0.01$ ) and the number of independent directors on the board ( $p \leq .05$ ). While the lack of a significant correlation between written code and board presence is intriguing, the associated board practices of meeting regularly and having independent directors suggests a strong positive relationship among governance practices, at least for larger family businesses.

As noted in Table 2, a surprising 40 percent of respondents reported that they developed their written codes by themselves, and 39 percent had used an outside professional to help them. Only 11 percent reported their spouse, a previous generation, or “other” person had developed their code. The founders or leaders apparently take it upon themselves to initiate and deliver at least a draft for consideration by the family, but the data clearly suggests that code development is not a widely-participative or collaborative task. We could not determine what type of professionals were involved from the survey data, but several conversations with family businesses close to the two centers conducting the research indicate that process consultants and lawyers have tended to be most widely used.

When no written code existed, as was the case for 46 percent of the sample, we asked whether there were specific ethical values or expectations regarding family member or employee behavior that were still understood and accepted. Ninety-four percent responded that they did believe they had specific unwritten ethical values and expectations that were understood and accepted. Table 5 summarizes in rank order the major values or beliefs provided as examples. Even when codes are not formally expressed, family business owners assume their values are known in the family and business.

-- Insert Table 5 Here --

### **Code Compliance Practices**

When asked how their codes were communicated, 27 percent reported that they were verbally communicated, 25 percent said they were communicated both verbally and in writing, 12 percent

have them formally written, and 34 percent formally expressed their written codes in employee training and/or orientation sessions. We used this variable as a measure of how highly developed compliance practices were among sample businesses. Sample businesses were viewed as increasingly compliant as their codes became less verbally communicated and more formally communicated in writing with their actual application in training and orientation classes for employees.

We found significant correlations between the two board practices – regular meetings and number of independent directors – and formalized code communication ( $p \leq .05$  and  $p \leq .01$  respectively). In addition, code communication and business size in terms of number of employees and gross revenues were both strongly correlated (both  $p \leq .01$ ). There was a clear pattern of the larger family businesses adopting code compliance practices that would objectively be considered acceptable to regulators.

Respondents were also asked if there were important opportunities or situations where they have relied on, referred to, or directly used their ethics and values codes, whether written or unwritten. While 38 percent chose not to answer this “yes” or “no” question, of those that did, more than 97 percent answered that they had done so in a variety of situations, most related to regulating specific types of employee behavior.

From an ethics compliance process perspective, it is interesting that over a quarter of respondents only verbally communicated their codes, yet 97 percent operationally used them. How much consensus there is across employees about the exact nature and meaning of those codes would be interesting to explore, since low consensus could obviously create undesirable outcomes when employees were held to those standards. In addition, verbally communicated codes do not meet the regulatory expectations set in either SOX or FSGO.

Finally, it was even more interesting that responses clearly indicated that only very small percentages of family businesses had responded to either SOX or FSGO regulations – only two percent and six percent of all those in the sample respectively. These results are actually not surprising given the very early stage of development of these regulatory trends toward private sector application.

## **SURVEY IMPLICATIONS**

Several important issues are raised by these results. In many respects, the results are initially disconcerting. We would have hoped, for example, that larger numbers of family businesses would have adopted such widely advocated governance practices as the use of written codes and formal boards of directors that met regularly and had at least some degree of independence. Family business researchers, consultants, and professionals have been calling for the adoption of such governance practices for years (Robinson 1982; Schwartz and Barnes 1991).

While these practices are generally found most frequently within the larger family businesses in this study, the overall use percentages -- 57 percent for formal boards and 54 percent for written codes -- indicate an undesirable level of utilization across the entire spectrum of sample businesses. This could be seen as a question of whether the glass is half empty or half full, since

these are still relatively large percentages. However, the increasingly stringent regulatory environment facing private businesses suggests a need for much more intensified work by family business leaders and the professionals serving them to meet these rapidly evolving expectations.

Nor does the presence of such practices actually say anything about their actual effectiveness in use. We did not try to directly assess ethical practices effectiveness, although past research regarding several such family business practices, including the use of boards, has indicated a positive relationship with competitive performance (e.g., McCann, Leon-Guerrero, and Haley 2001). We know from this research that significant percentages of family businesses are utilizing boards, although their independence is in question, judging from the limited number of independent directors utilized. There are a number of useful resources, including books and articles, about how to construct and manage effective boards of directors for family businesses (Aronoff and Ward 1996; Ward 1992; Ward and Handy 1988).

### **Creating Effective Compliance Processes – the Missing Element**

Many of the governance practices revealed in this research would not satisfy the growing demands of the regulatory and business stakeholders expecting well-defined and executed compliance practices. The family businesses in this study have developed codes and applied them in a variety of forms within a variety of situations. While many of them are utilizing effective compliance methods judging from the way they are communicating their codes, the larger pattern reveals uneven use in terms of their explicitness and the ways they are communicated and applied.

The widely varying practices revealed in this study mean that a significant percentage of family businesses may be criticized for unprofessional governance practices, finding them selves paying higher costs for insurance or accessing capital. At an extreme, it may mean being unnecessarily exposed to legal liability in cases covered by regulations. There are, of course, also the very important cultural reasons why codes are important to family businesses, as noted at the opening of this paper.

We found numerous references about how family businesses can professionalize their practices (Dyer 1989; Flamholtz 1990), but little in the family business literature about the compliance process or implementation stage of family business codes. For example, one of the most widely referenced resources on writing a code is that by Aronoff, Astrachan, and Ward (1998). While these authors very effectively focus on the code development stage, they leave off without focusing on the equally important implementation stage in which compliance process issues are addressed. Compliance processes need more active attention, and the specific elements of effective compliance processes consistent with both SOX and FSGO guidelines are described in Table 6 and Table 7.

-- Insert Tables 6 & 7 Here --

For the smaller family business these guidelines can represent formidable obstacles; a tremendous amount of time, effort, and even expense could be involved in assuring an effective compliance process. Smaller businesses will and, judging from the relatively high percentages

without codes in this study, have made trade-offs of benefits against implementation costs. The family businesses with written codes which are already communicating them in training and orientation sessions very likely appreciate the importance of codes for their impact on their business cultures and work practices, and there is now the added benefit of being much better prepared for regulatory reasons. As business scholars and professionals, we must continue to stress such practices at every opportunity when working with family businesses. Our work is far from complete in this regard.

**Table 1\***  
**Demographic Characteristics**  
**(N = 167)**

|   | <i>n</i> | <i>%</i> |                                       | <i>n</i> | <i>%</i> |
|---|----------|----------|---------------------------------------|----------|----------|
| <b>State</b>  |          |          | <b>Number of Employees</b>            |          |          |
| Washington  | 110      | 65.9     | 0-25                                  | 71       | 43.8     |
| Florida   | 57       | 34.1     | 26-50                                 | 18       | 11.1     |
|   |          |          | 51-100                                | 23       | 14.2     |
|   |          |          | 101-250                               | 24       | 14.8     |
|   |          |          | 250 +                                 | 26       | 16.0     |
| <b>2003 Gross Revenues</b>                                      |          |          | <b>Age of Business</b>                |          |          |
| < \$5 M   | 75       | 46.3     | < 10 yrs.                             | 14       | 8.4      |
| \$5 – 10 M  | 25       | 15.4     | 11 – 25 yrs.                          | 38       | 22.9     |
| \$10 – 50 M   | 32       | 19.8     | 26 – 50 yrs.                          | 50       | 30.1     |
| \$50 – 100 M  | 14       | 8.6      | 50 – 75 yrs.                          | 33       | 19.9     |
| > \$100 M   | 16       | 9.9      | > 75 yrs.                             | 31       | 18.7     |
| <b>Ownership/Management Type</b>                                |          |          |                                       |          |          |
| Fam. Owned & Mgd.   | 141      | 84.9     |                                       |          |          |
| Fam. Owned & Non-Family Mgd.                                    | 12       | 7.2      |                                       |          |          |
| Comb. Fam. & Pub. Owned & Fam. Mgd.                             | 10       | 6.0      |                                       |          |          |
| Comb. Fam. & Pub. & Non-Fam. Mgd.                               | 3        | 1.8      |                                       |          |          |
| Publicly Owned & Fam. Mgd.                                      | 0        | 0        |                                       |          |          |
| <b>Number of Generations Currently Involved in the Business</b> |          |          |                                       |          |          |
| 1   | 32       | 19.4     |                                       |          |          |
| 2   | 100      | 60.6     |                                       |          |          |
| 3   | 32       | 19.4     |                                       |          |          |
| 4   | 1        | .6       |                                       |          |          |
|   |          |          | <b>Primary Nature of the Business</b> |          |          |
| Retail  | 45       | 26.9     | Tourism/Ent                           | 5        | 3.0      |
| Manufacturing   | 26       | 15.6     | Restaurant                            | 8        | 4.8      |
| Wholesale and Dist.   | 18       | 10.8     | Services                              | 24       | 14.4     |
| Engineering   | 1        | .6       | Computer Software/Hardware Dev.       | 3        | 1.8      |
| Construction  | 14       | 8.4      | Real Estate                           | 11       | 6.6      |
| Agricultural  | 7        | 4.2      | Other                                 | 4        | 2.4      |

\* Category totals less than n=167 reflect missing data.

**Table 2\***  
**Summary of Survey Results**

|   | <i>n</i> | <i>%</i> |   | <i>n</i> | <i>%</i> |
|---|----------|----------|---|----------|----------|
| <b>Have a written code</b>  |          |          | <b>Aware of or changed code due to FSGO</b>     |          |          |
| Yes   | 87       | 53.7     | Yes   | 9        | 5.5      |
| No  | 75       | 46.3     | No  | 154      | 94.5     |
| <b>If yes, written code applies to:</b>   |          |          | <b>Aware of or changed code due to SOX</b>      |          |          |
| Family Only   | 1        | 1.1      | Yes   | 3        | 1.9      |
| Business Only   | 37       | 40.2     | No  | 153      | 98.1     |
| Both  | 54       | 58.7     |   |          |          |
| <b>If yes, who developed code?</b>  |          |          | <b>Have a formal board</b>                      |          |          |
| By Myself   | 36       | 40.4     | Yes   | 93       | 56.7     |
| With Spouse   | 3        | 3.4      | No  | 71       | 43.3     |
| With Parents and/or children  | 9        | 10.1     |   |          |          |
| By previous gen.  | 5        | 5.6      | <b>Board meets regularly</b>                    |          |          |
| With profess'l. help  | 35       | 39.3     | Yes   | 71       | 63.4     |
| Other   | 1        | 1.1      | No  | 41       | 36.6     |
| <b>If no written code, are there values, etc. that you believe are understood &amp; accepted?</b>                           |          |          |   |          |          |
| Yes   | 92       | 93.9     |   |          |          |
| No  | 6        | 6.1      |   |          |          |
| <b>Are there important situations where you have relied upon or utilized formal or unwritten ethics, values or beliefs?</b> |          |          | <b>No. Independent Non-Family Board Members</b> |          |          |
| Yes   | 101      | 97.1     | 0   | 75       | 68.8     |
| No  | 3        | 2.9      | 1   | 10       | 9.2      |
|   |          |          | 2   | 9        | 8.3      |
|   |          |          | 3   | 9        | 8.3      |
|   |          |          | 4   | 1        | .9       |
|   |          |          | 5   | 2        | 1.8      |
|   |          |          | 6   | 2        | 1.8      |
|   |          |          | All   | 1        | .9       |
| <b>How are codes introduced to employees and other family members?</b>  |          |          |   |          |          |
| Do not have   | 3        | 0        |   |          |          |
| Only verbally communicated  | 45       | 27.4     |   |          |          |
| Both verbally and written   | 41       | 25.0     |   |          |          |
| Formally expressed in written manuals   | 20       | 12.2     |   |          |          |
| Both formally and introduced in all training programs   | 55       | 33.5     |   |          |          |

\* Category totals less than n=167 reflect missing data.

**Table 3**  
**Pearson Correlations**

|  | 1       | 2     | 3      | 4       | 5      | 6     | 7      | 8      | 9     | 10    |
|--|---------|-------|--------|---------|--------|-------|--------|--------|-------|-------|
| <b>1</b> Business has Written Code                   |         |       |        |         |        |       |        |        |       |       |
| <b>2</b> Code Applies to                             | -.088   |       |        |         |        |       |        |        |       |       |
| <b>3</b> How Code is Communicated                    | -.506** | .212* |        |         |        |       |        |        |       |       |
| <b>4</b> Presence of Formal Board                    | .121    | -.137 | -.053  |         |        |       |        |        |       |       |
| <b>5</b> No. of Independent Non-family Board Members | -.227*  | .071  | .257** | -.150   |        |       |        |        |       |       |
| <b>6</b> Board Meets Regularly                       | .265**  | .094  | -.186  | .467**  | -.173  |       |        |        |       |       |
| <b>7</b> No. of Full-time Employees                  | -.120   | -.102 | .240** | -.246** | .354** | -.134 |        |        |       |       |
| <b>8</b> 2003 Gross Revenues                         | -.195*  | -.139 | .213** | -.216** | .312** | -.066 | .811** |        |       |       |
| <b>9</b> Business Age                                | .068    | -.075 | -.077  | -.080   | .075   | -.101 | .333** | .355** |       |       |
| <b>10</b> No. of Family Generations Involved         | -.129   | -.125 | -.004  | .041    | .032   | -.058 | -.012  | -.008  | .098  |       |
| <b>11</b> Ownership Structure                        | -.073   | -.063 | .083   | -.090   | .320** | -.157 | .141   | .165*  | -.047 | -.080 |

\* p < .05      \*\* p < .01

**Table 4**  
**ANOVA Relationships with “How Code is Communicated”**

| <b>Variable</b>                        | <b>F</b> | <b>Significance</b> |
|--|----------|---------------------|
| 1. Business has Written Code           | 54.133   | .000                |
| 2. Code Applies to                     | 3.743    | .027                |
| 4. Presence of Formal Board            | 3.900    | .051                |
| 5. No. of Independent Directors        | 2.680    | .014                |
| 6. Board Meets Regularly               | 3.917    | .051                |
| 7. No. of Full-time Employees          | 2.600    | .038                |
| 8. 2003 Gross Revenues                 | 2.150    | .078                |
| 9. Business Age                        | .650     | .630                |
| 10. No. of Family Generations Involved | .530     | .663                |
| 11. Ownership Structure                | .680     | .568                |

**Table 5**  
**Major Values/Beliefs of Importance to Family and Business**

| <b>Rank Order of Values/Beliefs Listed</b>                         | <b>Number of Times Cited</b> |
|--|------------------------------|
| Honesty  | 60                           |
| Respect for others   | 40                           |
| Interpersonal behavior attributes (how one gets along with others) | 31                           |
| Integrity  | 31                           |
| Fair   | 27                           |
| Customer focus   | 24                           |
| Employee focus   | 20                           |
| Quality/excellence in product/service                              | 18                           |
| Don't lie, cheat, or steal   | 18                           |
| Golden Rule  | 14                           |
| Work ethic   | 13                           |
| Family focus   | 11                           |
| High ethical standards   | 10                           |
| Community service  | 9                            |
| Professionalism  | 7                            |
| Family sets example  | 7                            |
| Language standards (no profanity, etc.)                            | 6                            |

**Table 6**  
**Seven Elements of an Effective Compliance System**

1. Establish policies, plus procedures to achieve them (written codes, etc.).
2. Assign specific high-level person to be responsible and accountable for them.
3. Use care in delegating authority to appropriate person of high integrity.
4. Communicate them through training programs, publications, etc.
5. Utilize monitoring and auditing systems to detect illegal conduct and encourage reporting of criminal activity (audits, hotlines, etc.).
6. Consistently and quickly enforce the standards through discipline of offenders.
7. Respond quickly to offenses – take steps to prevent further similar offenses and modify the codes and policies as necessary.

Source: U.S. Sentencing Guidelines from <http://www.ussc.gov/2003guid/2003guid.pdf>

**Table 7**  
**Practical Advice for Implementation and Compliance**

1. Don't Just Print, Post and Pray:
  - Thoughtful and effective codes provide guidance for making ethical business decisions.
  - Must be actual living documents encouraged and valued at the highest levels.
  - High-level executives need to model behavior and not tolerate exceptions.
  - Publicly restate code and publish it every year in the annual report.
2. Have a committee of independent non-executive directors on the Board who are responsible for code compliance
3. Staff training – at least annually
4. Evaluate ethics procedures
5. Establish “hot line” or “help line” for employees seeking guidance or facing unethical conduct
6. Publicly commit to being an ethical organization:
  - Be open about ethical standards and conduct
  - Post vision, values and codes of conduct on Web site for public viewing
  - All company board members, legal and accounting firms should sign the code and pledge support
7. Managing by Walking Around (MBWA) is good way for managers and supervisors to clearly and consistently communicate their ethical expectations and requirements.
8. Let employees know how they are doing regarding supporting the organization's mission, vision and ethical goals.
9. Build ethical conduct into the firm's systems -- Provide employees and customers with a written code of ethics and values
10. Share how the code applies to particular cases and actions Measure success – simple systems to measure the effectiveness of ethics initiative
11. Determine if employees are living the code -- reward those who do, remove those who don't
12. Keep the lines of communication open:
  - Ask questions to identify pitfalls before they occur.
  - Communicate openly and honestly.
  - Talk with employees at all levels...often!

Source: Ethics Resource Center, October 2003. “Ten Things Your Company Can Do to Avoid Being the Next Enron.”

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## Appendix 1

# 2004 Survey of Ethics, Conduct and Values in Florida Family Businesses

The Florida Family Business Program at The University of Tampa invites you to participate in this survey of ethics, conduct, and values in family businesses. Please respond by June 25, 2004. For your convenience, a prepaid, addressed envelope is enclosed. If you choose, please attach any written codes of ethics, conduct, and values you believe may be of value in this research. If you have any questions or comments, please contact Wendy Plant at 813-253-6221, ext. 3782 or wplant@ut.edu. Thank you!

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1. Do you consider your firm to be a family business?  Yes.  No.  
If no, please stop here and return the survey. Thank you for participating.
2. Does your family business have a written code of ethics, conduct or values statement?  Yes.  No.  
If no, please skip to question # 5.
3. If yes, is the written code of ethics, conduct, or values statement meant to apply to:  
 Family only.  Business only.  Both family and business.
4. If yes, who developed the written code of ethics, conduct, or values statement? Check the one(s) that best applies.
  - a.  Developed by myself
  - b.  Developed with spouse
  - c.  Developed with parents and/or children
  - d.  Developed by previous generation
  - e.  Developed with help of outside professionals (accountant, lawyer, consultant)
5. If you do not have a written code or statement, are there specific ethical values or expectations regarding family member or employee behavior that you still believe to be clearly understood and accepted?  
 Yes.  No
6. Whether or not you have written statements, please list below some of the unwritten ethical values, conduct, or expectations that you think are most important and valuable to your family and business?  

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7. How have you communicated these ethical, conduct, and values expectations, whether written or unwritten, to employees and other family members not involved in their development?
  - a.  Do not have
  - b.  Only verbally communicated
  - c.  Both verbally communicated and written (e.g., vision mission statements)
  - d.  Formally expressed in writing (e.g., policy/procedures manuals)
  - e.  Both formally expressed and introduced in areas such as training programs and orientations

8. Are there important opportunities or situations where you have relied upon, referred to, or directly used your ethics and values, whether formal or unwritten? If yes, please provide a brief example (or attach additional pages):
- 
- 
- 
9. Have you become aware of and changed your code of ethics due to requirements in the *Federal Sentencing Guidelines for Organizations*? \_\_\_\_\_ Yes. \_\_\_\_\_ No.
10. Have you changed your code of ethics due to the *Sarbanes Oxley Act*? \_\_\_\_\_ Yes. \_\_\_\_\_ No.
11. Do you have a formal board of directors? \_\_\_\_\_ Yes. \_\_\_\_\_ No.  
If no, please skip to #14.
12. How many independent non-family members are on the board of directors? \_\_\_\_\_
13. Does the board meet regularly? \_\_\_\_\_ Yes. \_\_\_\_\_ No.
14. Approximately how many full-time employees are in your firm?
- |                           |                                  |
|---------------------------|----------------------------------|
| a. _____ 0 - 25 employees | d. _____ 101-250 employees       |
| b. _____ 26-50 employees  | e. _____ more than 250 employees |
| c. _____ 51-100 employees |                                  |
15. What were your 2003 gross revenues? (As with all data, this is confidential.)
- |                            |                             |
|----------------------------|-----------------------------|
| a. _____ Below \$5 million | d. _____ \$50-\$100 million |
| b. _____ \$5-\$10 million  | e. _____ Over \$100 million |
| c. _____ \$10-\$50 million |                             |
16. How recently was your family business established?
- |                                 |                                 |
|---------------------------------|---------------------------------|
| a. _____ Less than 10 years ago | d. _____ 50-75 years ago        |
| b. _____ 11-25 years ago        | e. _____ More than 75 years ago |
| c. _____ 26-50 years ago        |                                 |
17. How would you best characterize your family business ownership and management?
- |  |
|--|
| a. _____ Family owned and managed  |
| b. _____ Family owned and non-family managed                                 |
| c. _____ A combination of family and other ownership, and family managed     |
| d. _____ A combination of family and other ownership, and non-family managed |
| e. _____ Family managed but not owned by the family                          |
18. How many family generations are actively involved in the business at present? \_\_\_\_\_
19. What is the primary nature of your business?
- Retail
  - Manufacturing
  - Transportation/Distribution
  - Engineering
  - Construction
  - Agricultural Production
  - Tourism/Entertainment
  - Restaurant Industry
  - Professional Services
  - Technology/Communications
  - Health Care Services
  - Other \_\_\_\_\_

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Would you like to receive a summary of the results of this survey? \_\_\_\_\_ Yes. \_\_\_\_\_ No.

May the research results list your firm as participators in this study? (Your responses will not be personally identifiable.). \_\_\_\_\_ Yes. \_\_\_\_\_ No.

If you answered “yes” to either (or both), please provide contact information:

Name \_\_\_\_\_

Company \_\_\_\_\_

Address \_\_\_\_\_

Please return this survey and any attachments to: Wendy Plant, Family Business Program, The University of Tampa, 401 W. Kennedy Blvd., Tampa, FL 33606 or Fax to 813-258-7236. Thank you!

**THE ROLE OF INTELLECTUAL CAPITAL IN  
OPPORTUNITY RECOGNITION OF ENTREPRENEURS**

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# THE ROLE OF INTELLECTUAL CAPITAL IN OPPORTUNITY RECOGNITION OF ENTREPRENEURS

## Abstract

The study hypothesizes that intellectual capital of entrepreneurs enhances their opportunity recognition. The study investigated the population of metal- and ICT-ventures established in 1998 in three regions of Finland. The results of the study illustrated, first, that knowledge acquisition in opportunity recognition requires formal knowledge of a particular domain. Second, the results revealed that formal knowledge increases competitive scanning in opportunity recognition. Third, the results indicated that proactive searching in opportunity recognition is enhanced by prior management experiences, intrinsic motivation, and creativity of entrepreneurs. Fourth, innovative behavior in opportunity recognition needs strong intrinsic motivation, since it is internal, mental playing with ideas. In addition, management experience decreases innovative behavior. Last, management experience hindered collective action in opportunity recognition.

## 1. Introduction

Entrepreneurship has been defined at least as ownership of firms (Cuevas 1994), management of small businesses (Scott and Bruce 1987), innovativeness (Schumpeter 1934), networking (Larson and Starr 1993), organizing (Johannisson 1988), and making ideas work although the needed resources are not controlled (Stevenson and Jarillo 1990). One of the central definitions is presented by Kirzner (1979, 1981, 1997), who claims that entrepreneurship is about alertly recognizing and exploiting opportunities. Entrepreneurship is then a process of creating new businesses, in which an opportunity is recognized and then turned into a form in which it creates economic value by using own and others' resources and personal relations (see Bygrave and Hofer 1991; Gartner, Bird and Starr 1992; Christensen, Madsen and Peterson 1994; Muzyka, de Koning and Churchill 1997). Several recent studies have proposed that the focus of academic interest in entrepreneurship should be specifically in studying op-

portunity recognition and realization (e.g. Shane and Venkataraman 2000; Sarasvathy 2001; Dew, Velamuri and Venkataraman 2003; Davidsson 2003).

Shane and Venkataraman (2000) have argued that opportunity recognition is about creating new means-ends relationships between goods, services, raw materials, and organizing methods. Sarasvathy (2001) has put forward that in opportunity recognition is merely question of creating imaginatively various possible end-results based on given means. Thus, if opportunity recognition is seen as an artifact of problem solving, so the artifact is not possible to logically deduce because the “information space” is so complex that the best possible decision is impossible to “calculate” (see Mayer 1992). Opportunity recognition is like creating a game at the same time that you are playing it (as children’s games many times are) instead of trying to play the familiar game more efficiently (see Sarasvathy 2001). Thus, an opportunity is not an end-result of a logical process but merely a conglomeration of fragments that will have to be made sense of while the situation is developing. This implies that opportunity recognition is about creating a sketch or a rough illustration of the way a business is going to be created (see also Vesper 1991).

Based on the studies of opportunity recognition it is possible to see that certain intellectual capabilities characterize those entrepreneurs who are able to recognize opportunities (Christensen et al. 1994; Hills 1995; de Koning and Muzyka 1996; Hills and Shrader 1998; Erikson 2002; Baron and Ensley 2003; Davidsson and Honig 2003; Sternberg 2003; Ucbasaran, Westhead and Wright 2003). These entrepreneurs have experience-based skills in the domain where they work, their formal knowledge of the area is often high, they have previous entrepreneurial/managerial experience, their intrinsic motivation pulls them to seek opportunities, and they are able to creatively question the present business situation. Like Davidsson and Honig (2003) have argued entrepreneurs involve their intellectual capital in opportunity recognition in order to be able to create imaginary end-results, i.e. opportunities (see also Sarasvathy 2001).

The research on opportunity recognition is still in its infancy (Chandler, DeTienne and Lyon 2003) although it has been seen as one of the main activities involved in entrepreneurship (Gaglio and Katz 2001). Especially empirical studies are needed to develop the knowledge of the phenomenon (see Davidsson 2003). On the other hand, opportunity recognition is often seen as one-dimensional concept, although recent studies have shown that it consists of several distinct lines of behavior (Davidsson and Honig 2003; Delmar and Shane 2004). This has caused that we do not know how intellectual capital affects the different dimensions, i.e. different behaviors involved in opportunity recognition. In addition, intellectual capital has been often seen in opportunity recognition consisting of only domain knowledge, formal knowledge, and entrepreneurial/management experience (e.g. Davidsson and Honig 2003). Present study proposes that this is too narrow view and it neglects recent developments in the research on intellectual capital specifically. Sveiby (1998) and Rastogi (2000), for example, stress that the concept should besides knowledge include also motivation and creativity because these have been noticed to be important vehicles of processing the knowledge. Based on the above argumentation, the study examines how intellectual capital of entrepreneurs affects their different behaviors involved in opportunity recognition. This study proceeds so that it is presented first the theoretical background, second hypotheses, third the used methodology, fourth the results, and last conclusions of the study.

## **2. Theoretical Background of the Study**

Becker (1975) in his seminal study on human capital suggested that human capital strongly affects quality of behavior in business life. He defined human capital as consisting of experience-based and formal knowledge. Gimeno, Folta, Cooper and Woo (1997) widened this to embrace entrepreneurs as well. Sveiby (1998) and Rastogi (2000) changed the term and used instead of human capital the term intellectual capital because it more clearly shows that it is a question of cognitive, learned (and learn-

able) capabilities. Sveiby (1998) and Rastogi (2000) also pointed out that motivation and creativity should be parts of the concept because cognitive human information processing consists of besides knowledge storing also knowledge aiming and knowledge interpreting and re-interpreting.

Cooper (1981) stressed the importance of knowledge of the domain to be one of the main factors affecting opportunity recognition. The domain-specific experience is important in order to be able to alertly scan the market and find gaps that could be filled (see Kirzner 1979). Without the domain knowledge it is very difficult to interpret the information cues in the industry because the information processing of entrepreneurs is tied to existing knowledge structures, e.g. domain knowledge (Manimala 1992; Shane and Venkataraman 2000). Former experiences and knowledge of the area are required to see opportunities that others do not recognize (Kaish and Gilad 1991). The domain knowledge is needed to scan relevant information, give it appropriate meaning, and make good judgments based on it. Human beings do not just perceive information, interpret it, and act based on it as rationally as possible but are guided by the knowledge they already have acquired in their processes of perceiving, interpreting, and acting (e.g. Woo, Folta and Cooper 1992; de Koning and Muzyka 1996). Thus, less experienced entrepreneurs might miss relevant information, understand poorly what they perceive, and make decisions and actions that are unwise.

Cooper (1981) was the first to suggest that formal knowledge would help to use domain specific experience. Formal knowledge creates knowledge structures that do not have to be learned by trial and error but by education and training. It is suggested here that formal education and training are needed because this type of more general knowledge gives capabilities to examine issues in their entity. Experience-based knowledge as the only knowledge type could cause entrepreneurs to have a narrow view, which could sometimes be even dangerous because it might create biases and errors in thinking of entrepreneurs (Baron 1997, 1998; Zietsma 1999).

This is also argued by Shane and Venkataraman (2000), who proposed that two factors influence opportunity recognition: (1) the information an entrepreneur possesses, and (2) his/her cognitive capabilities. Here it is proposed that these are developed by the interaction of formal knowledge and domain knowledge. The importance of formal knowledge in the creation of excellence is clearly verified in the studies of expert problem solving (see Mayer 1992). First, every individual has a certain stock of information, and this information has an impact on behavior of a person, and also on opportunity recognition (Shane and Venkataraman 2000). Furthermore, such prior information is stored as mental schema to our minds, and these are like "road-maps" guiding our thinking, behaving, and discovering. This information we possess could be knowledge of cheap raw material, the latest research results of digital communication, values of customers, etc. Second, every individual processes information differently. Some are able to connect many kinds of old and new pieces of information into a new value-adding opportunity. What is here suggested is that this second ability is mostly in the form of formal knowledge and achieved through formal education.

The study done by Muzyka, Birley and Leleux. (1996) revealed that in venture creation investors appreciate leadership potential of the lead entrepreneur and the management team, industry experience, and track record of the leading entrepreneur and the management team. Birley, Muzyka and Hay (1999) indicated that investors trust management competencies of a leading entrepreneur and a team to hold in any investment opportunity. Furthermore, the authors stress that the leader capabilities of an entrepreneur are important to investors, i.e., the skills to build a team, inspire others, manage the winds of change, and think strategically of the whole business situation. Thus, it could be seen that entrepreneurial management skills are important in opportunity recognition.

Intrinsic motivation is in many studies seen to be an important inspiring factor in opportunity recognition. Cooper (1981) stressed that motivation makes skills, knowledge, and perceptions work together so that they are made use of in opportunity search. Without intrinsic motivation it could happen

that, although entrepreneurs were experienced and their expertise was high, success make them satisfied with the situation (Kaish and Gilad 1991). Thus, despite being skilled they are not any more internally motivated to search for opportunities. Sigrist (1999) claimed that an entrepreneur's own personal line is crucial. By this she means that subjective principles, ideas, and style of an entrepreneur lead him/her to create a unique kind of a venture. This underlines the importance of intrinsic motivation in the form of a personal way to do things. She also found that inner strength is needed in order to achieve goals because often entrepreneurs do not get enough social support. Thus, an entrepreneur must have a very strong intrinsic need to search for an opportunity and confidence to go on even though some might advise him/her not to. The above argues the motivational aspects to be powerful in opportunity recognition.

Gilad (1984) was the first to suggest opportunity recognition to happen due to creativity of entrepreneurs. His point of view is based on Kirzner's (see e.g. 1979) idea that entrepreneurs are more alert to opportunities in the market than others. Gilad (1984) sees that others than entrepreneurs overlook possibilities to establish a new business. The ability to discover inconsistencies by linking information cues requires creativity. Creativity in his case could be understood as seeing of links between many types of information and finding a solution that does not exist yet. Thus, creativity in opportunity recognition is not about routinely searching for the best solution from solutions that already exist – *"it is non programmable, non standardized, and unpredictable insight about the true nature of reality"* (Gilad 1984).

### 3. Hypotheses of the Study

#### **Hypotheses 1a–1e: Effects of Intellectual Capital of Entrepreneurs on Knowledge Acquisition in Opportunity Recognition**

Woo et al. (1992) indicated that lack of domain knowledge created cognitive barriers preventing the knowledge acquisition (see also Mayer 1992; Baron 1998). Shane and Venkataraman (2000) underlined as well the importance of domain knowledge in order to be able to acquire knowledge. De Koning and Muzyka (1996) studied the behavior of entrepreneurs who had been successful in finding several opportunities. What was illuminating was that entrepreneurs with domain knowledge knew how to acquire knowledge and what kind of knowledge they need. In addition, Hills and Lumpkin (1997) and Hills, Lumpkin and Singh (1997) indicated that entrepreneurs who had domain knowledge of the industry actively seek new knowledge. Gaglio and Taub (1992) showed in their experiment where entrepreneurs were asked to develop opportunities based on the data the researchers gave them that entrepreneurs were not willing to do that because they did not have real domain knowledge of the area. Thus, the following hypothesis is presented: **H1a:** The higher the domain knowledge of entrepreneurs, the more intense is their knowledge acquisition in opportunity recognition.

Cooper (1981) already considered formal knowledge to interact with domain knowledge in knowledge acquisition. Gaglio and Taub (1992) indicated that entrepreneurs used formal skills to make sense of the situation. This is supported by the study by Woo et al. (1992). Bhave (1994) also pointed out that formal knowledge motivates entrepreneurs to search the needed knowledge. Last, Sigrist (1999) illustrated how entrepreneurs used their formal knowledge to manage and control the knowledge acquisition of domain knowledge. This suggests that formal knowledge provides the frames and aim for knowledge acquisition. **H1b:** The higher the formal knowledge of entrepreneurs, the more intense is their knowledge acquisition in opportunity recognition.

Hills (1995) found that entrepreneurial/managerial experiences enhanced knowledge acquisition. De Koning and Muzyka (1996) pointed out as well that entrepreneurs who had prior experience in entrepreneurship and/or management acquired knowledge more frequently. In addition, Hills et al. (1997) and Hills and Shrader (1998) illustrated that entrepreneurs with prior entrepreneurial/managerial experience search actively new knowledge of opportunities. **H1c:** The higher the management experience of entrepreneurs, the more intense is their knowledge acquisition in opportunity recognition.

Kaish and Gilad (1991) suggested that entrepreneurs who achieved success lost their motivation to search new opportunities. Herron and Sapienza (1992) noticed that intrinsic motivation has a very important role in the knowledge acquisition of opportunities. They proposed that only after entrepreneurs are motivated to change their lives somehow and search for opportunities for their own business does knowledge acquisition start. Sigrist (1999) also stressed that intrinsic motivation "kicks" entrepreneurs to search opportunities. Drucker (1998), who has studied the sources of opportunities, has stated that entrepreneurs need full commitment to entrepreneurship before the gap finding is possible. Manimala (1992, 1996) illustrated how high-innovative entrepreneurs spent more time continuously searching for new opportunities, and what was important they were intrinsically motivated to do that. The study by Hills (1995) also revealed that knowledge acquisition was activated by the intrinsic need to find a business. **H1d:** The higher the intrinsic motivation of entrepreneurs, the more intense is their knowledge acquisition in opportunity recognition.

Gilad (1984) considered opportunity recognition to be creative behavior. He suggested that creativity is needed to acquire information and connect pieces of information to form a new opportunity. On the basis of this, it is argued that creativity enhances knowledge acquisition as it gives cognitive thinking tools to connect pieces of information that superficially look as if they do not have anything to do with each other into knowledge of an opportunity. Hills and Lumpkin (1997) illustrated how entrepreneurs spend quite a lot of time creatively thinking about the information they have received (see

also Hills et al. 1997; Hills and Shrader 1998). Hills, Shrader and Lumpkin (1999) go further and propose that opportunity recognition is inherently creativity of entrepreneurs. They see that in order for knowledge acquisition to happen creativity is needed. De Koning and Muzyka (1996) saw also that entrepreneurs used their creative capabilities to turn the complex information into the knowledge of the situation. **H1e:** The higher the creativity of entrepreneurs, the more intense is their knowledge acquisition in opportunity recognition.

### **Hypotheses 2a–2e: Effects of Intellectual Capital of Entrepreneurs on Competitive Scanning in Opportunity Recognition**

Long and McMullan (1985) found that entrepreneurs use their domain knowledge to scan the competitive arena. De Koning and Muzyka (1996) proposed that the experience of entrepreneurs made them actively scan the competitive environment in order to find gaps that are big enough for profitable business but not big enough to make big companies interested. Hills and Lumpkin (1997) propose that entrepreneurs see competitive scanning to be very important in opportunity recognition, and this to be affected by the level of domain knowledge. Christensen and Peterson (1990) suggested as well that domain knowledge is very important to able to understand markets and competitors in it. The above studies all propose that domain knowledge should increase competitive scanning. **H2a:** The higher the domain knowledge of entrepreneurs, the more intense is their competitive scanning in opportunity recognition.

Active competitive scanning of skilled entrepreneurs was noticed by Woo et al. (1992). Hills (1995) and Hills and Lumpkin (1997) have suggested that formal knowledge might affect competitive scanning positively. De Koning and Muzyka (1996) proposed as well that formal knowledge enhances competitive scanning. It is proposed that formal knowledge offers tools that could be used to analyze

more effectively the competitive arena. **H2b:** The higher the formal knowledge of entrepreneurs, the more intense is their competitive scanning in opportunity recognition.

Thakur (1999) proposed that management experience is needed in order to be able to scan the competitive arena. Hills et al. (1997) and Hills and Shrader (1998) also pointed out that prior experience of entrepreneurship and/or management is needed in competitive scanning. De Koning and Muzyka (1996), then, found that experienced entrepreneurs put a lot of effort into understanding markets. The positive effect of management experience on competitive scanning is also supported by the study by Christensen et al. (1994). **H2c:** The higher the management experience of entrepreneurs, the more intense is their competitive scanning in opportunity recognition.

Gaglio and Taub (1992) showed that entrepreneurs, who relied on their intrinsic motivation, put more effort into trying to understand competition. Manimala (1992) pointed out that intrinsically motivated high-innovative entrepreneurs scanned competition intensively. De Koning and Muzyka (1996) showed how entrepreneurs enjoyed the scanning of the competitive arena. This illustrates clearly how intrinsic motivation enhances competitive scanning. Hills and Lumpkin (1997) showed how entrepreneurs were internally eager to scan competition suggesting that intrinsic motivation would increase competitive scanning. **H2d:** The higher the intrinsic motivation of entrepreneurs, the more intense is their competitive scanning in opportunity recognition.

Hills et al. (1999) noticed that competitive scanning requires skills to creatively question the market situation. This is supported by Hills and Lumpkin (1997), Hills et al. (1997), and Hills and Shrader (1998), according to whom creativity plays an important role in searching for knowledge of a competitive arena and making competitive decisions. De Koning and Muzyka (1996) also pointed out that successful entrepreneurs use their creativity to find market niches. In addition, Sigrist (1999) and Shane and Venkataraman (2000) argue about the skills to link information into new solutions invisible to others, i.e. creativity to give possibilities of flexibly learning from customers, intuitively read market

dynamics, and impulsively react to situations. **H2e:** The higher the creativity of entrepreneurs, the more intense is their competitive scanning in opportunity recognition.

### **Hypotheses 3a–3e: Effects of Intellectual Capital of Entrepreneurs on Proactive Searching in Opportunity Recognition**

According to Cooper (1981), the knowledge of domain gives tools to search for future changes in a business environment. Peterson (1985), as well, underlined how experience is used to proactively position a venture in a business arena. Domain knowledge, thus, creates a kind of cognitive map, which could be used to build a vision of what will happen. It is probable that those who don't know the domain see the future just when it is already the reality. Hills (1995) also indicated this, suggesting that experience in the domain lead entrepreneurs rather to vision of what will happen than to what has happened. Rea et al. (1999) proposed that entrepreneurs construct visions of the future without exact information but merely on the basis of their experience. This is line with the study by Baron (1998), who revealed that entrepreneurs easily fix their eye on the future because their prior experiences advise them to do that. Regrets for past behavior are not leading anywhere. Last, the importance of domain knowledge is clearly shown by Martello (1994). He argues that opportunity recognition is serendipitous future scanning, in which previous experiences in the domain have a central role. **H3a:** The higher the domain knowledge of entrepreneurs, the more intense is their proactive searching in opportunity recognition.

Christensen and Peterson (1990) showed that what is needed besides domain knowledge is also general alertness, i.e. formal knowledge, to be capable to strategic thinking. This contains the idea that formal knowledge is needed to strategically see the future. Hills and Lumpkin (1997) found that entrepreneurs were able to transfer general opportunity recognition skills to different types of situations than

the domain they were familiar with. This also implies that more general skills to use knowledge are used to proactively search for future opportunities. Most importantly, Zietsma (1999) indicated that higher technical education significantly increased the likelihood of deliberate future scanning of opportunities. Herron and Sapienza (1992), as well, stress that formal skills affect positively proactive opportunity searching. **H3b:** The higher the formal knowledge of entrepreneurs, the more intense is their proactive searching in opportunity recognition.

Hills et al. (1997) and Hills and Shrader (1998) indicated that behavior that characterized opportunity recognition was proactive searching for future possibilities. What they also found was that these entrepreneurs had experience in entrepreneurship and management of ventures. This is supported by the study by de Koning and Muzyka (1996), in which they came to the conclusion that experienced entrepreneurs have a skill to vision the future. In addition, Kaish and Gilad (1991) showed how experienced entrepreneurs were able to interpret the information cues. **H3c:** The higher the management experience of entrepreneurs, the more intense is their proactive searching in opportunity recognition.

The study by Baron (1998) was interesting in respect of the motivational background of entrepreneurs searching for opportunities. It showed that entrepreneurs were intrinsically motivated to search for future opportunities. Entrepreneurs were not so much concerned with the past or even the present. Thus, intrinsic motivation for entrepreneurship turn they attention to the future and proactive behavior. Martello (1994) as well suggested that entrepreneurs are highly motivated to work in the field that interests them. At the same time they scan information cues in order to recognize future possibilities. Thus, intrinsic motivation pulls them to proactive searching, at the same time as they are working at other things in the field. In addition, based on the study by Hills (1995) it is possible to see how passionate interest in the domain makes entrepreneurs search for proactive ideas. **H3d:** The higher the intrinsic motivation of entrepreneurs, the more intense is their proactive searching in opportunity recognition.

According to Gilad (1984), creativity is the main cognitive vehicle of human beings in proactive behavior. Hills (1995) and Hills et al. (1999) also proposed that creativity enhances future scanning of opportunities. Christensen et al. (1994) put forward that capability to turn problems into possibilities is linked to the ability to strategically think of the future of the business. De Koning and Muzyka (1996) also suggested that creativity supports proactive behavior. **H3e:** The higher the creativity of entrepreneurs, the more intense is their proactive searching in opportunity recognition.

#### **Hypotheses 4a–4e: Effects of Intellectual Capital of Entrepreneurs on Innovative Behavior in Opportunity Recognition**

Hills (1995) showed that successful entrepreneurs, who were experienced in their field, created ideas actively. Further, Hills et al. (1999) argued that domain knowledge should increase innovative behavior. Manimala (1992, 1996), then, found that more innovative entrepreneur knew customers, dealers, supplier, and others dealing with the products and services in that industry better. Thus, domain knowledge enhanced innovative behavior. **H4a:** The higher the domain knowledge of entrepreneurs, the more intense is their innovative behavior in opportunity recognition.

Christensen and Peterson (1990) came to the conclusion that formal knowledge of a market or a technology might be the source of innovative venture ideas. This suggests that formal knowledge should support innovative behavior. Gaglio and Taub (1992) pointed out, when studying opportunity recognition of entrepreneurs and managers, that managers were more skilled innovators. This suggests that formal knowledge, which is arguably higher among managers, affects innovative behavior positively. Zietsma (1999) also found that both high-tech entrepreneurs (high formal knowledge) and managers (high formal knowledge) were good at innovating ideas. The reason for this might be as Shane and Venkataraman (2000) suggested that some are better at processing information than others. This

skill to process information is probably enhanced by formal education, which provides general thinking skills (see Mayer 1992). **H4b:** The wider the formal knowledge of entrepreneurs, the more intense is their innovative behavior in opportunity recognition.

Cooper (1981) stressed managerial experience to support innovative opportunity recognition. Thakur (1999) proposed that without managerial capabilities it would be difficult to create solutions that are useful and appropriate. Hills (1995), Hills et al. (1997), and Hills and Shrader (1998) studied entrepreneurs with prior entrepreneurial and/or managerial experience and found that they spend quite a lot of time playing with ideas. **H4c:** The wider the management experience of entrepreneurs, the more intense is their innovative behavior in opportunity recognition.

Gaglio and Taub (1992) noticed that entrepreneurs were intrinsically motivated in their innovative behavior. Manimala (1992) came to the conclusion that intrinsic motivation increased innovative behavior. The results reached by Hills (1995) suggested that internal motivation enhances innovative behavior. It is also interesting that internal motivation to work with other people enhances innovative behavior (Steyaert, Bowen and Van Looy 1996). **H4d:** The higher the intrinsic motivation of entrepreneurs, the more intense is their innovative behavior in opportunity recognition.

Gaglio and Taub (1992) proposed that entrepreneurs use their creativity to innovate ideas. Hills (1995) studied opportunity recognition of successful entrepreneurs and found out that they frequently try to innovate ideas. On the other hand, the entrepreneurs said that they use creative thinking as a tool for this. In the studies of Hills and Lumpkin (1997), Hills et al. (1997), and Hills and Shrader (1998) entrepreneurs also told the authors that they frequently use creativity in order to play with new ideas, i.e. to innovate. De Koning and Muzyka (1996) pointed out that entrepreneurs use their personal creativity to innovate new opportunities. **H4e:** The higher the creativity of entrepreneurs, the more intense is their innovative behavior in opportunity recognition.

## **Hypotheses 5a–5e: Effects of Intellectual Capital of Entrepreneurs on Collective Action in Opportunity Recognition**

De Koning and Muzyka (1996) pointed out that experienced entrepreneurs discussed intensively with their social context. The authors found that opportunity recognition was affected especially by expertise in the field and skills to communicate socially to find opinions, advise, information, and partners. In addition, domain knowledge created such self-confidence among the entrepreneurs that they were open to their own weaknesses and relied on other people. The above results show quite clearly how domain knowledge increases collective action because it gives such self-esteem that you do not have to know everything and that you are "allowed" to discuss with other people without the fear that they steal your idea, or think "what a silly thought". This common trust in others might be created through social conversations (Steyaert et al. 1996), in which parties together create domain knowledge, which then enhances further collective action. Hills and Lumpkin (1997) found that collective, social action with other people was one of the most important ways to look for opportunities in markets (see also Christensen et al. 1994). **H5a:** The higher the domain knowledge of entrepreneurs, the more intense is their collective action in opportunity recognition.

Burt (1992) has indicated that formal knowledge increases collective action. According to him, formal knowledge makes it possible to have higher positions in companies and hierarchies and., thus, better positions in a network structure. This, then, increases the collective action with information sources and not just with anybody. Manimala (1992) pointed out that highly innovative entrepreneurs developed their formal technical capabilities before they started to collaborate. This might mean that formal knowledge is needed in order to be ready for collective action. Hills et al. (1997) came to the conclusions that networking entrepreneurs were able to scan opportunities from a wide base. This suggests that networking entrepreneurs might have more general skills to process information than only in

the familiar context. This, again, suggests that formal knowledge might create more active collective action. **H5b:** The wider the formal knowledge of entrepreneurs, the more intense is their collective action in opportunity recognition.

Kaish and Gilad (1991) pointed out that although experienced entrepreneurs like to think themselves about their ventures they still gather opinions and actively discuss business issues with other people. Hills (1995) introduced that successful entrepreneurs, who had management experience, were active socially. De Koning and Muzyka (1996) also indicated that entrepreneurs with prior entrepreneurial/managerial experience discussed a lot with other people and even asked their opinions of questions in which they were not experts. Hills and Lumpkin (1997) proposed that entrepreneurial experience enhances network behavior. Last, Singh, Hills, Hybels and Lumpkin (1999) also showed how management experience produces intense collective action. **H5c:** The wider the management experience of entrepreneurs, the more intense is their collective action in opportunity recognition.

According to Manimala (1992) highly innovative entrepreneurs were intrinsically motivated and spend time discussing with their social relationships. De Koning and Muzyka (1996) also noticed that internally passionate and self-confident entrepreneurs were willing to discuss their venture ideas with other people. Last, Sigrist (1999) found that an own personal line of entrepreneurs supports interaction with external resource holders. **H5d:** The higher the intrinsic motivation of entrepreneurs, the more intense is their collective action in opportunity recognition.

Gilad (1984) suggested that entrepreneurs need creative capabilities in order to be able to see links between many types of information and that this information is achieved by collective action. Gaglio and Taub (1992) followed Gilad's (1984) ideas and indicated that those individuals who were more creative were also ready and willing to go in for social interaction. Hills (1995) also expressed the notion that entrepreneurs spent time thinking creatively about business ideas and taking active part in social dialogue (see also de Koning and Muzyka (1996). Rea et al. (1999) proposed that creativity and

social networking of entrepreneurs go hand in hand in opportunity recognition. **H5e:** The higher the creativity of entrepreneurs, the more intense is their collective action in opportunity recognition.

#### **4. Methodology**

The sample was drawn from Trade Register of Finland. The sample was defined by three criteria: First criterion was that firms must be established in 1998. Second criterion was that the regions of Jyväskylä, Oulu, and Vaasa in Finland were chosen. Third criterion was that metal- and information- and communication technology (ICT) firms were chosen. Metal- and ICT-industry sectors were defined and firms chosen based on the industry categories presented by Statistic Finland.

A questionnaire was designed based on the literature review (see Appendix 1). Factor analysis and the Cronbach alpha reliability coefficient were used to confirm the unidimensionality and inter-item reliability of constructs. The items were measured on a seven-point Likert-scale, where the choices ranged from 1 = strongly disagree to 7 = strongly agree. Measurement items, sources, and factor loadings are presented in Appendices 2 and 3. As a pilot test, three entrepreneurs from firms representing the population filled out the questionnaire. The main effect was that wording was changed to simpler and more exact. The three entrepreneurs in the pilot test were excluded from the sample. A total of 101 firms out of 213 firms returned the questionnaire.

In the data analysis was used structural equation modeling with AMOS-software. It is suggested that sample size in structural equation modeling should be counted so that there are at least five observations per parameter. In the present study there are in the hypothesized model 19 parameters and 101 observations, so the sample size is just enough (Schumacker and Lomax 1996).

The dependent and independent variables were operationalized in the following way: The dependent variables are knowledge acquisition, competitive scanning, proactive searching, innovative be-

havior, and collective action. Four items measured knowledge acquisition. The items were adopted from a study by Miller (1987). The items asked whether an entrepreneur gathered a lot of information on sales, gathered a lot of information on markets, did organized work to find an opportunity, and made forecasts about technological developments.

Competitive scanning was measured in the questionnaire by using three items (see Miller 1987). First, it was asked if the entrepreneurs had a strong proclivity for high-return projects, even though they involved high risk. Second, it was inquired in the questionnaire whether the entrepreneurs went in for bold and wide-ranging actions in opportunity searching. Third, it was asked whether the entrepreneurs tried to find original ideas.

Proactive searching was measured using three items (Miller 1987). The first of the measurement items asked whether the entrepreneurs did long-term planning. The second item asked whether the entrepreneurs tried to find an opportunity with high newness-value. The third question asked whether the entrepreneurs purposefully spent time on creativity.

Innovative behavior was measured through two items (Miller 1987). First, it was asked whether the searching is about trial and error with ideas and, second, whether entrepreneurs played and tried many different things. Two items also measured collective action. First, it was asked whether the entrepreneurs preferred to work alone rather than together with others. Second, it was asked whether the entrepreneurs negotiated and discussed a lot with other people.

The independent variables are domain knowledge, formal knowledge, management experience, intrinsic motivation, and creativity. Domain knowledge was measured by using three items. The first of them asks how similar entrepreneurs' recent customers are to the customers of the former employers of the entrepreneurs. The second item asks how similar the products of the entrepreneurs are to the former employers' products. Last similarity of suppliers is asked about. These questions are applied from the study by Gimeno et al. (1997).

Two items measured formal knowledge. These are, first, education of entrepreneurs and, second, technical skills of entrepreneurs. Phan and Lee (1995) and Gimeno et al. (1997) indicated these items to well reflect the knowledge of the theories, rules, knowledge etc. of the domain, i.e., formal knowledge of entrepreneurs.

Management experience was measured by using two items inquiring experience of managerial actions and entrepreneurial actions. The questions were adopted from Gimeno et al. (1997).

Five items measured the intrinsic motivation of entrepreneurs. The first item measures how strongly entrepreneurs wanted to show that they are able do it. The second item asked if entrepreneurs felt the situation as a challenge. The third question inquired how important it was that they were able to do work they enjoy. Fourth by it was asked how much entrepreneurs wanted to be respected by others. The fifth item measured the need to develop as a human being. These questions were adopted from the studies by Gimeno et al. (1997) and Kuratko, Hornsby and Naffziger (1997).

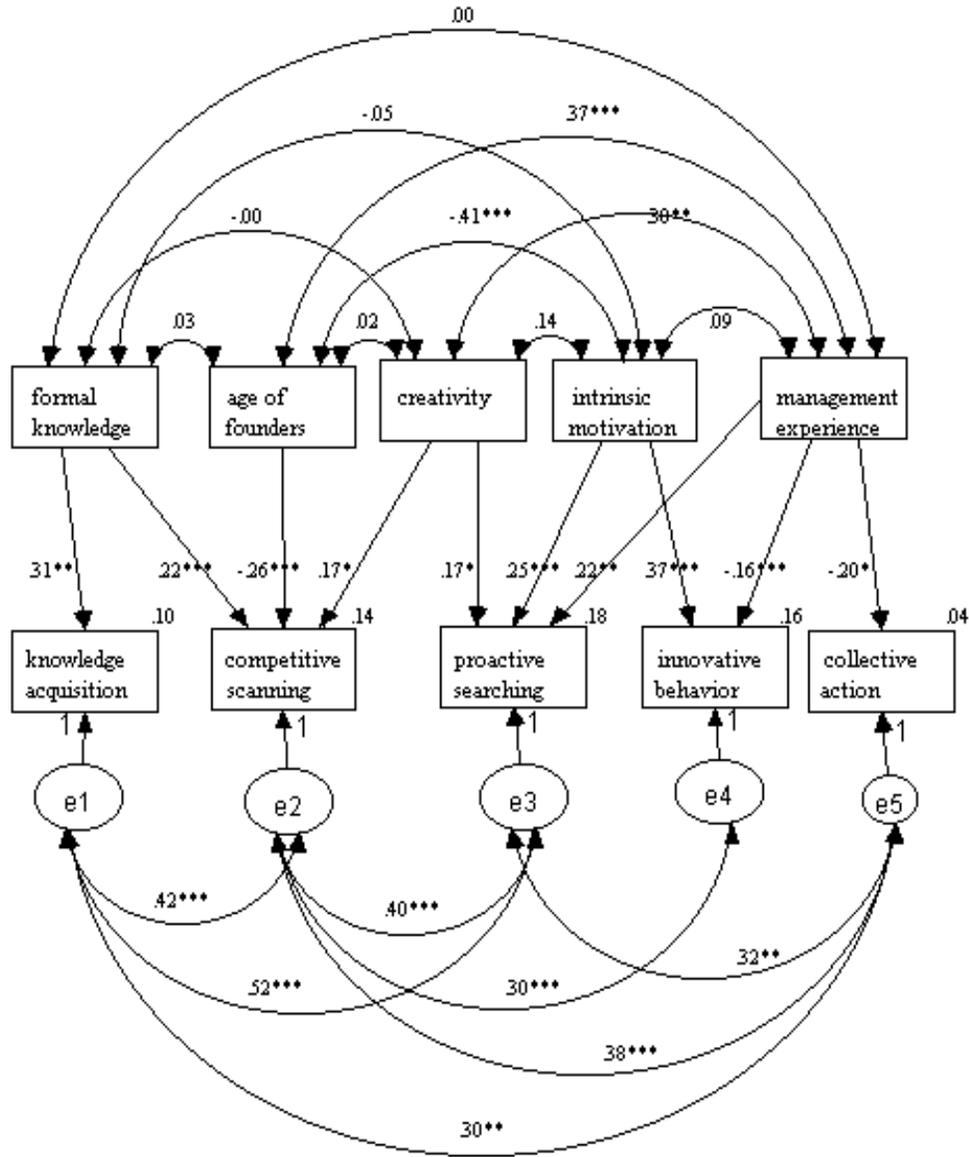
Five items measured creativity of entrepreneurs. First is asked how good an entrepreneur is when it comes to questioning normal ways of doings things. Second is asked how sensitive an entrepreneur is to seeing the kind of problems that others can't see. The third item asks how often new solutions come into an entrepreneur's mind though not necessarily wanted. The fourth item concerns originality of ideas. The last item asks if an entrepreneur has plenty of ideas. The questions are adopted from the studies by Kivikko (1977) and Vesalainen and Pihkala (1998).

The control variables of the study were age of founders, initial amount of capital, number of employees in the beginning, and radius of business in the beginning.

## 5. Results

The model was first run with the AMOS structural equation modeling program. The model was identified (see Figure 1). Second, error variances ( $e_1$ – $e_4$ ) were examined for negative or non-significant error variances. None of these types of results were found. Third, it was checked that none of the model coefficients were close or over 1 and standard error coefficients unusually large. Problems in respect of these issues are not to be expected. Third, multicollinearity of the exogenous variables was studied, and it was found that none of the correlations were above 0.80. Thus, multicollinearity should not cause trouble (Schumacker and Lomax 1996).

Knowledge acquisition in opportunity recognition was significantly affected only by formal knowledge of intellectual capital. This shows that formal education and -skills provide general abilities that could be used in turning pieces of information into useable knowledge. Knowing well the theories, rules, techniques, etc. of the domain offers tools to analyze the situation and create knowledge of the situation. Even though knowing the theories, rules, techniques, etc. is crucial in order to be able to analyze the situation, this type of knowledge is quite abstract to be used straightforwardly in real business-creating situations. Thus, entrepreneurs get involved in knowledge acquisition in opportunity recognition in order to combine both their abstract and empirical knowledge. Figure 1 illustrates the results with the standardized maximum likelihood parameter estimates for the paths.



Causal coefficients are standardized beta weights.  
 \*\*\*  $p \leq .001$ . \*\*  $p \leq .01$ . \*  $p \leq .05$ .

**Figure 1.** The effects of intellectual capital on opportunity recognition.

Formal knowledge affected significantly and positively competitive scanning. Thus, those who have learned the formal tools of thinking and had a thorough knowledge of the domain were able and willing to analyze competition and competitors and find more aggressively their own place in the competitive arena. Creativity also affected significantly and positively competitive scanning. This indicates

that by using creativity it is possible to understand the competitive arena in exceptional ways and see clues for opportunities that others are not able to see (Kirzner 1997). Creativity, thus, makes it possible to interpret the information from the competitive arena so that entrepreneurs perceive anomalies in the arena. Of the control variables, age of entrepreneurs influenced negatively competitive scanning. Thus, when the age of entrepreneurs rises, they do not analyze competition so actively. The reason for this might be that experience develops confidence in one's capabilities, and competitive scanning is set aside. Also it is possible that the age of entrepreneurs changes how entrepreneurs in general think about business and life as a whole. They are more willing to make room for others and less eager to compete.

It is interesting that management experience was used in proactive searching and not for knowledge acquisition or competitive scanning. Thus, management experience affected significantly and positively proactive searching. This result suggests that experience is used rather for intuitive future forecasting than for rational analyzing of the present situation. It is, thus, possible to suggest that management experience offers understanding of what has happened in the business before, what is happening now, and what will happen in the future. In this way by using management experience entrepreneurs are able to predict future trends and search proactively for opportunities. Intrinsic motivation also had a positive effect on proactive searching. This result could be interpreted so that searching for future opportunities requires more internal motivation from individuals than analyzing the present situation. Proactive searching of newness is about linking a complex set of weak cues, and to be motivated to do this demanding work, intrinsic motivation of entrepreneurs must be high. This result that intrinsic motivation do not support more rational analyzing, indicates that intrinsic motivation is connected more with intuitive searching for new possibilities than for rational information organizing. In addition, creativity enhanced significantly proactive searching. It is possible to propose that in proactive searching intrinsic motivation gives the enthusiasm, management experience the knowledge, and creativity mental information-processing tools.

Management experience affected significantly and negatively innovative behavior. This illustrates how experience decreases the flexibility of thinking and directs it to be close to prior experiences, thus affecting negatively questioning the present and innovating something new. This phenomenon is known as path-dependency, in which an individual stays in the path that is familiar to him/her in respect of his/her prior experiences (see e.g. Tversky and Kahneman 1974). Intrinsic motivation enhanced strongly innovative behavior. Research on creativity (e.g. Amabile 1997) has revealed that one of the most important factors supporting free play of ideas is the internal will of an individual to play for the sake of playing without any concrete and explicit goals.

Management experience affected as well significantly collective action. However, opposite to expected the effect was negative. This is an unexpected result because it would be reasonable to expect that the more management experience you have more willing and enterprising you are to work with others. But the above result indicates that instead through management experience entrepreneurs learn to count and make the decisions themselves and to keep others out of their opportunity recognition. This result, like results above, illustrates how prior experiences cause biases in thinking and overwhelming confidence in present knowledge.

### **The goodness-of-fit of the model and nested model tests**

The goodness-of-fit statistics in Table 1 below indicate a good fit between the hypothesized model and the data. The chi-square value of 20.55 with 18 degrees of freedom is not significant ( $p=.30$ ), indicating that the estimated and observed data matrices do not differ significantly. Further, the GFI value of 0.96 and the AGFI value of 0.88 indicate reasonable good fit between the model and the data. The AGFI value does not reach the recommended value of 0.90 (Schumacker and Lomax 1996) but is very close to it. Good fit is also supported by the NFI value of 0.92, which is clearly above the recommended 0.80.

The model fit was further assessed using nested model tests. The rival models are compared with each other in respect of the fit of the model to the data. Three rival nested models were compared: (1) the hypothesized model, (2) a null model, in which no relationships are posited, and (3) a saturated model, in which all the possible relationships are posited. As Table 1 shows, the null model does not fit the data because its chi square statistics indicate significant difference between the observed and estimated data matrices. Also GFI and AGFI values are clearly under 0.90 and NFI value under 0.80. The saturated model has a good fit between the observed and estimated data matrices. Also the other fit measures are acceptable. Nevertheless, the hypothesized model fits a little better. In addition, because the more parsimonious model (the hypothesized) fits better than the more complicated one (saturated), the more parsimonious model is chosen. The above results of the nested models increase the validity of the hypothesized model because the fits of both the simpler and the more complicated model were weaker than the fit of the hypothesized model.

**Table 1.** Structural equation model statistics for the intellectual model.

| Model           | Chi <sup>2</sup> | p   | df | GFI | AGFI | NFI |
|-----------------|------------------|-----|----|-----|------|-----|
| 1. Hypothesized | 20.55            | .30 | 18 | .96 | .88  | .92 |
| 2. Null         | 90.26            | .00 | 28 | .85 | .71  | .59 |
| 3. Saturated    | 4.45             | .22 | 3  | .98 | .84  | .90 |

## 6. Discussion

The prior studies of opportunity recognition have regarded formal knowledge to be less important than domain knowledge (see e.g. Hills 1995). However, formal knowledge has been widely seen to have an important role in knowledge acquisition as it gives more general analyzing tools to interpret informa-

tion (Christensen and Peterson 1990; Woo et al. 1992; Zietsma 1999). The results of this study were in line with the results of these previous studies. The results of the study pointed out, first, that knowledge acquisition requires formal knowledge of particular domain. This was also indicated by Woo et al. (1992) and Zietsma (1999). With formal knowledge entrepreneurs are able to analyze and synthesize information to create usable knowledge. However, the study disagrees with the previous studies as regards the idea that also domain knowledge, management experience, intrinsic motivation, and creativity should enhance knowledge acquisition. The results of this study suggest instead that knowledge acquisition is very rational, purposeful behavior that requires mostly formal abilities to analyze information and perhaps even strength to put aside the rest of the intellectual capital an entrepreneur possesses.

Prior research has strongly argued that domain knowledge of a particular profession should enhance opportunity recognition (e.g. Kaish and Gilad 1991; Woo et al. 1992; de Koning and Muzyka 1996; Hills and Lumpkin 1997). Shane and Venkataraman (2000) argue even that opportunity recognition is possible only when an entrepreneur has knowledge structures, i.e. domain knowledge, of that particular domain. Otherwise, entrepreneurs would not see what they should search for and what they should do with the information. Woo et al. (1992) indicated that less experienced entrepreneurs did not search because their lack of knowledge produced the bias that new knowledge is not important. This study revealed that the relationship is positive but at least here not significant. This might point out that experienced entrepreneurs in the domain rely on their existing knowledge and only fill the gaps they have. This suggests, as research on cognitive knowledge structures has revealed (Tversky and Kahneman 1974), that prior knowledge interferes and cause biases in thinking and behavior. Baron (1997, 1998) already indicated that this is possible in opportunity recognition. Thus, domain knowledge enhances opportunity recognition, but after some point, when domain knowledge is quite high, it starts to interfere with opportunity recognition because of the bias to think that it is known enough already (see Baron 1998). Hereafter, this study points out that domain knowledge might be important, as previous

studies have strongly argued, but it can also be dangerous when interfering with opportunity recognition behavior.

Second, prior studies have strongly argued competitive scanning to be based on domain knowledge, as it would offer the tacit knowledge of the area (Cooper 1981; Long and McMullan 1985; de Koning and Muzyka 1996; Hills and Lumpkin 1997; Kirzner 1997). However, this study revealed that formal knowledge is more important in competitive scanning than domain knowledge. The reason for this might be that knowing the business and actors there (domain knowledge) do not show where the anomalies are in the competitive arena. What is needed is also and especially formal analyzing- and technical skills to see where and what kind of gaps are going to open up.

The results also indicated that creativity is significant in competitive scanning. This was in line with previous results (e.g. Hills et al. 1999). It is interesting that creativity is significant but domain knowledge is not. This implies that tacit knowledge, or in other words alertness to connections between pieces of information that is needed, is involved in capabilities of entrepreneurs to process information in novel ways and not in knowing the business per se. This is also suggested by the fact that management experience was not significant in competitive scanning. This shows further that experience does not tell what kind the competitive arena is but that what is needed is ability to formally analyze it and willingness to creatively play with information to create in minds of entrepreneurs awareness of anomalies that are going to open. Interesting is also that intrinsic motivation is not so important, although it is proposed that competitive scanning is demanding emotionally (e.g. Herron and Sapienza 1992). This indicates that competitive scanning is not fun but hard work that must be done. Because it is an unpleasant job, it is thus possible that experienced entrepreneurs avoid it. Many times entrepreneurs even try to escape boring work and perhaps thus also avoid competitive scanning (see Kuratko et al. 1997). As a whole, in competitive scanning formal knowledge proposes the tools that are needed to understand the competition and creativity vehicles to see anomalies in this competition.

Previous studies have argued that proactive searching requires both domain- and formal knowledge (e.g. Woo et al. 1992; Christensen et al. 1994; Hills 1995). However, the results of the present study revealed that proactive searching is not about rational analyzing of information but merely intuitive visioning of the future. The results indicated that proactive searching is enhanced by prior management experiences, intrinsic motivation, and creativity of entrepreneurs. Proactive searching, which is more about abstract projecting of the future than rational and “hard” analyzing of the present situation, calls for knowledge of how an industry is developing in a larger frame (Hills et al. 1997; Hills and Shrader 1998). This knowledge is dependent on managerial/entrepreneurial experiences. In other words, if you have worked as a manager and/or an entrepreneur, it is probable that you have a vision of larger trends in that business, and thus you have also capabilities to forecast in some extent the future. However, proactive searching requires also strong intrinsic motivation to be able to explore the future. This is so maybe because proactive searching is largely based on intuitions, which are possible only if an individual is really internally motivated. Intuitions are not possible to create by force or necessity (see Manimala 1992; Martello 1994; Hills 1995; Baron 1998). Creativity is also necessary to be able to link weak information cues so that an entrepreneur recognizes future developments (Gilad 1984; Hills and Shrader 1998). Present study showed that although rational analyzing of the competitive arena and knowledge acquisition are very important in order to know what the industry stands for creative and intuitive visioning of future possibilities is the most crucial part of opportunity recognition. Thus, it should be underlined that, when capabilities to recognize opportunities are developed, serious time and effort should be given to developing creative and intuitive capabilities as well.

The results of this study indicated that innovative behavior is not enhanced by level of knowledge. Instead, innovative behavior is probably very natural to all human beings and thus it needs only intrinsic motivation to be turned on (Amabile 1997). Innovative behavior needs strong intrinsic motivation, since it is internal, mental playing with ideas. It is impossible if an entrepreneur does not enjoy it.

Innovativeness is hard to rationalize and thus it needs a pull from inside. Thus, this study agrees with Gaglio and Taub (1992) and Manimala (1992), who have suggested that innovative behavior in opportunity recognition requires a strong motivational ground. Management experience, again, decreases innovative behavior. This points very clearly how existing knowledge might hinder free play with ideas (Baron 1998). The fact that creativity does not enhance innovative behavior further shows that although innovative behavior is not about rational processing of information neither it is totally creative but has certain goals to obtain.

All the other variables besides management experience did not have any significant effect on collective action. Many studies have proposed that collective action is also a result of individual capabilities (de Koning and Muzyka 1996; Steyaert et al. 1996; Hills and Lumpkin 1997; Hills et al. 1997; Singh et al. 1999). However, this study proposes that collective action is merely learned in a social community and is thus a social phenomenon. Thus, in spite of intellectual capital, entrepreneurs can behave socially collectively dependent on how used they are to social behavior. Still, management experience hindered collective action. On the basis of this, it seems that managerially and/or entrepreneurially experienced persons want to control themselves the actions and decisions in opportunity recognition and keep others out. Perhaps experienced managers/entrepreneurs feel that somehow new opinions threaten their own opinions. On the other hand, management experience might create cognitive biases that cause managerially experienced entrepreneurs to trust themselves too much (Baron 1997, 1998). This shows again how dangerous experience can be if it is used in an inflexible way.

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## Appendices

### Appendix 1. The survey instrument of the study.

| Name and company   |  |
|--|--|
| <b>I. INTELLECTUAL CAPITAL</b>   |  |
| First group of questions deals with your personal qualities in time you were establishing your company under the study. The questions/statements are presented on the left side and possible answers on the right side of the page. Please read the questions/statements carefully and CIRCLE the number that <b>best</b> suits for you.   |  |
| .....  |  |
| 1. Which one of the followings is closest to your formal degree of education at the time of you established your company?  | 1 = no formal education<br>2 = elementary school<br>3 = vocational school/high school<br>4 = engineering school, commercial institute etc.<br>5 = polytechnic degree<br>6 = university degree<br>7 = licentiate/doctoral degree  |
| .....  |  |
| 2. How much did you have work experience from your company's field of business at the time of you established your company?  | 1 = less than a year<br>2 = less than 2 years<br>3 = less than 4 years<br>4 = less than 6 years<br>5 = less than 8 years<br>6 = less than 10 years<br>7 = 10 years or more   |
| .....  |  |
| 3. What were your main objectives when you started your company? Mark a cross beside those which were important to you (in the box) and number 1 (on the line) beside that one which was the most important one.   | <input type="checkbox"/> ___ = I hadn't any specific objectives or goals<br><input type="checkbox"/> ___ = my objective was to have a company and my recent job at the same time<br><input type="checkbox"/> ___ = my objective was to create a job for me<br><input type="checkbox"/> ___ = my objective was to create a family company, which I could then hand over to my children in the future<br><input type="checkbox"/> ___ = my goal was to establish a company, develop it further, sell it for a good price, and enjoy the fruits of my work<br><input type="checkbox"/> ___ = my objective was to establish first one company, and then when its life-cycle would end, establish a new company<br><input type="checkbox"/> ___ = my objective was to establish little by little several companies and run them at the same time. |
| .....  |  |
| 4. How close the products of your company were to products of your prior employees*?<br>* Think the situation at the moment of your company's establishment as the situation of your company might have been changed.  | 1 = completely different<br>2 = quite different<br>3 = a little different<br>4 = neutral<br>5 = a little similar<br>6 = quite similar<br>7 = very much the same  |
| .....  |  |
| 5. What were your technical capabilities* in the line of business in which your company was at the moment of establishment?<br>*By technical capabilities is meant here for example medical doctor's knowledge when heart transplant is needed, mechanic's knowledge how to change piston rings and why those are needed in an engine, or construction supervisor's knowledge how humidity affects building structures and how this is eliminated. | 1 = no technical capabilities<br>2 = beginner<br>3 = trainee<br>4 = skilled worker<br>5 = skillful<br>6 = expert<br>7 = "world beater"   |

6. How much did you have management experience\* at the moment of your company's establishment?  
 \*By management experience is meant responsibility of decisions, responsibility of planning, implementing, and supervising of issues in an organization, and responsibility of instructing, educating, and developing his/her subordinates.
- |   |                      |
|---|----------------------|
| 1 | = less than a year   |
| 2 | = less than 2 years  |
| 3 | = less than 4 years  |
| 4 | = less than 6 years  |
| 5 | = less than 8 years  |
| 6 | = less than 10 years |
| 7 | = 10 years or more   |

7. How close the customers of your company were to customers of your prior employees\*?  
 \* Think the situation at the moment of your company's establishment as the situation of your company might have been changed.
- |   |                        |
|---|------------------------|
| 1 | = completely different |
| 2 | = quite different      |
| 3 | = a little different   |
| 4 | = neutral              |
| 5 | = a little similar     |
| 6 | = quite similar        |
| 7 | = very much the same   |

8. How much did you have entrepreneurship experience\* at the moment of your company's establishment?  
 \*By entrepreneurship experience is meant prior ownership or significant partnership in a firm in which you and your partners hold the power of decisions.
- |   |                      |
|---|----------------------|
| 1 | = less than a year   |
| 2 | = less than 2 years  |
| 3 | = less than 4 years  |
| 4 | = less than 6 years  |
| 5 | = less than 8 years  |
| 6 | = less than 10 years |
| 7 | = 10 years or more   |

9. How close the suppliers of your company were to suppliers of your prior employees\*?  
 \* Think the situation at the moment of your company's establishment as the situation of your company might have been changed.
- |   |                        |
|---|------------------------|
| 1 | = completely different |
| 2 | = quite different      |
| 3 | = a little different   |
| 4 | = neutral              |
| 5 | = a little similar     |
| 6 | = quite similar        |
| 7 | = very much the same   |

10. What were the important reasons for you to establish a company of your own? Please read the questions/statements carefully and CIRCLE the number that **best** suits for you. Choose only one number per statement. The scale for statements is the following: 1 = not important, 2 = little important, 3 = somewhat important, 4 = moderately important, 5 = quite important, 6 = important, and 7 = very important

|   | <i>not important</i> |   |   |   |   |   | <i>very important</i> |
|---|----------------------|---|---|---|---|---|-----------------------|
| a. I wanted to achieve high personal wealth.                  | 1                    | 2 | 3 | 4 | 5 | 6 | 7                     |
| b. I wanted to have appreciation.                             | 1                    | 2 | 3 | 4 | 5 | 6 | 7                     |
| c. I wanted to show that I can do it.                         | 1                    | 2 | 3 | 4 | 5 | 6 | 7                     |
| d. I wanted to develop as an individual.                      | 1                    | 2 | 3 | 4 | 5 | 6 | 7                     |
| e. I wanted to get higher incomes.                            | 1                    | 2 | 3 | 4 | 5 | 6 | 7                     |
| f. I wanted to enjoy the excitement of being an entrepreneur. | 1                    | 2 | 3 | 4 | 5 | 6 | 7                     |
| g. I wanted to do that kind of work I like.                   | 1                    | 2 | 3 | 4 | 5 | 6 | 7                     |
| h. I wanted to have more money.                               | 1                    | 2 | 3 | 4 | 5 | 6 | 7                     |
| i. I wanted to do work that offers personal challenges.       | 1                    | 2 | 3 | 4 | 5 | 6 | 7                     |
| j. I wanted to create a successful company.                   | 1                    | 2 | 3 | 4 | 5 | 6 | 7                     |

11. How you see your own creativity? Please read the questions/statements carefully and CIRCLE the number that **best** suits for you. Choose only one number per statement. The scale for statements is the following: 1 = I don't agree at all, 2 = I agree a bit, 3 = I agree somewhat, 4 = neutral, 5 = I agree quite a bit, 6 = I agree, and 7 = I strongly agree

- |   |   |   |   |   |   |   |   |
|---|---|---|---|---|---|---|---|
| a. I have plenty of ideas.  | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| b. I search for new solutions even then when those are not needed.                      | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| c. I'm alert to see problems which are possible to solve by new solutions.              | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| d. My ideas are often very original.  | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| e. I'm good at questioning the used ways to do things.                                  | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| f. It is easy for me to find proposals for improvement.                                 | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| h. When a wall comes in my way I can find a detour from completely different direction. | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| i. I find special and surprising solutions to problems.                                 | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| j. When I see a new solution, new, additional solutions becomes to come in my mind      | 1 | 2 | 3 | 4 | 5 | 6 | 7 |

## 2. OPPORTUNITY RECOGNITION

Instruction: The early phase of a business before the actual business actions is possible to divide into three phases: (1) business opportunity recognition, (2) planning of business actions, and (3) formal establishment of a business. In the business opportunity recognition phase it is tried to recognize and create that kind of idea for a business that grabbing on that it would be possible to add new value to customers and earn profit to owners. In the planning phase, then, it is planned how this idea for business is possible realize. In the formal establishment the business is then actualized and formally registered by the laws of the country. These phases take place before the business earns any revenues. This study is interested in business opportunity recognition. By an opportunity it is meant here that kind of need in markets that, if this need is served by products and services of the business, it would create that kind of new value for customers that they are willing to buy products and services and by that way earn profit to the business. The above phases are, of course, overlapping in reality but I kindly ask you to think back what and how you did things when you tried to recognize an opportunity for your business. Questions are presented as statements (25).

Please read the questions/statements carefully and CIRCLE the number that **best** suits for you. Choose only one number per statement. The scale for statements is the following: 1 = I don't agree at all, 2 = I agree a bit, 3 = I agree somewhat, 4 = neutral, 5 = I agree quite a bit, 6 = I agree, and 7 = I strongly agree

- |   | <i>I don't agree at all</i> |   |   |   | <i>I strongly agree</i> |   |   |
|---|-----------------------------|---|---|---|-------------------------|---|---|
| 1. I gathered a lot of information on sales, tastes, technology etc. in order to recognize an opportunity.                  | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 2. I did organized work in order to find an opportunity.  | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 3. I gathered a lot of information on markets to recognize an opportunity.  | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 4. I outlined things in a few years perspective when I tried to recognize an opportunity.                                   | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 5. I used often experts to help me in opportunity recognition.  | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 6. I tried very actively to sketch that kind of an opportunity that would be  | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 7. I gathered a lot of information on competitors in order to recognize an opportunity.                                     | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 8. I didn't plan that carefully my opportunity recognition but it merely just happened and developed in time by itself.     | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 9. In order to recognize an opportunity I made a lot of forecasts about sales, profit, and nature of markets.               | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 10. I gathered a lot of information on needs, plans, and opinions of customers in order to recognize an opportunity.        | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 11. I played with and tried a lot of different and new types of ideas to the industry in order to recognize an opportunity. | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 12. I had a strong proclivity for high-return projects, despite high risk, rather than for low-profit, low-risk projects.   | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 13. I purposefully spent time on creativity when I tried to recognize an opportunity.                                       | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |

|   | <i>I don't agree at all</i> |   |   |   | <i>I strongly agree</i> |   |   |
|---|-----------------------------|---|---|---|-------------------------|---|---|
| 14. I planned far ahead (for example 3 years) already from the phase of opportunity recognition.  | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 15. I made forecasts about technological developments that would be important to my products and services of my company in order to recognize an opportunity. | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 16. I preferred to work alone rather than together with others in order to recognize an opportunity (reverse).  | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 17. I made forecasts about future investment needs in order to recognize an opportunity.  | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 18. I tried actively to recognize an opportunity that would be growth oriented and innovative rather than thoroughly tried and secure idea.                   | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 19. I did often organized work to find and evaluate markets, new products, new technologies, etc. in order to recognize an opportunity.                       | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 20. I tried very actively to recognize an opportunity that would beat competitors rather than let all flowers bloom.  | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 21. I used often information technology to assist me in my opportunity recognition.   | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 22. I went actively in for bold, wide-ranging actions in opportunity searching rather than accepted too cautious and thoroughly studied ways of doing things. | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 23. I liked a lot to negotiate and discuss with other people in order to recognize an opportunity.  | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 24. I tried to find original and new type of ideas in order to recognize an opportunity.  | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |
| 25. Recognizing of opportunities was more about trial and error with ideas than carefully planned activity.   | 1                           | 2 | 3 | 4 | 5                       | 6 | 7 |

### 3. BACKGROUND INFORMATION

1. Age and gender:

2. How many years have you worked in the industry of your business?

3. Are you the founder/one of the founders of the company:?  
 Yes  No → Who was/were?

4. First customer of your company (year and month):

5. Home municipality of the registered office of your company:

6. Estimate how many kilometers from your office 80% of your customers live:

**Appendix 2.** Measurement items, sources, and factor loadings of intellectual capital.

| Items   | Sources                                 | Factor loadings |
|---|---|-----------------|
| <i>Domain knowledge</i>   |   |                 |
| How close are your prior employers' customers to your own firm's customers? | Gimeno, Folta, Cooper and Woo 1997      | .90             |
| How close are your prior employers' products to your own firm's products?   | Gimeno et al. 1997                      | .82             |
| How close are your prior employers' suppliers to your own firm's suppliers? | Gimeno et al. 1997                      | .71             |
| <i>Formal knowledge</i>   |   |                 |
| What is your highest official degree of education?                          | Phan and Lee 1995; Gimeno et al. 1997   | .88             |
| What is your amount of technical skills in your firm's industry?            | Phan and Lee 1995                       | .83             |
| <i>Management experience</i>  |   |                 |
| How much entrepreneurship experience have you from your prior jobs?         | Gimeno et al. 1997                      | .88             |
| How much management experience have you from your prior jobs?               | Gimeno et al. 1997                      | .88             |
| <i>Intrinsic motivation</i>   |   |                 |
| I wanted to show that I can do it.  | Kuratko, Hornsby and Nafziger 1997      | .89             |
| I felt it like a personal challenge.  | Kuratko et al. 1997                     | .87             |
| I wanted to do work that I enjoy.   | Gimeno et al. 1997; Kuratko et al. 1997 | .78             |
| I wanted to be respected by others.   | Kuratko et al. 1997                     | .77             |
| I wanted to develop as a human being.                                       | Kuratko et al. 1997                     | .77             |
| <i>Creativity</i>   |   |                 |
| I'm good at questioning normally used ways of doing things.                 | Vesalainen and Pihkala 1998             | .89             |
| I'm sensitive to seeing problems that others don't see.                     | Kivikko 1977                            | .82             |
| New solutions come into my mind also when they are not especially needed.   | Kivikko 1977                            | .82             |
| My ideas are very original.   | Vesalainen and Pihkala 1998             | .76             |
| I have plenty of ideas.   | Vesalainen and Pihkala 1998             | .71             |

Principal component analysis using VARIMAX rotation. Item loadings not less than 0.6 on a primary dimension and not more than 0.4 on any other dimension were retained.

**Appendix 3.** Measurement items, sources, and factor loadings of opportunity recognition behavior.

| Items  | Sources     | Factor loadings |
|--|-------------|-----------------|
| <i>Knowledge acquisition</i>   |             |                 |
| I gathered a lot of information on sales.                              | Miller 1987 | .94             |
| I gathered a lot of information on markets.                            | Miller 1987 | .90             |
| I did organized work in order to find an opportunity.                  | Miller 1987 | .89             |
| I made forecasts about technological developments.                     | Miller 1987 | .70             |
| <i>Competitive scanning</i>  |             |                 |
| I had a strong proclivity for high-return projects, despite high risk. | Miller 1987 | .92             |
| I went in for bold, wide-ranging actions in opportunity searching.     | Miller 1987 | .86             |
| I tried to find original ideas.  | Miller 1987 | .62             |
| <i>Proactive searching</i>   |             |                 |
| I planned far ahead.   | Miller 1987 | .90             |
| I tried to find an opportunity with high newness-value.                | Miller 1987 | .68             |
| I purposefully spent time on creativity.                               | Hart 1992   | .60             |
| <i>Innovative behavior</i>   |             |                 |
| Searching was about trial and error with ideas.                        | Miller 1987 | .91             |
| I played with and tried a lot of different ideas.                      | Miller 1987 | .71             |
| <i>Collective action</i>   |             |                 |
| I preferred to work alone rather than together with others (reverse).  | Miller 1987 | .92             |
| I negotiated and discussed a lot with other people.                    | Miller 1987 | .64             |

Principal component analysis using VARIMAX rotation. Item loadings not less than .60 on a primary dimension and not more than .40 on any other dimension were retained.

**THE SME PULSE:**  
AN EXPLORATORY STUDY OF THE PERFORMANCE OF SME'S IN PAKISTAN  
AND THE  
CHARACTERISTICS OF SUCCESSFUL FIRMS

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**Abstract**

In 2003, the Small and Medium Enterprise Center (SMEC) at the Lahore University of Management Sciences undertook a survey of 650 SMEs in the manufacturing sector of Pakistan. This paper presents key findings from the survey. Our results show that firms in the SME sector of the country in general revolve around the owner/entrepreneur. Analysis was done to identify what characteristics of the owner/operating head affect the SME performance. Sales increase/ decrease, sales per employee and investment plans were the performance indicators selected for the analysis. The results showed owners' education, media related habits, use of information technology, number of investors and

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generations in business have a significant relationship with the health of the firm. Another key finding of the study was that the SME sector lacks formal systems for employee appraisal & training and quality control. Less than half of the SMEs had bank accounts. Only a handful of firms were into exports. Thus another interesting follow-up question studied was what company/business characteristics have a significant relationship with performance? Our results show positive relationship between firms' performance and whether or not they have formal HR, QC and financial systems in place. Additionally, we also found a positive relationship between firms' performance and percentage of goods exported, number of products produced, number of customers, amount of sub-contracting and whether or not they had better machinery.

## **1. INTRODUCTION**

Like the rest of the world, in Pakistan the small and medium sized enterprises (SMEs) have come under “public policy limelight” (Schlogl 2004) in recent years. Several authors (Bernice et al 1997; Neck 1987) have identified SMEs as source of significant employment potential, revenue generation and technological advancement. The Government of Pakistan established a Small and Medium Enterprise Authority (SMEDA) in 1998 with the aim of developing its burgeoning SME sector. After major setbacks in the larger industrial sector in the mid nineties, most commercial banks in the country have setup specialized departments to cater for the SME sector's financing needs. This followed the establishment of a national SME Bank to finance this sector, considered

crucial to the national economy. Additionally, almost all major international donor agencies (e.g., ADB, World Bank, ILO, UNDP, and others) have started major initiatives in the SME sector of Pakistan within the last five years. While economic development policy makers generally identify the employment potential and the number of firms as major reasons for focusing on this sector, this shift in focus has been even more profound in Pakistan.

According to SMEDA, SMEs constitute nearly 90 percent of the all business enterprises in Pakistan; employ 80 percent of the non-agricultural labor force; and their share in the national GDP is around 40 percent. A major challenge for most policy researchers in the SME area is the virtual non-existence of scientific data on this sector in the country. The only available sources of data are Census of Establishments (Government of Pakistan, 1988) and Directory of Industrial Establishments (Government of Punjab, 2002). Although much of this “official” data have serious credibility issues, some parts of it, like the number and location of establishments, is considered reliable by most standards.

The Small and Medium Enterprise Center (SMEC) at the Lahore University of Management Sciences undertook a survey in 2003 to “gauge the health” of this sector. A field survey of 651 firms in 10 national districts was conducted. These 10 districts were selected as they are home to over 50 percent of the SMEs in the country. (Census of Establishments – GoP, 1988). The survey questions focused on SME characteristics, characteristics of their owners, and the overall firm performance issues. It was aimed at identifying factors that significantly affect the health of the firm. This paper provides a summary of our key findings from the study.

In Section 2 we present the methodology; Section 3 gives the demographics/description of the data; in Section 4 key findings from the data are presented; in Section 5 we describe two of the research questions posed by the key findings (presented in the previous section) and subsequently analyzed in section 7 and 8; in Section 6 we describe the success indicators selected for the analysis and the results from the study of relationship between owner characteristics and the health of the firm; in Section 7 characteristics of better performing firms are presented.

## **2. METHODOLOGY**

The definition of SMEs vary from country to country as they are defined by a wide variety of criteria, more notably the number of employees and annual turnover. SMEs are generally considered to be non-subsidary, independent firms (OECD 2002).. Verhees and Meulenberg (2004) define a small firm as “a firm that is run and is controlled under the direct supervision of the owner.” Pakistan does not have a working definition of SMEs yet<sup>1</sup> and enterprises employing up to 99 persons constitute over 95 percent of all enterprises in the industrial sector and nearly 78 percent of non-agricultural labor forces.

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<sup>1</sup> The Government of Pakistan has recently set up a task force to formulate a comprehensive policy for SMEs. The objectives of the task force include developing a uniform definition for SMEs in the country. <[www.pakistan.gov.pak/ministries/contentinfo](http://www.pakistan.gov.pak/ministries/contentinfo)>

For the purpose of this study, a market research firm [AcNeilson (Pakistan) Ltd] was employed for data collection because they had a well-established network for (random) data collection and quality assurance across the country. Target organizations included all manufacturing firms in the SME sector that had a total workforce in the range of 7 - 100. The market research firm conducted interviews of the executive heads (CEO, Chairman, MD, GM etc.) of target organizations and information related to different functions including finance, human resource, marketing and production, was collected. This paper is based on part of the data collected.

According to the Census of Establishments (1988), there are 72 geographic districts in Pakistan and more than 50 percent of SMEs in the country are located in the ten districts, namely: Karachi, Lahore, Faisalabad, Multan, Hyderabad, Sialkot, Gujrat, Shiekhupura, Gujranwala and Quetta. Furthermore, 25 percent of SMEs in the country were in Karachi, Lahore and Faisalabad districts. It was decided to sample 100 SMEs each, from these three districts, and 50 SMEs each from the other seven districts. The total sample size for the study was 651 firms.

Depending upon the sample size, 10 to 20 areas were randomly selected in each district of Pakistan. The market research firm conducted 5 interviews in each area. Areas were selected using the following publications; Punjab Directory of Industrial Establishments (for districts in Punjab) and the Chamber of Commerce listings, Jamal's Yellow Pages and Stock Exchange listings (for Karachi, Hyderabad and Quetta).

An area was selected by generating a random number corresponding to the page number of the specific publication. The 10<sup>th</sup> address on that page was selected. This address (and the corresponding company) gave the starting point of that area where around 5 interviews could be conducted. In case the company had moved, or become bankrupt, the surveyor would still use that address as a starting point for five interviews. If the surveyor was unable to find any SMEs (manufacturing) in the area, the market research firm replaced that area with another randomly selected area using the same technique.

### **3. SAMPLE CHARACTERISTICS**

#### **3.1 Industry Sectors**

A detailed sector-wise breakdown of the study sample of manufacturing SMEs is provided in Table I.

Table I about here

#### **3.2 Organization Size**

The survey results showed that about 50 percent (327/651 firms) of the firms had between 7 to 10 employees. SMEs having 11 to 25 employees were about 36 percent

(237/651) of the total while the firms having 26 to 96 employees were about 14 percent (87/651 firms) of the total.

### **3.3 Type of Organization**

In our survey about 61 percent firms were sole proprietorship, 29 percent firms were family partnership, 6 percent firms were non-family partnership and 4 percent of the firms were private limited.

### **3.4 Age of the Organization**

Within our data the breakup of firms (in percentages) established over the years, is as follows; about 15 percent of the SMEs were established between 2001-2003, 38 percent between 1991-2000, 26 percent from 1981-1990, 20 percent between 1947<sup>2</sup>-1990 and only 1 percent before 1947.

## **4. KEY FINDINGS**

### **4.1 SME Owner**

#### Owner as Decision Maker

According to the results of the survey, the owner runs the show at most of the SMEs. About 82 percent of the company owners are the operating heads of their companies as well. A high percentage of them (about 98 percent) handle decisions related to human resource, marketing/distribution/sales, production, finance/accounts and legal/governance issues in their companies themselves. More than 96 percent of the owners take strategic decisions themselves while 89 percent of the owners take decisions regarding day-to-day affairs, showing a high level of control.

#### Employee Profile

The average number of total employees in an SME is about 17; out of which about 98 percent are males. It is not surprising in a conservative and developing country like Pakistan, where the skill/literacy rate in women is extremely low. Note that (see Table II) the owner is the only “executive”, which further explains the key role of the owner in SMEs.

Table II about here

#### Education Level of the Owner

About one quarter of the SME owners had graduate degrees (see Figure). About 66 percent were either matric (grade 10) or above while only 8 percent of them were illiterate.

Figure about here

#### Generations in Business

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<sup>2</sup> Pakistan came into being in 1947.

The results show that about 65 percent of the SME owners were entrepreneurs. About 28 percent of the SMEs were established by the fathers of the existing owners while the rest were setup by their grand parents or great grand parents.

#### Family Connections

A very high percentage of SME owners-operating heads belonged to families with multiple people having their own businesses. About 47 percent of the owners have relatives that own some other business.

#### Information Gathering Habits and Computer Usage

The survey results showed that a high percentage of the company owners/operating heads were regular in watching TV and reading newspapers. About 74 percent of the owners/operating heads watched television regularly (at least 2 days a week). Similarly 76 percent of them read newspapers/magazines at least twice a week. Studies by Hankinson (2000) and Hankinson, Barlett and Ducheneaut (1997) of the SMEs in UK showed that owner-managers there as well were quite regular in keeping themselves abreast of the surroundings using TV, newspapers/magazines, radio etc. As expected a low percentage (only 15 percent) of owners/operating heads of SMEs in Pakistan use computers for their office work, mostly for writing letters, e-mails, Internet, accounts/finance and making bills.

### **4.2 Human Resource**

#### Department Wise Breakup

The survey results show that human resource of the SME sector (manufacturing) in the country is concentrated in the production area. On average, there are about 16.25 employees in an SME and about 14.2 of them work in the production department. This result indicates that beside the operating head of the company there was only one other employee (on average) for all the other departmental functions. A reason for that, as stated by Hankinson (2000), could be “I have to do everything” mentality. As a result it appears that owners-operating heads in the manufacturing sector (SMEs) take care of all the other functions that is QC, Marketing, Finance, HRD, and Procurement etc.

#### Education

The survey results verified that employees working in the SME sector in the country are not that educated. About 15 employees (out of 16) are either matric (grade 10) or below.

#### Turnover

The average employee turnover was 27 percent in 2002. Out of 651 firms, 229 either did not keep any record of hiring/firing, or they were recently established. For the rest of the firms (422), average number of employees hired was 4.5, average number of employee fired was 1 and on average 3 employees themselves left the firms in 2002.

#### Training

Employees in the SME sector do not get formal training, and external training is virtually non-existent. On average, executives in about 56 percent of the firms, skilled/technical

workers in 49 percent of the firms and unskilled labour in 61 percent of the firms get no formal training at all (see Table III for details).

Table III about here

#### Performance Appraisal

The results show that human resource systems in most SMEs lack formal appraisal mechanism for their employees. In case of executives 68.5 percent, in case of skilled/technical workers 63.7 percent and in case of unskilled workers 66.4 percent of the respondents did not have any regular system of increments for their employees.

### **4.3 Markets/Contracts**

#### Sales Trends

The results of the survey show that in 2002 the performance of SMEs was generally poor; only 17 percent of the firms indicated increase in sales (18.7 percent on average) over the last year and 58 percent of the firms showed decrease in sales (34.1 percent on average). SMEs did not seem to be too optimistic about their future in 2003, as about 49.3 percent expect their sales to be stagnant, 20.9 percent expect decrease in sales (26.6 percent on average) while only 29.8 percent expect an increase in sales (22.3 percent on average).

#### Competition with Large scale Sector

Firms in the SME sector do not seem to operate in markets served by large firms (Eden, Levitas and Martinez 1997; Christensen 1997; Carson 1985). Only 3.5 percent of the firms said that their competitors had more than 100 employees (large firms). Among the rest about 58.6 percent of the firms said that their competitors have less than 15 employees and 37.9 percent said that their competitors' employees are in between 15-99.

#### Marketing Function

Market Information: According to Verhees and Meulenber [2004], in small firms "*market intelligence is based mostly on secondary data or on personal contacts*". Our analysis shows that formal systems for market data/information collection are almost non-existent in the SME sector of the country. Only 3.3 percent of the firms ever had proper marketing research conducted.

Subcontracting: The data shows that only 20 percent of the firms subcontract. For the firms that sub-contract, the percentage of cost-of-goods-sold emanating from the vendors is 24 percent of total.

Where in the Value Chain?- Out of the firms that sell in the local market, 46.3 percent firms sell their goods through wholesaler, 16.3 percent through retailer, 8.3 percent through distributor and 28.8 percent sell directly to the end user.

#### Supply Chain Management

Relationships/Partnerships: Out of 651, 159 firms (24.4 percent) sell their goods to some other manufacturer, about 80 percent (521 out of 651) sell their goods in the local market and 4.8 percent (31 out of 651) export their products. About 19 percent of total sales of the SMEs are to some other manufacturer, 75 percent of the sales are from selling goods in the open market and only 4 percent are in the forms of exports. On average about 62 percent of total sales of the SMEs were to two biggest clients (37 percent and 25 percent) and the SMEs have been in business with them since last 10 to 11 years.

The sample results indicate that SMEs purchase about 83.8 percent of their raw material from open market, 13.7 percent from some other manufacturer while only 2.5 percent is imported. Raw material purchased from open market, specific non-family source and a specific family source is on average 80.5 percent, 15.3 percent and 4.2 percent respectively.

Joint buying of raw material with competitors or with other firms in a similar line of production is almost negligible (1.06 percent of the total purchase only, in terms of rupees). Similarly the raw material purchased directly from a competing firm or from other firms involved in a similar line of production is on average 1.8 percent only (in terms of rupees).

Customers/Clients: SMEs had an average of about 25 current customers each and the average number of new customers attracted by SMEs was about 4.

#### **4.4 Productivity and Technology**

##### Machine and Technology

Each SME has about 10 machines (on average) and about 4 workers per machine. The age-wise breakup of average number of machines in SMEs is as follows: machines less than 5 years old: 2.2, 5-15 years old: 4.1 and more than 15 years old: 3.4 machines. More than 84 percent of the machinery is imported while only 16 percent is locally manufactured. The average estimated value of machinery is equal to Rs 1,187,366. The average cost of machinery as percentage of annual sales is 30 percent, indicating that on average SMEs investment on machinery is about one third of their annual sales.

##### Quality Control Procedures

Results of the survey indicate lack of formal quality control systems at most SMEs. Only 24.4 percent firms have proper quality control system, 66.9 percent of the firms perform informal quality control while no quality checking is performed by 8.7 percent of the respondents.

##### Production Cost Function

In 2002, average sales of the surveyed SMEs were Rs 4,058,725<sup>3</sup>. The sales per employee were Rs 190,793. However, the sales data was given by only 21.8 percent (142 firms) of the firms. Average expenditure (in 2002) on raw material was Rs 1,840,590, expenditure on utilities was Rs 624,292 and expenditure on labour was Rs 545,974. About 63 percent

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<sup>3</sup> During the period of this study, the exchange rate for Pakistani rupee varied from Rs 55-60 per US dollar.

of the respondents said that the property on which the firm was built was self owned or company owned while 37 percent of the respondents had rented the property. Average price of the self or company owned land was Rs 2,628,984 and average monthly rent paid by SMEs was Rs 10,857.

#### Value Added per Employee

The average value added per employee<sup>4</sup> of the sample was Rs 39,431 (111 firms).

### **4.5 Finance/Trade Credit**

#### Investors

Results of the survey show that most of the SMEs are single person ownership firms. About 68 percent (445/651) of the firms had only 1 large investor (>10 percent share) in the company, 21 percent had 2 investors and the rest had more than two investors.

In SMEs having more than one large investor (31.6 percent of the total), about 78.7 percent of the large investors (>10 percent share) were close relatives (sibling, spouse, children or parents), 14.4 percent were non-family members and 6.8 percent were distant relatives (uncles/aunts, cousins, nephews) of the owner.

#### Short Term Loans

Only 46.5 percent (303 firms) of the firms relied on loans to arrange running finance for their business. Among the firms that take short term loan about 60 percent of their total working capital need was fulfilled through personal investment or investment through other family sources. The contribution of commercial banks was about 19 percent only.

#### Long Term Loans

Only 33.2 percent of the firms (216 firms) acquired loans for fixed/long term investment. For the firms that take loans for fixed investment about 73 percent of their long term financing needs is contributed by investment through personal and family sources while commercial banks contribute only 16 percent of the total requirement. According to Hankinson (2000) and Hankinson, Barlett and Ducheneaut (1997), SMEs in UK also tended to avoid external finance for investment purposes unless it was absolutely necessary.

#### Funds Management

Fund management practices in the SMEs sector of the country seem to be highly informal in nature. About 49.3 percent (316) of the firms have a bank account and only 43 percent of the payments received by SMEs are by way of checks. The average time since these SMEs have a bank account is nine and half years. Unbiased audits are conducted by only 15.8 percent of the firms to evaluate the financial situation of their firm. Average time since these firms have been conducting unbiased audits is almost 9 years.

#### Planned Investment in Equipment and Machines

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<sup>4</sup> (Sales – Expenditure on raw material – Expenditure on utilities)/Total number of employees

About 79 percent (513) of the SMEs have no intention of making any investment on fixed assets other than building). Out of those who intend to make any investment in the future on fixed assets (other than building); 126 firms are planning to invest Rs 770,238 in 2003 (on average) while 101 firms are planning to invest Rs 1,886,782 (on average) in 2004-2006.

The firms that are not interested to make any new future investment are about 56 percent of the total. About 14 percent of the firms cited expensive inputs, 13 percent of the firms cited expensive utilities/electricity and 10 percent of the firms cited expensive labour as the foremost reason for not making any new future investment.

#### Ease of Obtaining Bank Loans and Rates Charged

The SMEs think they will have to pay annual interest on loan of about 10.7 percent to the banks. The respondents also feel that on average it will take 84 days to get the loan after the application. About 59 percent of the respondents think that they will have to show personal land / money as security for the loan while 38 percent think that assets of the company will act as security for the loan.

#### **4.6 Governance**

For giving a boost to their businesses 29 percent of the firms wanted reduction in electricity/utility charges and about 13 percent said that taxes should be reduced.

According to 51.8 percent SMEs, tax department was among three government organizations with whom the owner/operating head had to spend maximum amount of time and 46.1 percent SMEs said that WAPDA<sup>5</sup> was among three government organizations with whom the owner/operating head have to spend maximum amount of time.

Responding to the question on ways to improve SMEs health, 29 percent of the respondents said the government should reduce the electricity/utility rates, 13.2 percent said that the taxes must be reduced/removed, 7.8 percent said that loans must be given to small businessmen, 5.6 percent said that loans should be given on low markup rate and 4.3 percent said that the price of raw materials should be reduced.

#### **5. RESEARCH QUESTIONS STUDIED**

The descriptive presented in the previous section provided interesting insights that were used to explore answers to two questions;

- 1- Owner Characteristics and the Health of Small and Medium Enterprise: One of the important finding of the study was that firms in the SME sector of the country in general revolve around the owner/entrepreneur. About two thirds of the owners were the entrepreneurs as they themselves setup the business. More than two thirds of the SMEs in the country were single ownership firms. Among the rest

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<sup>5</sup> Water and Power Development Authority is the national utility company.

about three fourth were family (close relatives) partnership firms. About two thirds of the company owners do business on their own property. Hence an interesting follow-up question was; what characteristics/traits of the owner have a significant correlation with performance in the SME sector?

- 2- Characteristics of Successful SMEs: Another pattern quite obvious from the data was that most of the SMEs do not have formal HR, quality control, marketing and finance systems in place. Only 50 percent of the SMEs had bank accounts. About 5 percent were into exports. There is limited long-term relationship building with the suppliers. Thus another interesting follow-up question was ‘what company/business characteristics have a significant relationship with performance?’

## 5.1 Performance Indicators

SMEs in Pakistan (like in most developing countries) are quite wary of sharing data on sales or profitability with any stranger. In our pre-testing of the questionnaire very few firms gave any response to the question on pre-tax profits. Hence it was decided to drop this question from the survey. However, a number of other questions were included that give a similar indication of a firms performance. Out of those, three performance parameters: sale per employee, increase/decrease in sales over the last year and investment plans on fixed assets (other than building) next year, were selected as indicators of a firm’s performance. These parameters were a) the most comprehensive in the whole list, and b) had enough data size.

### Sales Increase/Decrease

For our analysis we defined better performing firms as those having greater than or equal to 10 percent (74 firms) increase in sales (in 2002) over the last year. Low performing firms were defined as those whose sales showed greater than or equal to 20 percent decline (278 firms) in sales. The total sample size constituted of 352 firms. This variable is a measure of growth/expansion of the firm. A problem with this measure is that many companies might not have reported an increase in sales (although we had not asked them for the exact amount) out of mistrust for the surveyor.

### Sales/Employee

We had sale per employee figures (Rs) for 142<sup>6</sup> firms (21.8 percent firms). The average sale per employee for these 142 firms was Rs 190,793. For our analysis an SME was considered healthy if its sale per employee was more than Rs 190,793. This variable measures the efficiency of the firm. A problem with this measure is that a company can have higher sales/employee and still be non-profitable.

### Investment Plans

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<sup>6</sup> We used sales per employee as one of the health indicators although we had a response rate of only 21.8 percent. However, the readers should not expect a bias as we compared the average number of employees for the firms who gave their sales figures (Mean 16.26: SD 16.3) with those who did not (Mean 17.96: SD 14.66). As seen from above numbers the results were not much different

The response rate to this question was 99.2 percent. About 15.3 percent firms intend to make investment on fixed assets (other than building), while the rest (547 firms: 84.7 percent) do not intend to make any investment. Investment plans were assumed to be a measure of owner's confidence in the firm's future; the authors recognize that at times firms make investments even when the current performance is not good.

## **6. OWNER CHARACTERISTICS AND HEALTH OF THE FIRM**

While this topic has been studied for employees in the large-scale sector in Pakistan (Raja 2004), similar studies has not been done on the SME sector. In the United Kingdom work has been done by Hankinson (2000) to identify key factors in the profiles of small manufacturing firm owner-managers. A similar study by Hankinson et al. (1997) also identifies key factors in the profiles of small-medium enterprise owner-managers. However, both these studies ran short of identifying key factors in the owner characteristics of high performing firms. We segregated the better performing firms from the low performing firms, on the basis of the health indicators. Then we analyzed (using statistical tests) how the different personal characteristics of the owner/manager of the better performing firms were from those of the low performing firms. At the onset, it was hypothesized that ownership/manager factors such as the education level, their ability to use technology, and being an informed owner have a direct impact on the health (performance) of the firm. Sales/employee, increase/decrease in sales, and investment plans of the firm were taken as surrogates for the health of the firm.

### **6.1 Performance/Health Indicators Vs Owner Personality**

As stated earlier, analysis was done between the three health indicators (increase/decrease in sales over the last year, sale per employee and plans of making investments on fixed assets, other than building, in 2003) and different characteristics of the owner. A summary of significant results is given in Table IV.

Table IV about here

Based on literature review as cited above, and the analysis of data gathered during our research the following hypothesis were developed and subsequently tested.

Hypothesis 1: (Education) Firms which show better performance have better educated owners.

Hypothesis 2: (Family Ownership and Business Connections) Owners of the firms showing better performance are better connected than others.

Hypothesis 3: (Using Computers for Office Work) The use of computers by owners/mangers is more common among better performing firms.

Hypothesis 4: (Watching TV and Reading Newspapers/Magazines) Owners/managers with above average firm performance are better informed than others.

Hypothesis 5: (Number of Large Investors) Number of investors has an impact on the health of the firm.

## 6.2 Results

The results showed that education, media related habits, use of information technology, number of investors and generations in business have a significant relationship with the health of the firm.

Results by testing hypothesis 2 were quite interesting. It is generally believed that people in “business families” have a better chance at doing well in business. Our survey showed that 67 percent of the respondents were entrepreneurs (first generation in business). The health indicator of sales per employee showed that the SMEs setup by the fathers of the existing owners have performed better in 2002 while according to the health indicator of increase/decrease in sales, the SMEs setup by the fathers and grandfathers of the existing owners performed better. Sales per employee is basically a measure of a firm’s efficiency while increase/decrease in sales is a measure of a firm’s growth. The results suggest that an entrepreneur is basically involved in business growth; he does not focus on efficiency. The second generation in business has to prove itself to the family, so they focus on business consolidation and efficiency improvement. For the third generation (in business) business expansion again becomes the center of attention, as the business actually might have shrunk during the years their fathers were running the businesses.

Results from hypothesis 5 suggested that firms owned by two investors were more efficient in 2002 as compared to single ownership firms or firms having more than two owners. Thus collaborating with another partner seems to have a positive impact on a firm’s performance in the SME sector. On the other hand, the performance of SMEs owned by three or more investors was poor (indicated by health indicators of sales per employee and plans of investment). Hence it seems “too many cooks spoil the broth” in the SME sector.

A relationship could not be established between the health indicators and caste (ethnic background) of the owner, owner’s relatives’ occupation, and whether the relatives of the owner owned some other business or not.

## 7. CHARACTERISTICS OF SUCCESSFUL FIRMS

Based on the descriptive data presented in section 3, the authors also analyzed the characteristics of successful SMEs. At the onset it was postulated that SMEs having formal HR, Marketing, Quality Control and Financial systems in place would show better performance as compared to others. The health indicators used for the study were sales increase/decrease, sales per employee and investment plans on fixed assets other than building (see Section 5 for details). Analysis was done between these three health indicators and different characteristics of the firm. A summary of significant results is provided in Table V.

Table V about here

## **7.1 Hypothesis Tested**

Hypothesis 1: Firms that show better performance have formal HR systems in place. The literature in the field of HRM emphasizes the importance of well-motivated, highly skilled work force as a determinant of a small business's ability to remain competitive (Hodgetts and Kuratko, 2001; Longenecker, Moore, and Petty, 2000). Our results also showed that regular system of increments for employees and formal training programs for skilled/technical workforce have significant positive relationship with the performance of SMEs.

Hypothesis 2: Firms that show better performance conduct proper marketing research. Proper marketing research was conducted by only 3.3 percent of the respondents; thus the sample size was too small to show statistically significant relationship with performance.

Hypothesis 3: Firms that show better performance have Quality Control procedures in place.

Formal Quality Control procedures showed a positive relationship with the health of the firms.

Hypothesis 4: Firms that show better performance have formal financial systems in place. Having bank accounts, conduction of un-biased audits and a high percentage of payments being made through checks (as opposed to cash) showed positive relationship with the health of a firm.

The results also showed a positive relationship between firm size and performance. One interpretation could be that greater the firm size more is the need to have formal systems in place.

Hypothesis 5: There is positive relationship between performance and exports. Our results showed that better performing firms exported a significantly higher percentage of goods as compared to others.

Hypothesis 6: Firms that show better performance have partnerships

We also observed a positive relationship between firm performance (as indicated by the health indicator of investment plans) and sub-contacting. Positive relationship was also seen between the investment plans of a firm and purchase of raw material from specific source.

Hypothesis 7: Firms that show better performance have better machinery

The results showed that better performing SMEs had newer machines and a high percentage of machinery was imported. According to Berry, Rodriguez, and Sandee (2001) technological upgrading (which also includes better machinery) is one of the mechanisms for raising productivity.

Comparatively more efficient firms had more number of machines and consequently significantly higher value of machinery.

Hypothesis 8: Multi-product SMEs show better performance

The results showed that better performing firms offered/produced a larger number of products. This result points towards the concept of economies of scope achieved by the multi-product enterprises (Panzar and Willig, 1981).

## **7.2 Other Findings**

The analysis showed that price of land on which the SMEs were built was more for better performing firms. It needs to be tested but this result might be indicating that efficient firms are in 'clusters' thus the price of land on which they are built is relatively higher.

The better performing firms had a larger number of customers and a higher percentage of them competed with medium sized firms.

Table VI shows the relationship between the performance of a firm and the selling channel of the firms selling in local market (and not to original equipment manufacturers).

Table VI about here

When we analyzed firm performance in terms of percentage of goods sold to wholesaler/distributor and retailer/end user we observed seemingly conflicting relationships for the three success criterion. Growing firms ( $\geq 10\%$  increase in sales) and expanding firms (having plans of investment in 2003) sell more to the retailer/end user (56% and 64% of their sales in local market) while efficient firms (above average sales per employee) sell more to the wholesaler/distributor (63% of their sales in local market). These results show that owners of SMEs focusing on growth and having plans of investment are more market oriented, that is, a high percentage of their sales are directly to the retailer/end user; while firm owners focusing on efficiency are more operations oriented and a high percentage of sales are through wholesaler/distributor.

## 8. CONCLUSION

The SME Pulse survey is the first attempt in Pakistan to collect scientific data on the SME sector. An important finding of the study was that firms in the SME sector of the country in general revolve around the owner/entrepreneur. About two thirds of the owners were the entrepreneurs as they themselves setup the business. More than two thirds of the SMEs in the country were single ownership firms. Based on these results hypothesis were developed to analyze what characteristics/traits of the owner have a significant correlation with performance in this sector. The results showed that owners' education, media related habits, use of information technology, number of investors and generations in business have a significant relationship with the health of the firm.

The results also showed that SMEs' total investment on equipment/machinery is only about one third of their annual sales. Most of the SMEs do not have formal HR, quality control, marketing and finance systems in place. Only one half of the SMEs had bank accounts. About 5% were into exports. Hence another interesting question studied was what company characteristics have a significant relationship with performance? Our results show positive relationship between firms' performance and whether or not they have formal HR, QC and financial systems in place. Some of the other factors that showed significant relationship with SME performance were percentage of goods exported, number of products produced, number of customers, amount of sub-contracting and whether or not they had better machinery.

Lastly, various indicators suggest an overall negative trend in performance within the SME sector warranting the need for in-depth study for the underlying causes for a decline in this key sector of Pakistan's economy.

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## **TABLES AND FIGURES**

**Table I: Breakdown of the Sample by Industry**

| Sectors  | Number of Firms | Percentage of Firms |
|--|-----------------|---------------------|
| Food & Beverage  | 73              | 11.2                |
| Textiles   | 144             | 22.1                |
| Leather, Footwear, Sports, Handicraft                              | 39              | 6.0                 |
| Chemical, Plastic, Rubber, Paper, Non-metals, Industrial, Printing | 115             | 17.7                |
| Metals   | 181             | 27.8                |
| Others   | 99              | 15.2                |
| <b>Total</b>   | <b>651</b>      | <b>100.0</b>        |

**Table II: Type of Employees and Average Experience**

| Breakup of Employees      | Males (Average) | Females (Average) | Total (Average) | Average Experience (Years) |
|---------------------------|-----------------|-------------------|-----------------|----------------------------|
| Total Employees           | 16.24           | 0.37              | 16.61           |                            |
| Executives                | 1.04            | 0.01              | 1.05            | 14.22                      |
| Skilled/Technical Workers | 10.08           | 0.14              | 10.22           | 7.28                       |
| Unskilled Workers         | 5.12            | 0.22              | 5.34            | 3.68                       |

**Table III: Employee Training**

| Type of Employee  | Type of Training             |                            |                               |
|-------------------|------------------------------|----------------------------|-------------------------------|
|                   | Informal In-House In Percent | Outside Company In Percent | No Formal Training In Percent |
| Executive         | 42.7                         | 1.7                        | 55.6                          |
| Skilled/Technical | 44.5                         | 6.5                        | 49                            |
| Unskilled         | 35                           | 4                          | 61                            |

**Table IV: Summary of Results**

|  | <b>Increase/Decrease in Sales</b>   | <b>Sales per Employee</b>   | <b>Plans of making investment next year (Y/N)</b>         |
|--|---|---|---|
| <b>Owner's Education</b>   | Spearman Rank Test<br>Co-efficient Value:<br>0.222<br>Significance: 0.000 | Spearman rank test<br>Co-efficient value:<br>0.268 Significance:<br>0.001 | NR <sup>7</sup>   |
| <b>Partner's Education</b>   | Spearman rank test<br>Co-efficient value:<br>0.244 Significance:<br>0.012 | NA <sup>8</sup>   | NR  |
| <b>Owner's Father's Education</b>                                  | Spearman rank test<br>Co-efficient value:<br>0.223 Significance:<br>0.000 | Spearman rank test<br>Co-efficient value:<br>0.244 Significance:<br>0.004 | NR  |
| <b>Generations in Business</b>                                     | Chi square Test of<br>Independence<br>Significance: 0.022                 | Chi square Test of<br>Independence<br>Significance: 0.017                 | NR  |
| <b>Number of Large Investors</b>                                   | NR  | Chi square Test of<br>Independence<br>Significance: 0.081                 | Chi square Test of<br>Independence<br>Significance: 0.01  |
| <b>Watching TV at least 2 days in a Week</b>                       | Chi square Test of<br>Independence<br>Significance: 0.016                 | NR  | Chi square Test of<br>Independence<br>Significance: 0.069 |
| <b>Reading Newspapers/<br/>Magazines at least 2 days in a Week</b> | Chi square Test of<br>Independence<br>Significance: 0.001                 | Chi square Test of<br>Independence<br>Significance: 0.069                 | NR  |
| <b>Using Computer for Office Work</b>                              | Chi square Test of<br>Independence<br>Significance: 0.000                 | Chi square Test of<br>Independence<br>Significance: 0.016                 | Chi square Test of<br>Independence<br>Significance: 0.062 |

**Table V: Summary of Results**

|  | <b>Increase/Decrease in Sales</b>   | <b>Sales per Employee</b>  | <b>Plans of making investment next year (Y/N)</b>  |
|--|---|--|--|
| <b>Firm Size</b>                               | Chi square test:<br>Significance: 0.000   | Chi square test:<br>Significance: 0.000  | NR   |
| <b>Training of Skilled/Technical Workforce</b> | NR  | NR   | Chi square test:<br>Significance: 0.017  |
| <b>Regular System for Salary Increments</b>    | Chi square test:<br>Significance: 0.006 for Executives; 0.009 for skilled/technical workers; NR for non-skilled workers | Chi square test:<br>Significance: 0.019 for Executives; 0.027 for skilled/technical workers; 0.028 for non-skilled workers | Chi square test:<br>Significance: 0.000 for Executives; 0.002 for skilled/technical workers; 0.056 for non-skilled workers |
| <b>Quality Control Procedures</b>              | Chi square test:<br>Significance: 0.000   | NR   | Chi square test:<br>Significance: 0.011  |
| <b>Bank Account</b>                            | Chi square test:  | Chi square test:   | NR   |

<sup>7</sup> NR = No relationship<sup>8</sup> NA = Not enough data

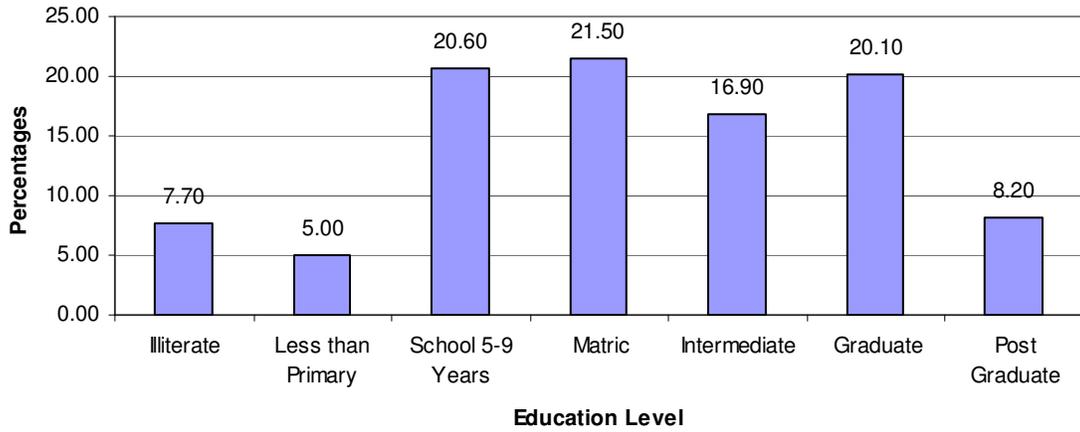
|  |   |   |   |
|--|---|---|---|
|  | Significance: 0.002                       | Significance: 0.000                       |   |
| <b>Duration since Account</b>  | NR  | Independent t-test<br>Significance: 0.003 | NR  |
| <b>Percentage of Payments through Checks</b>                         | Independent t-test<br>Significance: 0.01  | Independent t-test<br>Significance: 0.049 | NR  |
| <b>Unbiased Audits</b>   | Chi square test:<br>Significance: 0.000   | Chi square test:<br>Significance: 0.023   | NR  |
| <b>Duration since Unbiased Audits</b>                                | NR  | Independent t-test<br>Significance: 0.015 | Independent t-test<br>Significance: 0.028 |
| <b>Percentage of Goods Exported</b>                                  | Independent t-test<br>Significance: 0.023 | Independent t-test<br>Significance: 0.000 | NR  |
| <b>Sub-Contracting</b>   | NR  | NR  | Chi square test:<br>Significance: 0.000   |
| <b>Raw Material Purchase from Specific Source</b>                    | NR  | NR  | Independent t-test<br>Significance: 0.049 |
| <b>Number of Stages (main product passes through)</b>                | Independent t-test<br>Significance: 0.005 | NR  | NR  |
| <b>Number of Machines</b>  | NR  | Independent t-test<br>Significance: 0.002 | NR  |
| <b>Percentage of New Machinery (&lt;5 years old)</b>                 | Independent t-test<br>Significance: 0.015 | Independent t-test<br>Significance: 0.014 | NR  |
| <b>Percentage of Old Machinery (&gt;15 years old)</b>                | Independent t-test<br>Significance: 0.024 | Independent t-test<br>Significance: 0.016 | NR  |
| <b>Imported Machinery</b>  | Independent t-test<br>Significance: 0.000 | Independent t-test<br>Significance: 0.084 | NR  |
| <b>Value of Machinery</b>  | NR  | Independent t-test<br>Significance: 0.000 | NR  |
| <b>Number of Products</b>  | NR  | Independent t-test<br>Significance: 0.05  | Independent t-test<br>Significance: 0.016 |
| <b>Price of Land</b>   | NR  | Independent t-test<br>Significance: 0.000 | NR  |
| <b>Number of Customers/Clients</b>                                   | Independent t-test<br>Significance: 0.01  | NR  | Independent t-test<br>Significance: 0.04  |
| <b>Selling Channel (wholesaler, distributor, retailer, end user)</b> | Kruskal tau test<br>Significance: 0.013   | Chi square test:<br>Significance: 0.049   | Chi square test:<br>Significance: 0.002   |
| <b>Size of Competing Firm</b>  | NR  | Chi square test:<br>Significance: 0.004   | NR  |

**Table VI: Selling Channel vs Percentage of Goods Sold**

| Selling Channel for the Firms Selling in Local Market | Increase in Sales     |                   | Above Average Sales per Employee |                   | Plans of making Investment next year |                   |
|---|-----------------------|-------------------|----------------------------------|-------------------|--------------------------------------|-------------------|
|   | Successful In Percent | Others In Percent | Successful In Percent            | Others In Percent | Successful In Percent                | Others In Percent |
| <b>Wholesaler</b>                                     | 39                    | 50                | 42                               | 43                | 30                                   | 49                |
| <b>Distributor</b>                                    | 4                     | 10                | 21                               | 7                 | 6                                    | 9                 |

|                 |    |    |    |    |    |    |
|-----------------|----|----|----|----|----|----|
| <b>Retailer</b> | 14 | 15 | 21 | 15 | 20 | 16 |
| <b>End User</b> | 43 | 25 | 16 | 35 | 44 | 26 |

**Figure: Education Level of the Owner**



**TURNAROUND STRATEGIES FOR DECLINING ENTREPRENEURIAL FIRMS:  
THE EFFECTS OF PERFORMANCE AND RESOURCES**

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**Keywords**

Entrepreneurship, small business, turnaround strategy, diversification strategy, organizational decline, and resource-based theory.

# **TURNAROUND STRATEGIES FOR DECLINING ENTREPRENEURIAL FIRMS: THE EFFECTS OF PERFORMANCE AND RESOURCES**

## **ABSTRACT**

Growth has been described as the essence of entrepreneurship. Organizational ecologists theorize an inevitable progression from growth through maturity, revival, and eventually decline. During the organizational life cycle entrepreneurs choose between growth, stability, or retrenchment strategies to overcome deteriorating trends in performance. Using survey data, this study tests a contingency model of strategic choice for declining entrepreneurial firms in the U.S. Small Business Administration database. The results indicate entrepreneurs choose growth strategy when their perceptions of resource availability and past financial performance are both high and when both are low, indicating entrepreneurs remain aggressive when faced with adverse conditions.

## INTRODUCTION

Many firms experience deteriorating financial performance resulting from market erosion and maladaptive decisions by management. Managers respond by selecting corporate strategies that redirect their attempt to improve their firm's competitive position. Previous literature has described strategic choice employed by declining firms to reverse negative trends of performance as turnaround strategies (O'Neill, 1983; Pant, 1991; Pearce and Robinson, 1992). Turnaround strategy is a form of retrenchment strategy which focuses on operational improvement when the state of decline is not severe. Other possible corporate level strategic responses to decline include growth and stability. Exploring other options is particularly important for entrepreneurial firms because of their predisposition to growth and innovation. Managers' strategic responses are often contingent on internal and external factors that are historical and anticipated. Researchers have developed and tested several theories on the significant factors affecting strategic responses by managers in declining multinational corporations. Tan and See (2004) suggested that strategic choice is a function of organizational slack, size, and management's perception of external factors controllability. One of the more prominent historical factors affecting strategic choice is the severity of the financial deterioration (Hofer, 1980; Robbins & Pearce, 1992). Researchers have also established a link between corporate diversification strategy and resource constraints, but the contingent effects of the level of deterioration and limits to resource availability on strategic choice have not been addressed adequately (Penrose, 1959; Ackoff, 1970; Hofer and Schendel, 1978; Hitt and Ireland, 1985; and Wernerfelt, 1984).

The current study extends previous research by proposing and testing a contingency model that suggests the likelihood that entrepreneurs will choose growth or retrenchment

strategies when faced with deteriorating performance depends on their perception of resource availability and historical financial performance. This paper first discusses literature related to decline, corporate strategy, and resource-based theory. Next, hypotheses are presented and tested for the effects of performance and resource on strategic choices. The findings should help entrepreneurs understand at which combined levels of historical performance and resource availability are growth, retrenchment, or stability strategies most appropriate.

## **LITERATURE REVIEW**

Two basic theories have dominated the management literature on organization failure. A deterministic perspective in classical industrial organization and organization ecology literature suggests that managers are constrained by exogenous industrial and environmental constraints and therefore their strategic choices have limited impact. A more voluntaristic perspective in organization studies and organizational psychology literature suggests that managers' actions and perceptions are the fundamental cause of organizational failure (Mellahi & Wilkinson, 2004).

From the ecological perspective Cameron, Sutton, and Whetten (1988) described organizational decline as a two stage phenomenon. The first stage of decline occurs when an organization's adaptation to its domain or microniche<sup>1</sup> deteriorates. The second stage occurs when the organization's financial and human resources begin to diminish. Both stages of decline indicate that the organization has become less adapted to its microniche and is less successful at exchanging its outputs for new inputs. Weitzel and Jonsson (1989) characterized decline as the opposite of successful adaptation to the environment. They suggested that organizations enter the state of decline when they fail to anticipate, recognize, avoid, neutralize,

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<sup>1</sup> Microniche is defined by Cameron, Sutton, and Whetten (1988) as the product or market domain of the firm.

or adapt to external or internal pressures that threaten the organization's long-term survival. Additionally, Levy (1986) defined decline as the inability of the decision makers to heed the warning signals of the need for change. For the purpose of this paper, decline is defined as a trend of deteriorating financial performance.

According to population ecologists, strategic decisions differ as the company evolves through the stages of the organizational life cycle (Hanks, 1990). Entrepreneurs focus on survival during the start-up phase, and their strategy is limited to making their product or service innovation successful. During the growth phase entrepreneurs adopt competitive strategies that can require retrenchment. In the decline stage growth is negative, products are obsolete or have limited potential, and the organization is inefficient or bureaucratic. Decline is often preceded by ineffective or short-lived attempts at revival where entrepreneurs focus on internal changes that can be made by reallocating limited resources (Holt, 1992).

Research from the voluntaristic perspective suggests that managers make distinctive choices. Tan and See (2004) identified two main strategies taken in a declining Asian manufacturing industry: offensive strategic reorientation and defensive strategic shift. They found that firms adopting defensive strategic shift attributed decline to uncontrollable factors, are under greater severity of decline, have a lower level of slack and are smaller in size (Tan & See, 2004). Mone, McKinley, & Barker (1998) offered a contingency framework that predicted a firm responds either innovatively or conservatively to decline, based on constraints on an organization's capacity.

The strategic response to decline is expected to differ for entrepreneurial firms for a number of reasons. Although there are no indisputable definitions of entrepreneurship, one common denominator is that entrepreneurs create incremental wealth and assume major risks in

terms of equity, time, and career commitment (Ronstadt, 1984). Because they have assumed a personal risk, they are likely to have a different strategic response than the manager of a multinational firm when faced with the loss of their life savings as well as their reputation. Also entrepreneurs tend to be leaders who are emotionally involved in a venture, think strategically to create opportunities, and provide the inspiration for sustained momentum (Holt, 1992). Asian firms of varied size, often function as owner-managed, and are given more discretion and are more inclined to debt financing, even as the firm grows into publicly-held ownership (Burton, Ahlstrom, & Wan, 2003).

According to the theory of disequilibrium and chaos, entrepreneurs periodically introduce innovation, thereby creating disequilibrium (Stevenson & Harmeling, 1990). In the decline stage, they often have difficult transitioning from the visionary and aggressive competitor role of founder to the role of professional turnaround managers. When faced with the reality that the failure may be attributable to their poor management, they may resort to the more familiar aggressive role of innovator (Bruno & Leidecker, 1988). If they fail to make the transformation, either the venture suffocates or the entrepreneur does not survive the organizational evolution (Holt, 1992). A more recent study (McCarthy, 2003) suggested that the experience of crisis gave rise to a more rational, planned approach to the strategy-making process.

The other difference for entrepreneurial firms, when compared to large diversified corporations, is financial resource limitations. Strategic alternatives available to small firms are limited to internal changes that are made through the reallocation of limited resources. Despite resource constraints, however, entrepreneurs still tend to focus on growth and diversification. Growth through diversification, tends to preoccupy entrepreneurs, despite lack of evidence to suggest it is a successful strategy in the decline stage. From their perspective, growth may be

necessary to establish an image, increase the firm's asset base, meet competition, improve profits, satisfy the founder's need to head a large organization, or has become essential for survival (Holt, 1992).

Most prior research in the strategic management literature has focused on turnaround strategy when firms are in decline (Schendel, Patton, and Riggs, 1976; Hofer, 1980; Hambrick and Schechter, 1983; O'Neill, 1983; Pant, 1991; Pearce and Robinson, 1992). According to Wheelen and Hunger (2001) turnaround strategies are a form of retrenchment that emphasize the improvement of operational efficiency. The two principal types of turnaround strategies, contraction and consolidation, are used when a corporation's problems are not pervasive. However, researchers have largely ignored the possibility that firms may choose a growth strategy or stability strategy when experiencing declining performance.

The most common growth strategies are diversification at the corporate level and concentration at the business level (Wheelen & Hunger, 2001). Ramanujam and Varadarajan (1989) defined diversification as the entry of a firm into new lines of activity, through internal development or acquisition. Internal development can take the form of investments in new products, services, customer segments, or geographic markets including international expansion. Diversification can also be accomplished through external modes such as acquisitions and joint ventures. Concentration can be achieved through vertical or horizontal growth. Vertical growth occurs when a firm takes over a function previously provided by a supplier or a distributor. Horizontal growth occurs when the firm expands products into new geographic areas or increases the range of products and services in current markets. Much of the empirical research for large firms has focused on diversification strategy, however.

Previous researchers have established a linkage between decline and diversification by suggesting that poor financial performance affects the choice of diversification strategy. Burgelman (1983) maintained that the creation of new ventures is often stimulated by deteriorating performance in existing businesses. Ramanujam and Varadarajan (1989) also suggested that a diversification strategy is a likely response to poor financial performance.

International geographical diversification has also been linked to strategic choice for small firms in difficulty. Specifically, firms that are already involved in foreign business will grow internationally in response to declining performance (Chen & Martin, 2001). Tan and See (2004) proposed that firms with organization slack will choose a more offensive strategic orientation.

Prior studies have proposed that strategic choice for declining firms is contingent upon past financial performance trends. For example, firms substantially below financial break-even may initiate asset reduction strategies, while firms operating near break-even may implement revenue generation or cost reduction strategies (Hofer, 1980). Robbins and Pearce (1992) also linked strategic choice for declining firms to financial performance. They suggested that as severity of decline increased, retrenchment strategies should progress from cost reduction to asset reduction strategies. Consequently, this paper proposes the following:

H1: Perceptions of past financial performance influence small firms' choice between growth and retrenchment strategies.

The resource-based view of strategic management has received a great deal of attention recently as a perspective for understanding firm growth. Penrose (1959) established the conceptual foundation of the resource-based theory of the firm, maintaining that resource constraints are a limitation to growth created by the need to balance goodwill, excess capacity and organizational slack. The growth of the firm is limited only in the long run by its internal management resources (Penrose, 1959). Total managerial services that a firm requires at a point in time are partly constrained by the necessity to run the firm at its current size. Additionally, it is partly constrained by the requirements for expansionary ventures (Mahoney & Pandian, 1992). Although new managerial recruits increase the growth potential of a firm, training new managers and their integration into the work force occupies the time and effort of existing managers and thus temporarily reduces the managerial services available for expansion.

Resource availability has been suggested as a predictor of strategy choice, particularly in regards to diversification (Penrose, 1959; Ackoff, 1970; Hofer & Schendel, 1978; Hitt & Ireland, 1985; and Wernerfelt, 1984). The traditional concept of strategy suggests organizations establish competitive advantage by effectively evaluating their resources and focusing those resources on the generation of rent<sup>2</sup> (Andrews, 1971 & Ansoff, 1965). Therefore, it is the resources of the firm that limit market choice and profit expectations (Wernerfelt, 1989).

Penrose (1950) classified resources into the following: land and equipment; labor (including worker's capabilities and knowledge); and capital (organizational, tangible, and intangible). Subsequent research by Hofer and Schendel (1978) suggested that a firm's resource profile combines the following resources and capabilities: (1) financial resources (e.g., cash flow, debt capacity, new equity availability); (2) physical resources (e.g. plant and equipment, inventories); (3) human resources (e.g. scientists, production supervisors, sales personnel); (4) organizational resources (e.g. quality control systems, corporate culture, relationships); (5) technological capabilities (e.g. high quality production, low cost plants). Grant (1991) later added a sixth type of resource, intangible resources (e.g. reputation, brand recognition, goodwill). Since it is expected that growth strategies require resources for execution, the following hypothesis is offered:

H2: Perceptions of resource availability influence small firms' choice between growth and retrenchment strategies.

In addition to this link between resources and growth strategies, resource constraints have been associated with poor financial performance among publicly-traded firms. D'Aveni (1989) linked decline and resources by defining decline as a pattern of decrease over time in a firm's financial and managerial resources. He concluded that firms may delay or avoid bankruptcy by adopting a growth strategy to support a resource deficient firm. In other words, the strategy choice of a firm with poor financial performance is dependent upon the availability

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<sup>2</sup> Rent is defined as return in excess of a resource owner's opportunity costs (Tollison, 1982).

of resources. Chen & Martin (2001) found that the propensity to diversify internationally was contingent on managerial resources specific to foreign experience. As mentioned before, an entrepreneur's strategic alternatives are limited by the availability of resources, thereby precluding some complex strategic alliances or large acquisitions. It can also be concluded that the result of a trend in poor financial performance is resource constraints. Therefore, this study proposes a joint effect of resource constraints and financial performance on strategic choice as follows:

- H3: The perceptions of resource availability will moderate the effect of perceptions of past performance on small firms' choice between growth and retrenchment.

## **METHODOLOGY**

### **Sample**

The sample for this research was derived from the United States Small Business Administration's (SBA) database of small businesses that contract with U.S. federal agencies. Firms included in the database conform to the small business standards of the SBA for their respective Standard Industrial Classification Code.

A questionnaire was developed and tested using a pilot study of ten entrepreneurs, and revised based on their feedback. The questionnaire was then randomly distributed to 400 firms in the database with a cover letter to introduce entrepreneurs to the purpose of the study and assure confidentiality. Using a basic definition of an entrepreneur as one who creates incremental wealth and assumes major risks (Ronstadt, 1984) respondents were included in the survey if they were a founder, as well as a current majority owner and a primary manager, based on a survey question. There were 138 complete and usable instruments returned for an acceptable response rate (34%) for limiting the effects of selection error (Yu & Cooper, 1983). The sample was further stratified by considering only firms that indicated their most

recent performance period was stagnant or declining, resulting in a final sample of 88 firms. The final sample was compared to the 50 firms eliminated from the study, finding no significant differences in terms of size or industry. As categorized in the database, the proportion of respondents by industry were as follows: professional service (22%), non-professional service (23%), construction (17%), commodities (14%) , and manufacturing (24%). The average size in terms of employees was 35.

### **Measurement of variables**

Consistent with McDougall and Round (1984), strategic choice was measured on a binary basis, as growth or retrenchment strategy anticipated during the next twelve month period of performance. Strategy was coded “1” when they chose a growth strategy (acquiring another company, establishing a new market, or joint venturing with another company). Strategy was coded “0” when they chose a retrenchment strategy (turnaround, divestment, or liquidation), (Wheelen & Hunger, 2001). The 20 firms choosing stability were eliminated from the study to ensure better interpretation of the results.

Limited theory exists for developing a measurement scale for manager’s perceptions of resource availability. Although objectives measures are more popular, Venkatraman and Ramanujam (1986) found a high degree of correlation between perceptual and objective performance measures and concluded that perceptual measures are acceptable operationalizations of business economic performance. Therefore, this paper measures resource availability based on entrepreneur’s perceptions. In keeping with Hofer and Schendel (1978) and D'Aveni (1989), the resources considered were: (1) availability of debt financing; (2) availability of equity financing; and (3) availability of labor. Response options were coded on a Likert-like scale of 1 to 5, with “1” being not very available to “5 being very available. A Cronbach alpha (coefficient = .73) calculated the internal consistency estimates of reliability for the four items and their relationship to the resource availability factor. The

sum of the scores for the three items represents the degree of resource availability perceived by the entrepreneur, with scores ranging from 3 to 15.

Financial performance was measured by asking the respondent whether sales and profits increased, remained the same, or decreased each year over the past three years. Again, perceptual measures are an acceptable substitute for objective measures of economic performance (Venkatraman & Ramanujam, 1986). For both measures of performance—sales and profit—an upward trend was coded three (3), a stagnant trend was coded two (2), and a deteriorating trend was coded one (1). A Cronbach alpha (coefficient = .83) calculated the internal consistency estimates of reliability for the six items and their relation to the performance factor. The scores were summed for sales and profit trends for each year over the three year period, resulting in a potential range of 6 to 18.

Size and industry are often used as control variables to limit confounding effects. In this sample the effects of size are limited since all firms are classified as small in their respective industry. Research indicates that the change in total market sales may have an impact on business difficulties (Chen & Martin, 2001). In this study, industry effects are limited because firms in the sample derive an average of 28% of revenue from U.S. Federal Government procurement, and are therefore not included as a control variables.

### **Analysis**

Since the dependent variable, strategic choice was measured dichotomously (growth or non-growth), a hierarchical logistic regression model was used to determine if resource availability and financial performance have a joint influence on strategic choice. The following logistic regression equation (in linear form) suggests the relationship of the variables tested in the preceding hypotheses.

(a) Strategic Choice =

$$a + \beta_1 \text{ Resource availability (R)} + \beta_2 \text{ Financial Performance (P)} + \beta_3 \text{ R*P} + e$$

In this model, strategic choice represents a positive binary variable of growth or retrenchment. The signs of the parameter estimates are expected to be positive for the main effects and the interaction term.

## RESULTS

Table 1 provides means, standard deviations, and correlations for the variables used in this study. An analysis of the data indicates that none of the variables exceeded acceptable thresholds for skewness (2.0) and variance inflations factors (10.0) suggesting no problems with normality of data or multicollinearity that would violate assumptions for the general linear model (Lomax, 1992).

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insert Table 1  
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Table 2 shows logistic regression analysis results for the full and reduced models.

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insert Table 2  
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In the reduced model, the perception of financial performance coefficient is not significant and the perception of resource availability coefficient is negatively significant ( $p < .05$ ) and large, relative to its standard error. The full model includes the main effects as well as the interactive term, which is a cross-product of financial performance and resource availability perceptions. In the full model, the main effects coefficients are negatively significant ( $p < .05$ ) and large in relation to its standard errors. The results support Hypothesis 3, which proposes that the interaction of financial performance and resource availability perceptions significantly impacts the selection between a growth or retrenchment strategy. In moderated regression equations, a significant interaction term indicates that two or more lines fit the data better than a single regression line. This is demonstrated in Figure 1, since the slope of the curve is not zero.

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insert Figure 1  
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In linear regression the  $R^2$  would indicate the additional variance explained by the interaction term. This analysis calculates a pseudo  $R^2$  in keeping with Aldrich and Nelson (1984). The interpretation of a pseudo  $R^2$  is similar to the traditional  $R^2$ , providing a measure of the quality of fit for the model. The change in  $R^2$  (.0318) between the reduced and full models is significant ( $p < .05$ ), indicating that the interaction term adds significantly to the explanation of strategic choice.

Since there is a significant relationship between the moderator (resources) and both the predictor (performance) and dependent variable (strategy), the model is a quasi-moderating relationship (McArthur & Nystrom, 1991). In other words, resources moderate the form of the relationship but not the strength. In addition to the interpretation of the sign of the interaction, the form of the interaction can also be interpreted. A series of simple regression models were created by entering different values for the moderating variable, resource, in the interactive multiple regression models (Simerly & Li, 2000). Using Cohen and Cohen's (1983) guidelines, one standard deviation above, at, and below the means were used as the high, medium, and low values, respectively, to plot the interactive effects of resources and performance with respect to strategy. Substituting a range of low-low to high-high response values of performance and resource availability into the unstandardized regression equation, a symmetrical curve results, suggesting that firms are likely to choose a growth strategy at very low and very high levels of combined financial performance and resource availability (Figure 1). Specifically, the graph indicates that firms with low performance perceptions (1 through 3) and low resources ("1" on the x axis) will choose a growth strategy (above 1 on the y axis). As resources increase with respect to low performance perceptions (2-3), the likelihood of choosing a growth strategy diminishes. When performance perception is moderate (4-6) the slope nears zero, indicating limited preference for either growth or retrenchment. When performance perceptions are high (7-9) the likelihood of choosing a growth strategy increases as resource perceptions increase (7-

9). Specifically, firms with high resource and performance perceptions are likely to choose a growth strategy (9).

## **DISCUSSION AND CONCLUSION**

The purpose of this study is to develop a contingent perspective of strategic choice for small entrepreneurial firms in decline. The results indicate the choice between growth and retrenchment strategies depends on the interaction between perceived performance and resource availability. Specifically, entrepreneurs are likely to choose growth if they perceive high levels of past financial performance and perceive that resources are available to support their strategic plan. The symmetrical nature of the interaction of the main effects suggest an interesting phenomenon, however. Firms are also likely to choose a growth strategy if they perceive a very low combination of financial performance perception and resources availability. Although counter intuitive, this supports previous findings that entrepreneurs remain aggressive in their strategy choice, even when performance and resources are poor (Staw, Sandelands, & Dutton, 1983). Small business owners, by definition are risk takers, and may see growth as their only alternative to severe decline. These results support D'Aveni's (1989) finding among public firms that resource deficient firms near bankruptcy choose growth strategies. These findings also support Burgelman's (1983) contention that deteriorating performance stimulates efforts to create new ventures. Similarly, diversification strategists have suggested a curvilinear relationship between the relatedness of diversification and performance. If a firm allocates new resources and capabilities to a similar business, the likelihood of performance improvement is increased (Wheelen & Hunger, 2001).

One possible limitation of this study is the representativeness of this sample of entrepreneurs which contract with U.S. federal agencies. Since the study did not control for the

degree of public versus commercial market base, this study may not be generalizable to all firms. Secondly, this research does not consider the success of implementing a growth strategy as a response to financial decline. Future research could examine the effects of trends on the strategic choice of entrepreneurial firms in decline using objective financial data, although it is difficult to obtain from privately-held companies. Also, limiting strategic choice to a dichotomy improves the interpretability but lessens our understanding of stability strategy as a discrete choice. Although not directly measured as part of the dependent variable, Figure 1 suggests that firms with moderate performance perceptions (4-6) may choose stability strategies which are implicitly represented by zero on the y axis. Finally, using only declining firms and eliminating firms choosing stability strategies reduced the sample, but the power was still sufficient for a study of this nature (Cohen & Cohen, 1983). Although a mean difference comparison between declining firms and the non-declining firms related to strategy choice did not produce significant results, future research may investigate why not.

In conclusion, this study suggests there is merit to analyzing how strategic variables interact in periods of decline. It also should encourage the use of a resource-based approach for predicting how entrepreneurs respond to deteriorating financial performance. Although decline is not always the most popular subject, understanding the context of aggressive or passive strategic choices should help explain the behavior of entrepreneurs, when things get tough.

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**Table 1. Means, Standard Deviations, And Correlations<sup>a</sup>**

| VARIABLE    | MEANS | s.d   | 1      | 2     | 3     | 4 |
|-------------|-------|-------|--------|-------|-------|---|
| 1. STRATEGY | .46   | .50   | --     |       |       |   |
| 2. PERFORM  | 13.56 | 2.48  | .08    | --    |       |   |
| 3. RESOURCE | 6.95  | 3.46  | -.42** | .21   | --    |   |
| 4. INTERACT | 95.23 | 46.23 | -.35*  | .57** | .91** |   |

<sup>a</sup> N = 68.

+p <.10 or better, one-tailed test.

\*p<.05 or better, one-tailed test.

\*\*p<.01 or better, one-tailed test.

**Table 2. Results Of Logistic Regression Analysis**

| Independent Variables    | Parameter Estimates | Parameter Estimates |
|--------------------------|---------------------|---------------------|
|                          | Full Model          | Reduced Model       |
| Intercept                | 10.78+<br>(2.46)    | 1.66<br>(1.74)      |
| Financial Performance    | -.80+<br>(.59)      | .01<br>(.15)        |
| Resource Availability    | -1.64*<br>(.99)     | -.29*<br>(.12)      |
| Interaction Term         | .12*<br>(.08)       | --                  |
| Pseudo R <sup>2</sup>    | 13.66%              | 10.48%              |
| Change in R <sup>2</sup> | 3.18%*              |                     |
| Model Chi-Square         | 9.97*               | 7.4*                |
| N                        | 68                  | 68                  |

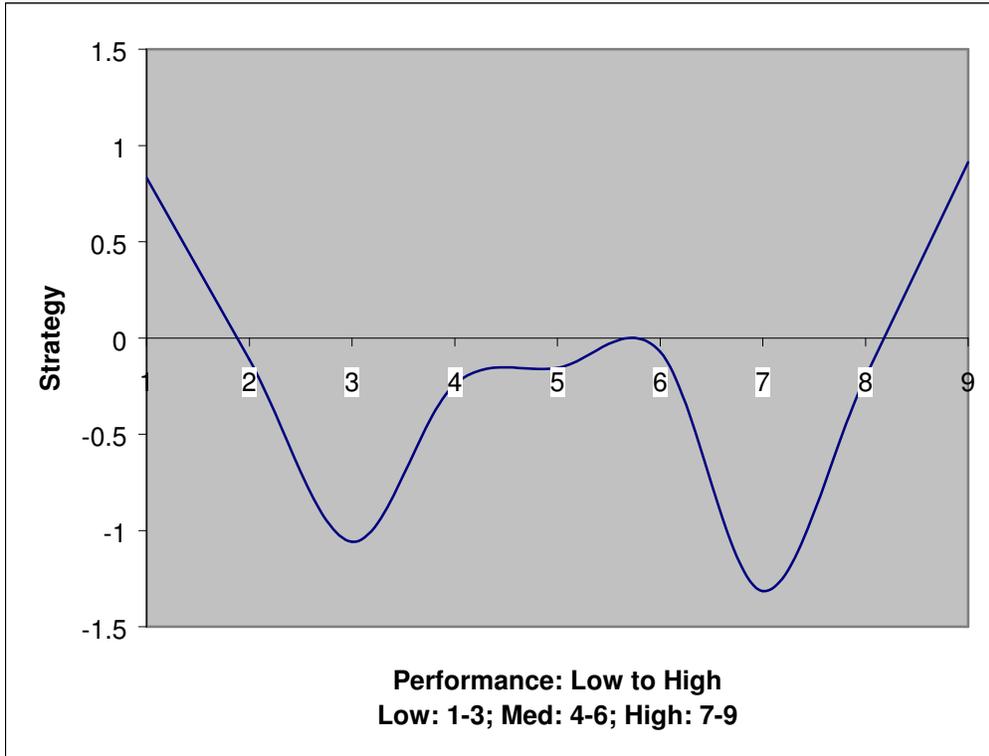
**Note:** Standard errors are reported in parentheses.

+p<.10 or better, one-tailed test.

\*p<.05 or better, one-tailed test.

\*\*p<.01 or better, one-tailed test.

Figure 1. Moderating Effects of Resources on Strategy and Performance



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# INTEGRATING MARKET KNOWLEDGE INTO R&D – TYPOLOGY OF CHALLENGES IN YOUNG BIOTECHNOLOGY FIRMS

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## ABSTRACT

Inspired by technology management literature and Austrian economics view on entrepreneurial opportunity discovery, this study looks at the dissemination of market knowledge in young technology ventures. Austrian economic theories emphasize the role of idiosyncratic knowledge, especially market knowledge, in entrepreneurial opportunity discovery. Also, previous research has directed attention to the importance of customer knowledge in research and development (R&D). However, little is known about processes employed by small and young technology firms to disseminate market knowledge within firm and to integrate market knowledge into their research and development efforts. This study addresses the research gap with a qualitative research approach. Based on interviews conducted in 85 research intensive, small, young biotechnology ventures in the USA and in Northern Europe, challenges that these firms face in integrating market knowledge into their R&D operations are identified. Even though most of the challenges are identified on the firm level, some of them reflect peculiarities of the biotechnological product development (industry level) or interaction between scientists and business people (individual level). The results suggest that technology ventures face challenges in integrating market knowledge into R&D because of (1) excessive focus on technology instead of e.g. asking future end users of products for their opinions on product features; (2) excessive focus on meeting development milestones instead of visioning end products in the markets one day; (3) forgetting the development of internal communication channels especially in the times of rapid growth; (4) failing to understand the different goals and mental models of scientists vs. business people.

## INTRODUCTION

As economic growth is increasingly driven by knowledge intensive industries, academics have become increasingly interested in the role that knowledge plays in the innovation process as well as in entrepreneurial opportunity discovery. According to Hammond and Summers (1972), knowledge reflects the extent of a subject's accurate detection of a task's properties. Thus, a manager who can correctly identify customer preferences and competitors is deemed knowledgeable about customer preferences and competitors (Marinova 2004). Day and Nedungadi (1994, p. 32) note that "the two most salient features of a competitive market are customers and competitors." When delineating the domain of market orientation construct, Narver and Slater (1990) build on customer knowledge, competitor knowledge, and interfunctional coordination. In this research, the term "market knowledge" implies knowledge about customers and competitors.

The purpose of the current study is to identify the bottlenecks that hinder market knowledge dissemination in high technology SMEs. More specifically, the focus is on integrating market

knowledge into R&D. Based on a qualitative research approach, I develop a typology of barriers that prevent this intelligence dissemination.

## **THE IMPORTANCE OF MARKET KNOWLEDGE FOR NEW VENTURES**

Austrian theories emphasize the role of idiosyncratic information in entrepreneurial behavior, especially in opportunity discovery (Hayek 1945; Shane 2000, Denrell et al. 2003). Seeking information, investing in human capital, and systematically searching through promising ideas are not entrepreneurial acts in themselves, but they can create an environment where entrepreneurial insights are more likely to be generated.

Entrepreneurs need to discover opportunities if they are to start new businesses. The fundamental questions of entrepreneurship research evolve around why, when and how some people are able to discover opportunities, while others cannot or do not? (Shane & Venkataraman, 2000). In today's competitive business environment also firms – and not only individuals - need to continually identify new opportunities beyond existing competencies if they are to survive and prosper. Prior knowledge of a particular field provides individuals the capacity to recognize certain opportunities (Venkataraman, 1997; Shane, 2000) In the same lines, firms tend to innovate in the areas where they already possess knowledge. A firm obtains information about entrepreneurial opportunities by mutual interaction with other market participants (Hayek, 1945). However, such information is dispersed unevenly among firms in the market. Owing to the variation in the information acquisition process, firms gain differential access to external information. Thus, they have different capabilities to see new markets and potential uses for existing (technological) knowledge and to understand their customers' needs and respond to them through new product development. It is for both of these purposes – i.e. market seeking and NPD - that firms generate market intelligence. However, frequently top management in small high technology firms is heavily biased towards technical disciplines such as science and engineering (Knight, 1986). Marketing and general management skills are often significant areas of weakness within small high tech firms, where entrepreneurs tend to over-emphasize the purely technological side of their business and neglect other key strategic issues (Knight, 1986; Oakey, 1991). This may lead to ignoring market intelligence generation, dissemination, and responsiveness to markets, which, in turn, may jeopardize the long term innovativeness and entrepreneurial spirit in such ventures.

Studies of entrepreneurship and technological innovation have much in common when explaining sources of information about entrepreneurial opportunities and new product ideas (Freeman, 1982; Scherer and Perlman, 1992). Opportunities are created in the process of technological innovation because of the change in existing resources, whether the change is disruptive or incremental (Utterback, 1994). If entrepreneurs discover information about these opportunities, they will capitalize upon the opportunities because the new combination of assets will result in profits. (Soh, 2003). Let us now look at market knowledge and its role more specifically in the context of technological innovations, i.e. new product development.

## **MARKET KNOWLEDGE AND NEW PRODUCT DEVELOPMENT (NPD)**

Two major reasons have been advanced in the new product development (NPD) literature to explain why listening to customers and partnering with them in NPD is beneficial (See e.g. Campbell and Cooper, 1999). Firstly, customers can provide major inputs which improve the quality of innovation. Second, especially in the settings of industrial markets and high technology products, close partnerships with customers during product development may provide access to resources that the manufacturer lacks in-house.

Recent research suggests that the degree to which a firm is involved in new product activity depends on the extent and nature of its market orientation (Athuene- Gima, 1996; Hurley & Hult, 1998; Frambach et al. 2003) and that market orientation and innovativeness are rather complementary than conflicting concepts (Slater and Narver, 1995; Becherer and Maurer, 1997). A central theme of the innovation- and NPD literature is that information gathering and analysis are critical to the successful development and execution of innovative strategies and new product development (Barringer and Bluedorn, 1999; Matsuno et al. 2002). In relation to market orientation of a firm – when understood as market intelligence generation, dissemination, and responsiveness to it in a firm (Kohli and Jaworski 1990) – innovativeness could be seen as “a consequence”. On the other hand, R&D and innovativeness have often been contrasted to marketing and market orientation in a firm (Christensen 1997; Hamel and Prahalad 1994). These contradicting views on the importance of market knowledge as a part of NPD may arise because of multiple reasons. It may be that the role and importance of customer input in NPD is dependent on the stage of the process (early vs. late stage NPD) as well as the nature of the product being developed (disruptive vs. continuous innovations).

## **CHALLENGES IN NEW VENTURES**

Harris (1999) divides the literature that has addressed barriers to developing market orientation<sup>1</sup> into two categories. Firstly, there are studies which focus on types of employees or employee behaviors. Secondly, other studies concentrate on systems and structures.

New technology ventures are often started by scientists or technologists that hold patent rights of inventions with commercial potential. E.g. Changanti & Sambharya (1987) have shown that the orientation of organizations is hugely dependent upon the commitment and abilities of top management. Messikomer (1987), Kelley (1990), and Gummesson (1991) have extended this argument to all levels of an organization; everyone in an organization is a potential barrier to the development of market orientation and, thus, to the dissemination of market intelligence within a firm. Since the principal barrier to market orientation development is the values, beliefs and assumptions of an organization (Messikomer 1987), technology oriented organizational culture in young technology firms is one potential challenge for integrating market knowledge into the whole organization, and especially to research and development of new products.

Focusing on systems and structures, Ruekert (1992) statistically analyzed the link between recruiting, training and reward processes, and market orientation of a firm, concluding that there was substantial empirical evidence to suggest direct associations. Jaworski and Kohli (1993) found that top management emphasis, reward systems, centralization, and connectedness each affect market intelligence generation and its dissemination as well as responsiveness to it in

organizations. Furthermore, interdepartmental conflict was found to affect intelligence dissemination.

Overall, the literature identifies numerous complex and interrelated challenges for the sourcing and integration of market information into all key functions of an organization. In the following, I report on a qualitative empirical study that has been conducted among young and small biotechnology ventures to find out about the challenges these firms face when trying to integrate market intelligence into organizational process, most notably R&D.

### **EMPIRICAL STUDY: METHODS**

The empirical study reported here is an integrated part of a study conducted to find out about market orientation in small biotechnology firms. The results reported here concentrate on the dissemination of market knowledge with a focus on marketing/business development and R&D interface, whereas the data collection was carried out to understand the larger concept of market orientation in the firms. Interview questions have been developed based on existing literature and pilot case studies of six biotechnology firms in early 2003. The unit of analysis in this research is the firm, and informants are company CEOs. Based on the pilot studies and existing literature, I concluded that there is a great variety of issues technology SMEs even in the same technological field face in the integration of market knowledge to their R&D activities. Consequently, instead of employing existing scales in the evaluation of these issues, I decided to take a more qualitative approach, use open ended questions, and let the respondents construct their answers themselves.

Empirical data was collected via face-to-face CEO interviews in small, young, and research intensive biotechnology firms in the US, Sweden, and Finland in 2003-2004. In each geographical area, biotechnology organizations' member listings have provided the basic directory, from which the populations of interest have been identified. The firms included in the study are independent, R&D based biotechnology firms with 250 employees or less, service firms excluded. Personal, one- to two-hour structured interviews were conducted in 85 such companies in Pennsylvania (n=13), Florida (n=19), Bay Area, CA (n=27), Finland (n=19), and Sweden (n=7). The first ten interviews also served as a pilot test for the questionnaire. Face-to-face interviews increase the validity of data collected. They are also probably the only way to reach the smallest firms, from which scarce secondary data is available. The mean size of these sample firms is 38 employees, and 81 per cent of firms employ 50 people or less. An average firm was six years old at the time of the interview. Most of the drug discovery and development firms do not have products on markets yet, whereas most of the medical devices firms typically do. This is due to the nature of product development in the two fields; pharmaceutical product development and testing is a process that requires typically 12 to 15 years. Table 1 below shows the key demographics of the firms included in the study.

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**Table 1 here**

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### **RESULTS: CHALLENGES IN INTEGRATING MARKET KNOWLEDGE TO R&D**

To understand the distribution of market knowledge within the study firms, I asked the managers to elaborate on “How would you describe the relations between people working in marketing/sales in your firm and other “departments”?” and “What kinds of challenges are there when you try to integrate the market intelligence into your R&D?”. The answers to these questions basically reflect three critical aspects of market knowledge on a firm level. In addition, some interviewees took an industry- or individual approach in their answers. Table 2 below summarizes the challenges in integrating market knowledge into R&D in the organizations studied.

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**Table 2 here**

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On the level of an organization, there are three kinds of challenges that prevent integration of market knowledge into R&D. Firstly, biotechnology companies are typically started by scientists or technology enthusiasts, which is reflected throughout the early years of operation of these firms. Some of the companies still operate in universities’ premises and are run by professors or ex-faculty. This naturally leads to excessive focus on technology and solving technological problems without devotion to business development and acquiring market knowledge. As suggested by Berry (1996), there is a continuum along which small high tech firms progress as they grow, from initial beginnings which are based on the internal technological competencies, towards an outward orientation focusing upon marketing issues.

Secondly, in most cases a small firm focusing on technology research and development does not have the resources to commercialize innovations to global end user markets. For distribution, commercialization and often also development of the innovation, these firms partner with larger companies. Often, the deals at this stage take the form of licensing deals. Many of the young, small biotechnology companies do not think they should worry about the marketability of the end product; instead of integrating end users views to product development, these small firms solely focus on meeting the milestones specified in the licensing deals and leave marketing and commercialization issues to the downstream licensing partners.

In addition, promising small, technology intensive firms grow rapidly over their early years of existence. Even if the growth in personnel is well planned out – which it often times is not – the growth brings along challenges for communication within the firm. Dissemination of market intelligence can initially be handled through informal meetings and “hall-talk”, but as the company grows there is more need for formalized channels of knowledge distribution.

Challenges do not only arise on the level of an organization, but also on the level of individuals interacting. In small biotechnology firms the “departmental” friction arises between individuals involved in R&D work – typically scientists – and those trying to make a business out of that science. At the very early stages of company development the two functions are actually carried out by the same people, focus being on science. Later on, when dedicated business development and marketing personnel is added to the team, the communication between them and the scientists presents challenges. Even though most interviewees described the relations between the two functions as “close” and “integrated”, they also identified challenges in communication and integration.

Finally, the field of biotechnology itself was mentioned by some interviewees as a challenging arena for combining market knowledge into R&D. The long product development time scales of medical products – especially pharmaceuticals - and scientific uncertainty of this development are reflected in the role that market knowledge gets in these firms. Overall, the less developed the product concept of the firm, the more difficult it is to talk about rigorous market research and knowledge. At an extreme, it may well be that the company does not initially know the potential its technologies have when applied into commercial purposes. When the goal of product development is not clear, it is naturally very difficult to gain knowledge of the markets for that product.

## **CONCLUSIONS AND IMPLICATIONS**

Small, young technology firms face a variety of barriers that hinder the integration of market knowledge into R&D. The typology developed in this paper reflects the various loci of these barriers. On the level of an organization, there are three kinds of challenges that prevent integration of market knowledge into R&D. Firstly, biotechnology companies are typically started by scientists or technology enthusiasts, who compose the top management team. These individuals do not typically emphasize the importance of market intelligence and its integration into research and development activities. Secondly, instead of taking products all the way to end markets, small and young biotechnology firms often aim at licensing their products to larger firms, who will take care of commercialization and distribution in the end. Thus, like suggested e.g. by Ottosson (2003), these firms do distinguish between customers and end-users and do not always see the need to integrate market knowledge that concerns end users into their R&D. Third, rapid growth of some technology firms over their early years of existence presents challenges; as the company grows, so does the need for formalized channels of knowledge distribution. Communication between scientists and business people in a firm often presents challenges because of the different mental models and goals of the two groups.

In addition to the organizational challenges, the field of biotechnology as such has a number of features that make it challenging for firms to integrate market knowledge into their R&D. Most importantly, the medical research and development process is a highly regulated one, and especially development that involves clinical trials is a long and expensive path. Because of the long time scales typical for biotechnology R&D, a reactive approach to, for example, competitors' actions is rather impossible. If a drug discovery company has proceeded to preclinical or clinical trials with an interesting new therapy, there are already numerous patents and probably years of scientific work behind the new therapy. Rapid, reactive responses by competitors are rather impossible.

So what is the take home message from this study to small firm managers? Initially, considering the science driven nature of biotechnology business, one is tempted to assume that market knowledge has a very limited role in small biotechnology firms. However, even though some researchers have even suggested that customer knowledge impedes innovation (Christensen 1997; Hamel and Prahalad 1994), growing body of literature on new product development suggests that innovation is achieved by combining technological knowledge with understanding of markets (Cooper 1988; Stevens et al. 1999). Even the early stages of pharmaceutical product

discovery and development are influenced by market considerations, typically channeled to firms through professional networks (Takayama & Watanabe, 2002). This study has identified bottlenecks that prevent the integration of market knowledge into research and development. Based on the study, technology venture managers that want to integrate market aspects into their companies R&D should be aware of the following traps: (1) excessive focus on science and technology instead of e.g. asking future end users of products for their opinions on product features; (2) excessive focus on meeting development milestones instead of visioning end products in the markets one day; (3) forgetting the development of internal communication within a firm especially in the times of rapid growth; (4) failing to understand the different goals and mental models of scientists vs. business people.

The research results reported in this paper is of interest for future researchers that want to study technology management, especially new product development, or entrepreneurial opportunity discovery. For those interested in NPD processes, the categories presented here can be further defined and empirically validated with a quantitative research design. For those interested in opportunity identification and innovativeness within existing small firms the results of this study raise following kinds of questions: If understanding markets as well as technology is critical for identifying opportunities, then how can firms identify opportunities if the two domains of knowledge within firms are separate? Do companies that are better in integrating market knowledge and technological knowledge also identify more entrepreneurial opportunities? And who are the entrepreneurs within existing small businesses – scientists, business people, or both?

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**Table 1: Demographics of companies in the empirical study (n=85)**

| <b>Firm location</b>      | <b>Field of business</b>    | <b>Firm age</b>   | <b>Number of employees</b> | <b>Products on markets</b> |
|---------------------------|-----------------------------|-------------------|----------------------------|----------------------------|
| Delaware Valley, PA<br>13 | Drug discovery & dev.<br>30 | 1-2 years<br>14   | 1-5<br>9                   | Yes<br>43                  |
| South FL<br>19            | Diagnostics<br>6            | 3-5 years<br>31   | 6-20<br>38                 | No<br>42                   |
| Bay Area, CA<br>26        | Medical devices<br>16       | 6-10 years<br>30  | 21-50<br>22                |                            |
| Sweden<br>7               | Technology platform<br>33   | 11-20 years<br>10 | 51-100<br>11               |                            |
| Finland<br>20             |                             |                   | 101-250<br>5               |                            |

**Table 2: Challenges in integrating market knowledge into R&D**

**Locus of barrier**

|                     |   |
|---------------------|---|
| <b>Industry</b>     | <p><i>Science:</i> Technological and scientific advances drive the development of biotechnology; commercial issues have a somewhat secondary role when science dominates.</p> <p><i>Long NPD processes:</i> Long product development timescales because of regulatory requirements in biotechnology → what is the “right” stage to incorporate market knowledge into NPD?</p> |
| <b>Organization</b> | <p><i>Science and funding:</i> Companies started by scientists, funded for their technology → focus on science and technology.</p> <p><i>Licensing:</i> Focus on meeting development milestones instead of taking products into markets one day.</p> <p><i>Growth:</i> Rapid growth brings along challenges to internal communication.</p>                                    |
| <b>Individuals</b>  | <p><i>Mental models:</i> Different mentalities and goals of scientists vs. business people.</p> <p><i>Role of marketing:</i> “Anyone-can-do”- mental model related to marketing and sales among scientists.</p>   |

**Endnotes:**

<sup>1</sup> Market orientation comprises market intelligence generation, dissemination, and responsiveness to it. (Kohli & Jaworski, 1990)

THE LEADERSHIP STYLE OF WOMEN ENTREPRENEURS:  
AN ALTERNATIVE MODEL OF  
SUCCESSFUL MANAGEMENT PRACTICES

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This study is based on the qualitative, comparative research, in which interviews were conducted with twenty-seven women business owners in three countries all of whom had founded and successfully grown their businesses into firms with annual sales exceeding half a million dollars. The findings of this research are also supported by three decades of working closely with women business owners in several consulting and educational settings.

This paper expands upon the earlier findings by more deeply examining the management philosophy and business practices that emerge from the experiences and successes of these successful, growth-oriented women entrepreneurs. The similarities among these women's leadership styles were constant across business size, industry, gender makeup, longevity, or the owner's age, educational level, previous work experience, or country. The only common factor shaping those responses is gender.

The findings suggest that these successful women more closely resemble those of other studied women entrepreneurs than the conventional "male" business model. The success of these women in motivating and retaining employees and in growing their companies demonstrates a highly successful alternative to the dominant model of running a company.

## **Introduction**

Internationally, women now account for 25-30% of all business owners and are starting businesses at twice the rate of men. This research contributes to our current knowledge regarding women entrepreneurs by examining growth-oriented women business owners, a largely overlooked category that has been ignored in the relatively small body of research on women entrepreneurs, which has focused almost exclusively on sole proprietors and owners of start-up and small companies. (Out of the thousands of research articles on entrepreneurship published between 1976-2000, a review by Greene, Hart, Gatewood, Brush, and Carter [2003] found only 173 specifically addressing women entrepreneurs, and few of those investigating management practices.)

This paper is based on an extensive research project in which I conducted in-depth interviews with twenty-seven women entrepreneurs in three countries--the United States, Ireland, and Finland--all of whom had founded and successfully grown their businesses into firms with annual sales exceeding half a million dollars. These countries were selected because they have

seen great increases in the number of women entrepreneurs, and the dollar amount because it represents the average revenues of male-owned businesses but of less than 10% of women-owned businesses. These interviews were guided by a set of 38 questions that explored the respondents' personal and professional backgrounds and a variety of issues germane to starting and growing a business. The findings of this research are also supported by three decades of working closely with women business owners in several consulting and educational settings, most currently as director of a university-based Center for Women Entrepreneurs.

In addition to offering new data regarding a significant but understudied population of entrepreneurs, this research offers new evidence relevant to the findings of both sides in the ongoing dispute among those scholars in the field who argue that women demonstrate a distinctive management style and those who claim that there are few actual empirical differences in the leadership practices of men and women business owners.

As I have reported earlier, the study found that in terms of character traits and attitudes, these successful women entrepreneurs more closely resemble their male counterparts than they do women owners of smaller businesses or women managers more generally (Riebe, 2001, 2003a, 2003b). These traits include similar propensities for risk-taking, achievement, autonomy, persistence, confidence, internal locus of control, and central life interests. In contrast to recent research describing women in business and the professions as ambivalent about ambition and success (Fels, 2004), the growth-oriented women in this study are very focused, resilient, determined, and self-confident.

When asked why they had started their businesses, their responses differed significantly from those of both men and women business owners queried in other studies. Unlike male entrepreneurs, none mentioned money or attainment of measurable financial goals, and only two indicated that they were motivated by family or personal issues—one by the death of a spouse and one because of a stress-induced illness—a finding quite different from earlier studies of the population of women entrepreneurs in general, among whom a desire to better balance work and home life has been found to be a major motivator. In contrast, they cited personal values, dissatisfaction, and situational pressures as driving their decision. These included their passion for the field, desire for independence, ethical differences, being bored or stuck in a corporate structure, discrimination against them as women, previous business closing, invitation to partner, and being unable to find anywhere they wanted to work.

In exploring their leadership philosophy and actual business practices, however, I discovered that these successful women more closely resemble those of other studied women entrepreneurs than the conventional "male" business model, and that they in fact attribute much of their success to those very practices. Their answers support the findings of scholars who have observed that women "think differently, manage differently, and define success differently" than their male peers (Center for Women's Business Research, 1994). (For fuller descriptions, see Weeks, 1994; Eagley & Karau, 2002; Eagley, Johannesen-Schmidt, & van Engen, 2003; Eagley & Johannesen-Schmidt, 2001; Fondas, 1997; Robinson & Lipma-Blumen, 2003; Entine & Nichols, 1997.) In Riebe (2003b), I have described the primary characteristics of this management approach as being (1) collaborative, (2) community-oriented, and (3) values-driven.

## Findings

This paper expands upon those earlier-reported findings by more deeply examining the management philosophy and business practices that emerge from the experiences and successes of these successful, growth-oriented women entrepreneurs. This particular set of subjects makes an especially good sample for examining this female management model, because as founders of their own companies, they have had full control over the organizational structure and work culture of their workplaces; this was not something they had inherited, but could shape from the beginning and maintain as their companies grew. Furthermore, the similarities among these women's leadership styles were constant across other possible explanations, such as business size, industry, gender makeup, longevity, or the owner's age, educational level, previous work experience, or country. In other words, these characteristics were true in companies with 50 employees or 500, in stereotypically male or female industries, in companies founded in the 1960s or the 1990s, in Helsinki or Boston. One could not guess the size, industry, age, or nationality of the women's company from their answers to my questions regarding their management philosophy and practices; the only common factor shaping those responses is gender.

Although most of the women did not have a formal education in business (although two had MBAs), all had experience working in other companies, most as managers, and thus they did not adopt their management style out of ignorance of the predominant model. In fact, they all reported making a very conscious choice when founding their companies to create a workplace environment that was different from the conventional business model with which they were familiar. As such, their philosophy constitutes both an explicit and implicit critique of that conventional model, one that their success should encourage us to take seriously.

In fact, to the extent that these women's past work experience influenced their vision of the workplace environment they wanted to create, it most often served as a negative example:

*In their jobs, I don't sweat the small stuff. At my previous company you would get called in if you were ten minutes late, which is the craziest thing I've ever heard of. They know what they need to do. (R1)*

*I know what it was like to work for someone else. If I had been treated the way I treat my staff, I would have died for my boss. I think that you can be very, very human. (R6)*

*I don't like the formality of business. I don't see that as existing here. My door is open all the time. Anybody can walk in or out, and likewise I can walk around and talk to everybody here. We don't have names on doors, and you don't have to go through my secretary to see me. I don't believe in that. I didn't like it when I worked for companies where it happened. (R10)*

In fact, many of the respondents noted that they had started their businesses in order to create a workplace in which they themselves could be authentic and productive. As one put it,

*It wasn't money. I think it really was to create a place for myself that I felt comfortable and exercise a lot of parts of myself. I could create the kind of environment that I really wanted to get up and go to work to everyday. (R14)*

Not surprisingly, some of their reported discomfort with the prevailing model was explicitly linked to their experience as women, but most was related to ethical issues and frustrations working within bureaucracies that, while not necessarily gender-specific, have been described in other studies as particularly discouraging to women in large organizations (Hewlett & Buck, 2005; Fels 2004). Thus their answers may serve to further explain or illuminate not only the behavior of female entrepreneurs, but also current research on why so many women managers are leaving their careers behind.

As noted earlier, the respondents also demonstrated a values-based approach to business that integrated their personal and professional commitments and values. These findings demonstrate that their workplaces were designed in large part to extend to employees the same values and desires that had led the subjects to begin their businesses in the first place. Among the conscious practices described by virtually all of the respondents was giving their employees a great deal of appreciation and recognition:

*There is one message I have to give to everybody. No matter how little you are, you are terribly important in any organization. And you must believe that you are, because that stimulates you to move a little farther. (R11)*

*Very strong feeling about respect. Respect the differences. I've been working very hard to make sure the unsung heroes are recognized. My employees gave me a bell. It's hanging in the warehouse, and people are supposed to ring the bell whenever anything good happens. I'm always complaining that it doesn't ring enough. The successes are the little things. The big things are easy. (R13)*

They also described offering their employees a good deal of flexibility, in terms of both time and task, and considerable trust in the form of independence and autonomy, all of which they had reported as chief among their motivations for starting their own businesses.

*One of the principles established early on was that employees should have a lot of flexibility. (R3)*

*I do expect them - because I'm not here very much - I expect them to run the show around here. Everybody does their own thing. If they have a problem, they talk with each other. We have fun. They have their own hours. If they are working on an area they don't like, I ask them what they would prefer to be doing. (R1)*

*I think we have a totally different work environment. We're here because we want to be. Willing to be accountable and take the risk. I delegate all kinds of responsibility. If somebody tells me they need a new computer, we get a new computer. I just write out the checks. (R2)*

*Absolutely. It's informal, the way we dress. We have flexible time. Particularly the creatives; they need to be managed differently. They need to have time away. I believe we've created a nice environment here, and I do it by modeling. The last two months, I leave for rehearsal every afternoon. I think that's a bigger impact than anything I could say. (R4)*

*If they want to have a role that is different, I try to give it to them. If they want to be free one day, I say okay, we'll arrange it. (R22)*

In their interviews, the subjects also described their management style and the working relationships within their businesses as equalitarian, collegial, and empowering. Many described their management philosophy as a team approach:

*I have a management team that reports to me who are top-notch, and we operate as a team. I don't make a lot of decisions myself anymore. (R14)*

*We work together as a team. It's very much based on team effort. I think that came from my involvement with Junior Chamber. Everyone worked as a team. There was never an issue about status or positions or matters, and I took it from there. (R9)*

*I think it's important to be part of a team. (R11)*

*We all work together. I've got a really good team. There's no sort of management system here. (R12)*

Many of the women used images of family and friendship to describe their management approach, as in the following comments:

*Oh, sure! It's not easy for people to come down at lunchtime, so we feed everyone. It's a homey feeling. We've got beds here. We work late. It's a family, I think, here. It's fun to be a part of it. (R15)*

*We have always tried to make the restaurant like we want – like a home for the workers. (R26)*

*Every day I think it is essential to go to each of them quietly, not publicly, to say "Hi, how are you? Any problems? How are you feeling?" You can kind of get into them that way. There might have been a horrible customer, they might have said the baby was up all night and have not gotten any sleep. But going and making them feel important, and they know it. I think it's important to be part of a team. (R11)*

*We try to keep it almost a family-type business. Everybody is as important as the other person. Nobody's more important. I don't want to tower over everybody: 'I'm the owner,*

*and I'm doing this.' That isn't the way I am. We can do this business together, and everybody's more important. (R15)*

*I don't know what my philosophy is. We do go on little trips. I take their kids to pantomime. We feed them. I think very strongly that you have to treat your staff well. (R12)*

An important element in the relationships they described as having with their workers is reciprocity. The women's heartfelt awareness of their interdependence was also reflected in a more participatory and democratic work and decision-making process.

*I really like to know them, their names, their values. I want them to know I care about them. We all help each other – I help them, they help me. (R23)*

*You only get back what you put in. (R12)*

*I try to be as fair as possible, and I try to manage them the same way I hope they are managing me. It is not easy, but a simple rule. (R24)*

*You have to have good people around you. You've got to have people to support you. You can say you're an owner of a business, but you didn't do it alone. I guess that's probably my advice - don't think you can do it for yourself, because you can't. (R15)*

Three of the respondents described this lack of hierarchy in almost identical terms:

*I have, yes. I consciously went out of my way, first and foremost, to get top-class staff and then give them their lead. I would try to create that environment where there's no boss. Okay, maybe you lead by example. I would never ask anybody to do something I wouldn't do myself. They know that. (R8)*

*My main one would be we're constantly on a friendly basis but not on a social basis. Most importantly, I don't ever ask my employees to do anything I wouldn't do myself and that goes down to office maintenance and upkeep. I think it's worked well. (R9)*

*Never ask them to do anything I wouldn't do myself. I see the people that have committed themselves to this company. They're involved with the company, and if this company can reward them for their loyalty and effort, they can share in the profits and share in what we have to offer, and I'm going to help them do that. (R10)*

While all the respondents were clearly successful leaders, a number explicitly rejected what they saw as the traditional role of boss, as in the following:

*We try to keep it almost a family-type business. Everybody is as important as the other person. Nobody's more important. I don't want to tower over everybody: 'I'm the owner,*

*and I'm doing this.' That isn't the way I am. We can do this business together, and everybody's more important. (R15)*

*I'm not the boss type at all. I mean I am not a very good manager. If I don't have a good friendship relation with my employees, it doesn't function. (R21)*

As the above excerpts from the interviews demonstrate, the subjects of this study spoke of their workers in personal terms, as family, friends, team members, partners, and equals, and described their management styles in terms familiar from earlier research claiming a distinctively female leadership style. Yet other scholars have challenged the validity of such self-reports, questioning whether they reflect actual practices in the workplace. Most recently, in a study of the management practices of men and women business owners subtitled "Gendered Rhetoric versus Business Behavior in Small Firms," Cliff, Langton, and Aldrich (2003) argue that although the women spoke of their management practices in more stereotypically feminine terms and men in more stereotypically male terms, their actual policies and practices were largely the same.

But before dismissing these women's descriptions as simply a matter of self-presentation, it should be noted that they all went on to describe a wide variety of specific practices through which they went out of their way to recognize and reward employees, to invite a more democratic and participatory work style, and to create a comfortable work environment that values workers as whole persons. This included deliberately trying to create family-friendly workplaces for their employees, even though, unlike many women owners of smaller businesses, they had not started their businesses in order to create more balance between their own family and work lives. They explicitly linked those practices to their own belief in the importance of families, their desire to contribute to the well-being of their communities, and their recognition of employees not only as workers, but as persons with families, needs, and obligations outside of the workplace. And while this study did not systematically observe the respondents' workplaces or interview their employees, I did interview each woman at her place of business and informally observed her interactions with her employees, and their practices seemed consonant with their descriptions.

Furthermore, I would argue that business owner's description of their management philosophies cannot be dismissed so simply a rhetoric, whatever form their actual implementation takes. Surely how one speaks about their leadership makes by itself a difference in how both entrepreneurs and employees view themselves, which in turn shapes their actions and interactions with one another. If a leader talks about their philosophy one way but acts another, this dissonance is going to create their ability to lead effectively. The success of the subjects' companies and their employees' satisfaction, loyalty, and retention would seem to speak at least as loudly about the reality and efficacy of the practices they describe.

### **Significance and Implications**

Yet in the end, the purpose of this paper is to analyze the management style described by these growth-oriented women entrepreneurs not as distinctively female but as demonstrably effective. That is, I am less interested in the degree to which these women entrepreneurs demonstrate a leadership style that is different from that favored by male entrepreneurs as I am in its

significance and implications for all entrepreneurs. Surely the success of these women in motivating and retaining employees and in growing their companies demonstrates a highly successful alternative to the dominant model of running a company, one applicable to male as well as female entrepreneurs and managers.

Thus this article is not arguing that the female management approach described here and elsewhere is necessarily superior, that women are necessarily better at it, or that its characteristics cannot be successfully adopted by men. The women I interviewed did not themselves describe their style as distinctively female, and were in fact adamant that they would give the same advice to both men and women wanting to start or grow a business. As Cliff, Langton, and Aldrich (2003) and other researchers have shown, many of these practices have already been appropriated by many male small business owners, a development, I would argue, that speaks less to gender than to their efficacy, the exigencies of small businesses, and the demands of dual-income families for more flexible and family-friendly accommodations. Furthermore, many elements of this approach have also been advocated by numerous widely-read management books intended for both sexes, including the books on managing for excellence, working in teams, and reengineering companies that Fonda (1997) analyzes and the more recent spate of books on such topics as character-based and reflective leadership.

One implication of the general applicability of this “feminized” approach to management (Fondas, 1997) is that it should be given more attention by entrepreneurship and management educators, who have been slower to incorporate it into their training of future business owners and managers than have executive development professionals and coaches. More specifically, the inclusion of more case studies involving female leaders, more women guest speakers, and more female mentors will expose students of both sexes to more female voices and approaches. Methods learned in the classroom are likely to be more effective if students of both sexes can connect them to their own worldviews and describe them in language with which they are comfortable.

Presenting female-friendly management approaches as legitimate may also help reduce the prejudice discussed by Eagley and Karau (2002), which makes it more difficult for women both to become leaders and to be successful in leadership roles. As the authors suggest, such prejudice might be lessened by changing the content of leader roles as such roles evolve toward more communal characteristics and fewer individualistic ones. As they and many other researchers have argued, adopting such a “feminized” approach becomes not only more acceptable but more urgent in today’s workplace and market. In their words, “Rapidly changing, globally competitive, high-tech environments may be inducing many organizations to adopt flatter, less centralized, more flexible structures and to develop participatory, delegatory, open-communication strategies conducive to rapid adaptation and responsiveness to customers” (25).

At the same time, that this approach is echoed in many of the practices of other women managers and business owners identified by earlier research studies does suggest that it may be more congenial to women, and this knowledge can be useful in designing women-specific programs that can address these “softer” and more “personal” issues directly and without apology or “translation.” After years of attending and hosting women-specific conferences workshops, I have found that discussions about business issues among women at such events tends to be talk

more about motivation and values than about skills and strategies, which male attendees sometimes find befuddling. Yet the high percentage of women business owners who seek out such opportunities testifies that many find it empowering to have place where they can discuss business issues in their own voice. More access to women talking about their own businesses and management principles in these terms may also attract more women to entrepreneurship.

In short, by developing a characteristic leadership style, these women entrepreneurs are not reinventing the wheel, but rather employing attributes to which they are socialized as women with traits they share with men to create high-growth businesses that can serve as a model for all entrepreneurs. As Entine and Nichols assert, “Neither men nor women have a lock on integrity, not on the ability to inspire a team, develop good personal relationships, and establish a flexible and accountable corporate structure—the diverse qualities all executives will need to make businesses thrive in the future” (1997, 4).

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# **Women Entrepreneurs in Pakistan: Profile, Challenges and Practical Recommendations**

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## **Abstract**

Women's productive activities, particularly in industry, empower them economically and enable them to contribute more to overall development of their country. Assisting women in achieving their leadership potential in business contributes to economic growth and to social and political development. However, in many societies such as Pakistan, women do not enjoy the same opportunities as men due to deeply-rooted discriminatory socio-cultural values and traditions, embedded particularly in the institutional support mechanisms.

The research conducted by the author shows that in Pakistan, women's full economic potential is not being tapped. Like most of the developing countries, women entrepreneurs in Pakistan also suffer from the lack of access to, including control over, capital, land, business premises, information and technology, training, production inputs, and assistance from governmental agencies. In addition, the main challenges they face are the limited spatial mobility, lack of encouragement from male family members, and improper networking mechanisms based on the widespread "religious belief" of its patriarchal society that men are inherently superior to women and that women are best suited to be homemakers.

The glowing role model of Prophet Muhammad's wife (Khadija, RA) and many other examples in the annals of Islamic history confirm that "women in business" are not frowned upon in Islam. The research also suggests that given the right moral and technical support, women entrepreneurs in Islamic society can also improve their success rate and their contribution to the economy. Therefore, awareness of women economic rights (confirmed by the religion) through media and inclusion in the education syllabus, in addition to better policy environment, revision of discriminatory legal rules and practices, increased access to finance and technology, provision of women-only business management training services, improved access to business development services (BDS), and more facilitation of national, and international networking for women entrepreneurs have been recommended to enhance women's entrepreneurship and integrate women into mainstream economic development.

## **INTRODUCTION**

Most of the emerging theories and prescriptions for success of women's entrepreneurship are derived from the growing body of knowledge comprising of the studies conducted in developed countries (Lerner et al, 1997). One of the main reasons is the scarcity of research conducted on the topic in developing countries (Allen and Truman, 1993). Whatever limited work that has been done on women entrepreneurs in the developing world, relates largely to the very poor and uneducated segments of women in the rural or the urban informal sectors. Most of this work has been conducted by the international development agencies, which have tended to focus on women's concerns from a 'macro-perspective' (Wees and Romijn, 1987). This is a critical omission from the understanding of women's entrepreneurship, because the social structures, work, family, and organized social life vary widely in developing countries (Allen and Truman, 1993; Aldrich, 1989).

As women's entrepreneurship development theories have emerged primarily from research in developed countries, it is important to examine the extent to which these apply in the context of developing countries such as Pakistan, where social and familial control over women's sexuality, their economic dependence on men, and restrictions on their mobility determine differential access of males and females to literacy and other supporting mechanisms.

The status of women in Pakistan is not homogenous because of the interconnection of gender with other forms of exclusion in the society. Religious prescriptions, cultural norms and actual practice, related to the women's status and role, vary widely and sometimes are highly contradictory. There is considerable diversity in the status of women across classes (the socio-economic status of a woman's family), geographical regions, ethnic origin and the rural/urban divide due to uneven socioeconomic development and the impact of tribal, feudal, and capitalist social formations on women's lives. However, no matter which class or region they belong to, women's situation vis-à-vis men, is one of systemic subordination, determined by the forces of patriarchy, greatly influencing their occupational role in all parts of the country by two factors, one being the cultural norm of 'Pardah'(veil)<sup>1</sup>, and the other being the notion of 'Izzat' (honor)<sup>2</sup>.

## **AIMS AND OBJECTIVES**

The aim of this study is to present a micro-level perspective on the gender-related challenges and opportunities of women entrepreneurs in the context of Pakistan. The intention is not only

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<sup>1</sup> "Pardah, meaning curtain, is the word used to describe the system of secluding women and enforcing high standards of female modesty in South Asian societies, such as India and Pakistan. There are two instruments of Pardah, first is the system of female seclusion and sex-segregation, defining different spatial boundaries for the activities of men and women. Women's activities are limited mainly to the home, while men work outside. The second instrument of the Purdah is the veil, or the concealing cloak known as the 'burqa', worn by women whenever they venture outside the home. The veil or burqa is meant by to act as a portable means of seclusion" (Papanek, 1982).

<sup>2</sup> "Women are considered to be the repositories of a family's izzat or honour, and their chastity and good reputation is highly values and guarded"(Shaheed, 1990).

to provide evidence that women experience gender-neutral constraints, such as the lack of access to, including control over, capital, land, business premises, information and technology, training, production inputs, and assistance from governmental agencies but to move beyond, and to explore and illustrate the additional challenges that women experience as related to their gender, based on feudal, tribal, and geographical traditions in the name of religious values.

The study was intended to contribute to a greater understanding of women's entrepreneurship in a different and difficult cultural setting and to help policy makers and development agencies to understand the assistance needs and constraints that are specific to promote entrepreneurship potential of women in an Islamic society. Keeping in view of the aims and objectives, the research was guided by three main questions:

- Which gender-related factors influence the entrepreneurial capabilities of Pakistani women?
- What is the role of cultural norms of 'Pardah' and 'Izzat' (honor) in the performance of these business owners?
- What could be done to promote entrepreneurship potential of women in an Islamic society like Pakistan?

## **METHODOLOGY**

The instrument for collecting primary information was in-depth one to one semi-structured meetings with a sample of 256 women entrepreneurs in five major cities of Pakistan. The in-depth meeting was considered to be the most appropriate method for a couple of reasons. Firstly, the indigenous researcher was able to draw on his own understanding of how the respondents see and experience the world in supplementing and interpreting the data. Secondly, the in-depth interview enabled the researcher to capture the details needed for penetrating qualitative analysis without requiring contact over a prolonged period of time with the respondents. This was particularly important to enable participants to discuss what was important for them, their perceptions and feelings given the limited resources and time available to the researcher.

The study initially started with almost 100 names of entrepreneurs picked up through stratified sampling from the lists of Federation of Pakistan Chambers of Commerce and Industry, Export Promotion Bureau, Small and Medium Enterprise Development Authority, First Women's Bank, WEXNet-2001, and local directories/yellow pages. Many of the initial participants were generous in providing names of additional potential participants to be contacted. The sample was stratified according to the geographical location<sup>3</sup>; and sector of operation<sup>4</sup>. At least 25 women entrepreneurs were selected from each city and sector of operation.

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<sup>3</sup> five major cities namely Karachi, Lahore, Rawalpindi/Islamabad, Quetta and Peshawar

<sup>4</sup> Manufacturing, retail trade, and services

The women entrepreneurs in this study are either owners of, or hold a controlling interest in an enterprise and manage it on a day-to-day basis. Out of 265 attempted contacts, only four declined, three were unavailable and in two cases it was not possible to arrange a meeting.

## **STRUCTURAL PROFILE**

Analysis of the data gathered through the research showed that majority of the women entrepreneurs (54%) owned/managed micro enterprises. Thirty six percent and 10% of the sample owned/managed small and medium enterprises respectively. These results are close (within +/-5%) to the structural profile of the women entrepreneurs described by a study conducted by ILO in 2001(Goheer, 2002). Most of the businesses (82%) are engaged in the traditional sectors of textiles and apparel, education, food, beauty, and health sector.

Deep rooted socio-cultural values of female segregation are evident in the industry profile. Majority of the female entrepreneurs (45.7%) are concentrated on the services sector and the local market, providing services mostly to the female customers. This is fairly typical of women's enterprises, in which the initial investment is relatively small and life experiences/hobbies are developed into businesses (Al-Riyami et al, 2003). Most of these services are in the sector where male-female interaction is either non-existent or minimum (in the case of education, beauty, and/or food sector). Manufacturing is mostly in the apparel and textiles sector, where most of the employees belong to the fairer sex, it consists of 34.4 % of the sample. Minimum numbers of female entrepreneurs (19.9%) are engaged in the retail sector due to increased chances of male-female interaction.

**TABLE 1: Industry Profile for Pakistani Women Entrepreneurs (n=256)**

| <b>Industry</b> | <b>Number</b> | <b>Percentage</b> |
|-----------------|---------------|-------------------|
| Services        | 117           | 45.7%             |
| Retail          | 51            | 19.9%             |
| Manufacturing   | 88            | 34.4%             |

## **PERSONAL PROFILE**

The literacy rate plays an important role to let Pakistani women aware of their rights (Shah, 1985). The same is evident from the result of this study that 82% of the sample are at least high school graduates, 52.7% earned their bachelor degree and 15.2% are post-graduate. One of the interesting facts is that their close relatives like father, mother, and husband are also well above the national literacy rate. Though, only 15.2% has formal education in management, 21.8% and 25.7% of them have previous managerial occupation and previous experience in industry.

One of the interesting finding is that almost 70% had their father and/or husband working as a business person at the time of start-up. Either those men supported their daughters and /or wives in the start- phase or at least encouraged them to take the plunge. Most of them (77%)

are married with children and became entrepreneurs when their children were grown. This is consistent with the strong family orientation prevalent in the Pakistani culture and the existence of acceptability of working women as long as she gives priority to family responsibilities.

**TABLE 2: Personal Profile for Pakistani Women Entrepreneurs (n = 256)**

| Variable  | Number | Percentage | Mean |
|---|--------|------------|------|
| Education level/high school                               | 212    | 82.8%      |      |
| Education level/university (Bachelor)                     | 135    | 52.7%      |      |
| Education level/university (Master)                       | 39     | 15.2%      |      |
| Area of university education: management, economics, etc. | 39     | 15.2%      |      |
| Previous entrepreneurial experience                       | 23     | 8.9%       |      |
| Previous managerial occupation                            | 56     | 21.8%      |      |
| Previous experience in industry                           | 66     | 25.7%      |      |
| Involvement in the start-up                               | 244    | 95.3%      |      |
| Membership in women's association                         | 77     | 30%        |      |
| Age of entrepreneur                                       |        |            | 39   |
| Marital status: currently married                         |        | 77%        |      |
| Number of children  |        |            | 3    |
| First child's age   |        |            | 16   |
| Father and/or husband in business                         | 179    | 69.9%      |      |

All interviewees were categorized as personal freedom seekers, personal security seekers or personal satisfaction seekers on the basis of reasons (such as family encouragement, ambition, independence, enjoyment, finance, economic necessity, challenge, corporate downsizing, job dissatisfaction, to utilize knowledge of skills, to make others happy, self recognition) for undertaking the business venture (Al-Riyami, 2002; Shabbir, 1996). Almost half of all the women interviewed (48%) started the business in order to maintain or improve their and their family's social and economic status. The need for the security of social and economic status was in many cases triggered by some personal mishap. Such as the death or retirement of whoever may have been the primary breadwinner in the family.

A number of women in this study (31.7%) took a decision to run their own business in order to prove to themselves and to others that they are a useful and productive member of the society. These were all women with little or no formal work experience, who were no longer content to be only a housewife. Most of them were relatively older women in their forties and/or early fifties. Only 20% opted to take a plunge in order to have the freedom to choose their own kind of work, hours, environment, and co-workers. These were mostly women who had experienced some kind of frustration in paid work and now wanted the freedom to gain control over their environment and type of work (Shabbir, 1996).

**TABLE 3: Category of Entrepreneurs based on Reasons for Starting up the Business (n = 256)**

| Category                      | Number | Percentage |
|-------------------------------|--------|------------|
| Personal freedom seekers      | 52     | 20.3       |
| Personal security seekers     | 123    | 48.0       |
| Personal satisfaction seekers | 81     | 31.7       |

Based on the findings of this study and information present in the literature (Goheer, 2002; Rajivan, 1997; Shabbir 1995; Shah, 1986), the common profile of the Pakistani woman entrepreneur can be summarized as: “a woman with a university/high school education, but an education unrelated to running her business; entering business in her thirties without a grooming for it, but with a strong motivation to do something significant; in their out of choice mostly for security reasons; restricts herself to one or two lines of business; preferring not to diversify; married with children; juggling between the enterprise on the one hand and home and children on the other; a supportive or at least a minimum objections family situation; coping in a much less supportive society which views her work as secondary business; without a serious motive”.

## CHALLENGES

An important question in entrepreneurship studies is whether women entrepreneurs face specific problems in setting up a business that are different from those faced by male entrepreneurs. Many researchers (Welter, 2004; McManus, 2001; Smallbone et al., 2000) indicate that women entrepreneurs experience a number of problems and issues that are greater than those facing small business in general. Based on the literature (Welter, 2004; Smallbone et al., 2000; Carter et al., 1998; Birley, 1989) challenges/issues were divided into gender-neutral and gender-related categories as listed in Table 4. The interviewees were asked to describe three biggest challenges faced in descending order in both the start-up and growth phases.

**TABLE 4: Challenges Faced by the Women Entrepreneurs**

| Gender-Neutral Challenges   | Gender-Related Challenges  |
|---|--|
| <ul style="list-style-type: none"> <li>• Access to Capital/Finance</li> <li>• Lack of Business Management Skills</li> <li>• Government Policy/Regulations</li> <li>• Registration</li> <li>• Utility Connections</li> <li>• Tax Harassment</li> <li>• Lack of Technical Skills</li> <li>• Purchase of Raw Material</li> <li>• Availability of Market</li> <li>• Access to Information Technology</li> </ul> | <ul style="list-style-type: none"> <li>• Spatial Mobility</li> <li>• Choice of Business</li> <li>• Support of Family</li> <li>• Networking and Trust-Building</li> <li>• Acceptance of Women’s Authority</li> <li>• Credibility (Employees, Customers, and Suppliers)</li> <li>• Fear of Failure</li> <li>• Time Distribution (Between Family and Business)</li> </ul> |

The biggest gender-neutral challenge was access to capital followed by lack of business management skills, and government regulations in the start-up phase. Again, access to finance was considered to be the most difficult challenge followed by the availability of the market, and lack of technical skills in the development (growth) phase. These results confirm the findings of previous studies (Nabeel, 2002; Roomi, 1999) that even in gender neutral problems women's immobility due to the notions of 'purdah' and 'Izzat' poses a big hindrance to all these problems in general and their access to capital in particular where female (nascent) entrepreneurs experience gender specific problems as well, i.e. mobilizing start-up capital, credit guarantees, investment capital, and possible discriminating attitude of bankers (Carter and Rosa, 1998).

**TABLE 5: Gender-Neutral Challenges\* Faced in the Start-up Phase**

| <b>Problems/Challenges</b>         | <b>1st challenge<br/>(% age)</b> | <b>2<sup>nd</sup> challenge<br/>(% age)</b> | <b>3<sup>rd</sup> challenge<br/>(% age)</b> |
|------------------------------------|----------------------------------|---|---|
| Access to Capital                  | 39                               | 27  | 21  |
| Lack of business management skills | 18                               | 21  | 25  |
| Government policies/regulations    | 8                                | 16  | 14  |

**TABLE 6: Gender-Neutral Challenges\* Faced in the Development (Growth) Phase**

| <b>Problems/Challenges</b> | <b>1st challenge<br/>(% age)</b> | <b>2<sup>nd</sup> challenge<br/>(% age)</b> | <b>3<sup>rd</sup> challenge<br/>(% age)</b> |
|----------------------------|----------------------------------|---|---|
| Access to Finance          | 27                               | 23  | 18  |
| Availability of Market     | 18                               | 21  | 26  |
| Lack of Technical skills   | 16                               | 24  | 21  |

\*Three most difficult challenges during the process in descending order

Most of the women are shy to approach banks because of the unavailability of collateral, their inability to develop viable business plan and above all social unacceptability of their interaction with the male bank professionals. They have to generate most of the finances through personal savings, family and friends. Because of their limited earning potential, it is quite impossible to have significant savings to start a business. Therefore, it is only possible for a female to start a business if her family has some extra cash as start up capital and she has a strong support from members of the family to do so.

Their restricted interaction with male members of the society limits the opportunities of acquiring business management and technical skills as there are very few institutions/organizations providing training only for women. They also face severe competition as far as the availability of market is concerned. Men are able to do much more than a woman and are able to attend or to appear in various places much more than a woman would do. In the Government departments man look at them as a "woman" (Al-Riyami, 2002). Women are encouraged to stay longer when they are there for official purposes, hence making delays in providing them with solutions regarding their problems. It creates frustration

for those women and worries for their families consequently discouraging them and other women to start their businesses.

## **GENDER-RELATED CHALLENGES**

The interviewees were asked to describe the gender-related challenges they face in start-up and growth phases as well. Not surprisingly, spatial mobility was considered to be the most challenging task for starting up a business. The restricted spatial has two dimensions, “One had to do with the actual physical limitation on the ability of women to move around because of the inadequacy of transportation facilities both private and public” (Shabbir, 1996). The second is the actual ability of women to move around freely. From the early childhood, they are not allowed to go out of their houses and mix with boys independently. They are protected and not encouraged to do things at their own. There’s a change in attitudes with the passage of time. Women are allowed to work in offices from 9 to 5 but it is very difficult for their families to allow them to move around freely to conduct their businesses.

**TABLE 7: Gender-Related Challenges\* Faced in the Establishment (Start-up) Phase**

| <b>Problems/Challenges</b> | <b>1st challenge<br/>(% age)</b> | <b>2<sup>nd</sup> challenge<br/>(% age)</b> | <b>3<sup>rd</sup> challenge<br/>(% age)</b> |
|----------------------------|----------------------------------|---|---|
| Spatial mobility           | 36                               | 32  | 31  |
| Choice of business         | 21                               | 12  | 4   |
| Support of family          | 19                               | 11  | 21  |

\*Three most difficult challenges during the process in descending order

Keeping in view of the problem of mobility, they have to restrict their businesses to areas, such as education, health, beauty, etc. where they provide services mostly to women customers or in the garments/textile sectors, where they have women employees to manufacture products for women customers. Though, one can find a few women working in the non-traditional areas but they can be counted on fingers and the most important factor for them being there is either involvement or support of their family to start and run that kind of business.

As their businesses grow, most of the women think that the hardest nut to crack is to deal with the labour. Most of the labour force is uneducated male, who are mostly rude and rough not ready to accept the authority of women. One has to be strong and stern to deal with them and their socio-cultural values prevents them to accept the same from a woman.

Another major gender-related challenge for women is to prove their credibility to the suppliers and customers. Especially, if they work in the non-traditional sectors, neither supplier nor customers take them seriously and consider that these women would not be able to achieve their target. They would not be able to pay in time to their suppliers and manufacture the goods or supply the products in time to their customers. They have to work hard to let their customers, suppliers and even employees aware of their credibility to run that business effectively and efficiently (Shabbir, 1995).

**TABLE 8: Gender-Related Challenges\* Faced in the Development (Growth) Phase**

| Problems/Challenges                           | 1st challenge (%age) | 2 <sup>nd</sup> challenge (%age) | 3 <sup>rd</sup> challenge (%age) |
|---|----------------------|----------------------------------|----------------------------------|
| Acceptance of women's authority               | 21                   | 20                               | 22                               |
| Networking and trust building                 | 17                   | 21                               | 15                               |
| Credibility (employees, customers, suppliers) | 19                   | 11                               | 10                               |

\*Three most difficult challenges during the process in descending order

Entrepreneurs require information, capital, skills, and labour to establish and develop their businesses. While they hold some of these resources themselves, they often complement their resources by accessing their contacts (Aldrich et al., 1989; Hansen, 1995). The contacts that lead to successful outcomes are their social capital and they are a key component of entrepreneurial networks (Burt, 1992). With respect to social capital in the form of networks, some research indicates gender-specific deficits in the networking contacts of female entrepreneurs even in western part of the world, drawing attention to the limited outreach and diversity of women entrepreneurs' networks (Cooper, Folta, & Woo, 1995; Aldrich et al., 1989). The same problem is evident in Pakistani women entrepreneurs as well with it severity because of the fact that it is very difficult for women to commute and get together at a place away from their homes. Most of the women feel that there is a lack of networks to exchange information, discuss issues, and seek advice on common topics, which is vital for the success of businesses.

## **PRACTICAL RECOMMENDATIONS**

The research suggests that most of the problems/challenges faced by Pakistani women entrepreneurs are a result of the inferior status of women in society, their underestimation as economic agents as well as the gender bias embedded in the regional, tribal, and/or feudal culture in the name of Islam. The main reasons of the challenges they face are the notions of 'purdah' and 'Izzat', which place severe restrictions on their mobility and they are not allowed to go out and work with men, which might cast doubts on their good reputation and reduce their marriage prospects (Shabbir, 1996; Shah, 1986; Hibri, 1982).

The most important point to mention is that there is nothing in the Qur'an<sup>5</sup> or in the hadith<sup>6</sup> which prevents women from working outside the home. In fact the Qur'an extols the leadership of Bilqis, the Queen of Sheba for her capacity to fulfill the requirements of the office, for her political skills, the purity of her faith and her independent judgement (*Al Naml*, 27:23-44). If a woman is qualified and the one best suited to fulfill a task, there is no Qur'anic injunction that prohibits her from any undertaking because of her sex. The hadith literature is replete with women leaders, jurists and scholars, and women who participated fully in public life. There is another hadith which states that 9/10 of our sustenance comes from business. For

<sup>5</sup> The Holy Book for Muslims

<sup>6</sup> Sayings of Prophet Muhammad

those who are able and are competent, Islamic society should encourage them to become entrepreneurs or get involved with other types of business activities (Hibri, 1982).

It is a fallacy to say women do not need work and that men have the primary responsibility to provide for their families. The glowing role model of Prophet Muhammad's wife (Khadija, RA)<sup>7</sup> and many other examples in the annals of Islamic history confirm that "women in business" are not frowned upon in Islam (Haddad, 1998). They are allowed to generate moneymaking activities that can help improve the economic state of the family, and the community. Therefore, Pakistani society's inclination to deny women the right to work on the basis of religion is an unrealistic proposition. It is just like that in large part of the society women have been denied the right to get education even though Islam has made it compulsory for men and women to pursue knowledge. Islam has given women the right to own property, to own business, to keep her 'maiden name', to choose her spouse, to divorce, to hold political office, and equality in honour and respect (Ahmad, 1992). The right to work is also an inalienable right of women, which is never objected by Islam. If this right is denied, it will, as a consequence, deprive women choice in many areas and affect other inter related rights such as the right to get education, the right to mobility, the right to decision making, and to political participation (Jalal, 1991). Therefore the situation demands following steps to be taken to improve women entrepreneurship opportunities:

- The first and foremost priority should be the 'True Islamisation' of thought regarding the status of women in the society. There's a need of change in syllabus at the school level to let society know the importance of inclusion of the womenfolk in economic activities. It can help changing the stereotype images of women in the society and encourage family support and help, which usually has a positive influence on women, both in venturing into and in making progress in business.
- Inadequate public transport plays a major role in immobility of women in Pakistan. Due to religious and cultural reasons-mainly purdah-the public transport facilities such as buses and vans have separate seating arrangements for men and women. These public buses and vans only have the first two or three rows of seats available for women. All the remaining seats are for men. This seating arrangement may have been adequate thirty years ago, when few women came out of their houses and fewer still went to work. But things have certainly changed dramatically since then. More and more women are now coming out to work, and the demand for transportation facilities by women has increased dramatically, but still only two or three rows are available on buses and vans for women (Shabbir, 1995). People don't like their women to go out as there are not enough seats for women to commute and being a developing country not all have the financial muscle to own a private conveyance. There is a dire need to change the whole system or at least provision of more seats for women in public transport. Government should play a vital role in providing these services as more women would be able to embark upon the business initiative if the problem of mobility is solved.

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<sup>7</sup> Khadija (RA) the first wife of the Prophet Muhammad, was one of the most successful traders of Makkah.

- Media can play an important role by portraying the appropriate picture of the ‘muslim woman’ (who has the right to acquire knowledge through education, right to own property and to have her own business) by showing the positive role models of successful women entrepreneurs. It will not only influence other women in their decisions and choice of careers but will also create a suitable environment for their family members to allow them to venture into their own businesses.
- Women generally have less access to external funding than men; hence women’s businesses tend to be concentrated in the service sectors, which usually require small initial capital outlay and less technical knowledge. Government has taken a few steps in improving their access to finance such as incorporating First Women Bank (a commercial bank for the women by the women), and establishing Pakistan Poverty Alleviation Fund (for the provision of micro-credits to women). However, there’s a need of more flexible banking policies especially for women, keeping in view of the unavailability of collateral and their inability to develop viable business plans.
- Research suggests women-only training can play an important role in developing the next generation of leaders, and in the enhancement of their careers (Vinnicombe and Singh, 2003). Non/limited-availability of women-only training opportunities has been expressed by the interviewees as a major cause of their lack of business management skills in the start-up and growth phase of their businesses. Women-only entrepreneurship training programmes in addition to, and not as a substitute for, other entrepreneurship courses and support mechanisms such as mentoring and coaching, can provide them with an opportunity to learn primary, hands-on techniques of running a business in socially acceptable and culturally viable environment.
- For local markets, there may be limited support to forecast market and financial trends because of lack of data. Business support institutions such as Export Promotion Bureau, First Women Bank, and Small and Medium Enterprise Development Authority should develop a mechanism of hand-holding of selected women entrepreneurs to tap international markets.
- Marketing gap can also be fulfilled with good networking among women entrepreneurs. To ensure that their businesses progress smoothly, established women entrepreneurs should establish networks to help other women entrepreneurs. Existing networking organizations such as chambers of commerce and Women’s entrepreneurs associations has limited membership and confined regional outreach. There’s a need to assist the existing forums to play an important role by providing women entrepreneurs business development services (BDS), especially for new and potential women entrepreneurs who are in need of these services.

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# ENTREPRENEURIAL COGNITION AND THE DECISION TO EXPLOIT A VENTURE OPPORTUNITY

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## Abstract

This paper reports on decision-making cognitions just before and during the start-up decision within the entrepreneurial process. It uses empirical results based on responses collected through questionnaires from 300 entrepreneurship, business, non-business students and entrepreneurs as respondents. The importance of entrepreneurial cognitions is reported and the possible implications of these correlations are explored.

Using a case design required respondents to read a case and decide whether they would start the venture or not. First viability thought about the venture happened as early as reading 12% into the case with 81% of the respondents having their first thought about viability before reading 36% of the case. As all the financial information was attached at the end, viability was judged to large extent without reading financial information. This confirms that respondents appear to have used heuristics (shortcuts) and biases to make their decision.

Correlation and inter-correlation strengths and directions between business risk perception, misconceptions, self-efficacy and illusion of control bias with the start-up decision and viability thoughts were established. Highly significant differences between those who supported the start-up and those who did not support start-up were observed for business risk perception and misconceptions, significant difference for illusion of control bias but none for self-efficacy.

Discriminant analysis and logistical regression analysis were performed to predict the start-up and not start respondents based on the business risk perceptions and misconceptions. It was possible to predict the not start category accurately (81.3%) with the discriminant analysis and the start-up category accurately (96.48%) with the logistical regression analysis based on the misconceptions and business risk perception.

The paper concludes the importance of cognitions in entrepreneurial thinking and the tendency to make judgments without complete information. This may lead to decisions that can contribute to failure or may be reason why entrepreneurs are successful.

**Keywords:** Entrepreneurial cognition, risk perception, start-up decision, misconceptions

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## 1 INTRODUCTION AND BACKGROUND TO COGNITION

The field of entrepreneurship seeks to understand how opportunities are discovered, created and exploited (Markman, Balkin and Baron 2002:149). The cognitive perspective, on the other hand, emphasises the fact that mental processes influence everything we think, say or do during this start-up process. These mental processes include the cognitive mechanisms through which we acquire, store, transform and use information (Baron 2004:221). The cognitive perspective provides us with some useful lenses with which to explore entrepreneur related phenomena and to address some meaningful issues that to this point we have been largely ineffective in probing (Mitchell, Busenitz, Lant, Mcdougall, Morse and Smith 2002:93).

Shepherd and Kreuger (2002:177) confirm that social cognition research offers considerable direction to understanding entrepreneurial thinking. Recent research has demonstrated the impact that cognitive and social processes have on entrepreneurial behaviour (Gatewood, Shaver, Powers and Gartner 2004:187). Although cognitive research has been going on for over a century, research in the entrepreneurial domain has prospered over last two decades (Baron, 1998:278) and led to the identification of several areas where it is specifically relevant for entrepreneurship namely:

- Our capacity to process new information about the world around us is severely limited and can be readily exceeded (Baron, 1998:278).
- We use sense making processes to scan through information (Forbes, 1999:415).
- As human beings we seek to minimise cognitive effort in coping with the information overload. As a result, we often use various heuristics (short cuts) in our thinking, techniques that reduce mental effort (Baron, 1998:278).
- Because of our limited information processing capacity, our tendency to minimise mental effort and several other factors (e.g. The powerful impact of emotions on thought), we are often less than totally rational in our thinking (Baron, 1998:278).
- Various aspects of human cognition are subject to a wide range of biases and errors (Baron, 1998:278).
- The environment wherein entrepreneurs operate is complex and demands quick decisions while the concepts of cognitive psychology are increasingly being found to be useful tools to help probe entrepreneurial related phenomena.
- The underestimated role of intuitive (sensing) rather than rational (thinking) in information on decision-making (Hayes and Allison 1994:59)
- Insights from the rich, broad social cognition literature give us several new insights about how to develop an entrepreneurship-friendly “cognitive infrastructure” at both self and collective efficacy level (Shepherd and Kreuger (2002:177).
- When receiving equivocal information, individuals are likely to perceive that which they are predisposed to see (Palich and Bagby 1995:428). Such predispositions and preferences for information when thinking has been categorised by Herrmann (1996) into four categories namely factual, procedural, affective and experimental information.
- The use of shortcuts, or heuristics, is sometimes efficient in that they facilitate judgements without tremendous information processing costs (Gowda 1999:60) as typically faced by the entrepreneur.
- The human judgement theory and decision-making are characterised by biases, errors and the use of heuristics (Watson, Rodgers and Dudek 1998:495).

The cognitive perspective should be viewed as complementary to, rather than incompatible with, other points of view in entrepreneurship such as personality and characteristic traits. The cognitive perspective may provide additional insights into the complex process of entrepreneurship (Baron 2004:237).

While the importance of entrepreneurial cognitions is acknowledged, the question arises if and how cognitive processes can be influenced by education. This paper attempts to better understand the thinking of respondents when faced with the decision of starting or not starting a business venture based on the perceived opportunity. Manimala (1992:478) proposes that the cognitive approach may be of more use to training and education of entrepreneurship than both traits and characteristics for which the findings proved mostly inconclusive (McClelland 1986 as quoted by Manimala 1992:479). Unfortunately it is difficult to compare thinking patterns between entrepreneurs, as there are too many complexities and different factors from the comparative environments, industry and business specifics that make it impossible to meaningfully compare them. For this reason an experimental design is pursued in this research (See research methodology).

## 2 THE NEW VENTURE CREATION PROCESS

Shook, Priem and McGee (2003:381) proposes an organising model that includes the following four stages (also shown in Figure 2) of venture creation namely: Entrepreneurial intent to start-up, searching for and discovering an opportunity, taking the decision to exploit the opportunity by new venture creation and then engaging in the exploitation activities.

Within each of these stages the role of the enterprising individual has been studied. They suggest that there is room for research to develop the understanding of cognitive processes during the different stages but simultaneously point out that the number of variables that determine each specific venture creation situation are so many that meaningful comparison of entrepreneurs is virtually impossible due to the complexities associated with each of the combinations of variables.

This article focuses on the thinking of respondents before and when they take the decision to start or not to start a venture. At the time respondents make the decision, the opportunity has been found (through whatever process might have been relevant at the time), and evaluation of the opportunity is foremost. At this point the entrepreneur is normally overloaded with data and information of different kinds (rational, procedural, innovative and intuitively felt information). Figure 2 shows the focus of this study relative to the entrepreneurial process as well as the specific constructs investigated and reported.

## 3 THE ROLE OF COGNITION ON ENTREPRENEURIAL DECISION-MAKING

### 3.1 *Cognition and the entrepreneurial decision*

Cognition (mental models) and cognitive psychology concern themselves with the study of individual perceptions, memory and thinking (Mitchell et al 2002:96). It involves all processes by which sensory input is transformed, reduced, elaborated, stored, recovered and used. Social cognition theory considers that individuals exist within a total situation or configuration of forces described by two pairs of factors: one being cognition and motivation, and the other being the person in the situation.

Cognition has to do with mental processing (thoughts) that individuals use to interact with their environments and helps to distinguish between entrepreneurs and non-entrepreneurs. Entrepreneurial cognitions have to do with the knowledge structures that people use to make assessments, judgements or decisions involving opportunity evaluation, venture creation, and growth (Mitchell et al 2002:97). In other words, research in entrepreneurial cognitions is about understanding how entrepreneurs use simplifying mental models to piece together previously unconnected information that helps them to identify and invent new products or services, and to assemble the necessary resources to start and grow businesses as well as pursuing opportunities or not.

Figure 1 shows a model for information processing as suggested by Miller (1987) as quoted by Hayes and Allison (1994). The role of perception (pattern recognition and attention) and thought (inductive reasoning as seen in classification, analytical reasoning and judgement) can influence the final response of the individual (Mitchell, Smith, Morse, Seawright, Perero and McKenzie 2002:13).

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Insert Figure 1 near here

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Baron (1998:297) suggests that entrepreneurs are more exposed to factors such as information overload, high uncertainty, high novelty, strong emotions, time pressure and fatigue than non-entrepreneurs. This leads them to increasingly being susceptible to the use of heuristics and biases such as counterfactual thinking, regret affect infusion, self-serving bias, planning fallacy, illusion of control, overconfidence and belief in the law of small numbers and self-justification. Based on Figure 1 the role of using the case study and leading to the start-up decision for the research was born. Finding the role of risk perception, self-efficacy, misconceptions and illusion of control bias is explored further.

### 3.2 *Business risk perception and decision-making*

Risk perception refers to the subjective judgement of the amount of risk inherent in a situation and has been found to differ between entrepreneurs and non-entrepreneurs (Keh et al 2002:19). Reduced perception of risk therefore contributes to the reason why some people but not others become entrepreneurs (Baron 2004:237).

Palich and Bagby (1995:426) reports that entrepreneurs did not vary significantly in their responses to a risk propensity scale, meaning that they did not perceive themselves as being any more predisposed to taking risks than non-entrepreneurs. However, multivariate tests revealed that entrepreneurs categorised equivocal business scenarios significantly more positively than did other subjects, and univariate tests demonstrated that these perceptual differences were consistent and significant (i.e. entrepreneurs perceived more strengths versus weaknesses, opportunities versus threats, and potential for performance improvement versus deterioration).

Risk perception is also influenced by cognitive biases. Simon, Houghton and Aquino (1999:113) report that before the decision to exploit the venture creation opportunity is taken, risk perceptions may differ because certain types of cognitive biases lead individuals to perceive less or more risk. These cognitive biases are common types of mental shortcuts used to make judgements. While judgment is at the heart of the decision making process, it involves several cognitive processes.

Based upon the tenets of cognitive theory, entrepreneurs may simply categorise and subsequently frame the same stimuli differently from non-entrepreneurs. That is, what has been widely recognised as a propensity for risk on the part of the entrepreneur may instead be an artefact of alternative framing based on misconceptions. Entrepreneurs may not necessarily prefer to engage in less risky behaviour; instead, their behaviour may be the result of different misperceptions about a given situation, thereby choosing to start the venture as a result of these misconceptions.

### 3.3 *Misconceptions and decision-making*

In the whole problem of a misfit between the entrepreneurs' cognitive make-up and the varying demands of the new venture over time, the central element is the individual entrepreneur. Both Busenitz & Barney (1997) and Baron (1998) found that entrepreneurs and managers use different biases and heuristics when faced with complex situations. These findings may explain the fact that entrepreneurs tend to operate in more uncertain and complex environments than do other individuals (Brigham & De Castro 2003: 42).

Very often entrepreneurs ignore the likelihood that the new venture will encounter substantial competition. According to Lieberman & Montgomery (1985:5) and Simon & Houghton (2002:10) underestimating competitive response can be defined as the extent to which a company will gain an advantage by pioneering its contingent upon the actions of its competitors.

Entrepreneurs are often overly optimistic in their perception of market acceptability. They believe that the output from this new venture will achieve its planned acceptance in the market place. According to Simon and Houghton (2002:11) the believe in small numbers bias may explain why entrepreneurs overestimate demand because individuals who utilise limited amounts of information may unintentionally select positive and not negative information, which could lead to overly optimistic forecasts of what their sales and in turn what the demand for their product could be.

Simon and Houghton (2002) argue that many pioneer entrepreneur's fail because they lack complementary assets. Complementary assets can include the following: sales and distribution costs, storage and stock holding and finance for slow payment. Misjudging these is a typical cause of failure in start-up ventures.

Misjudging the need for complementary assets can contribute to this misperception by creating an overly simplistic view of a very complex situation. These miscalculations may be more likely to occur in pioneering decisions, because the entrepreneur in pioneering decision context do not have other industry models to compare with and therefore have fewer cues regarding the potential problems of lacking complementary assets (Simon and Houghton, 2002:12).

### 3.4 *Self-efficacy (believe in own ability to effectively accomplish) and decision-making*

Beliefs in personal efficacy constitute the key factor to human agency. If people believe they have no power to produce results, they will not attempt to make things happen. In social cognitive theory, a sense of personal efficacy is represented as proportional beliefs that are embedded in a network of functional correlations with other factors that operate together in the management of different realities (Bandura 1997:3).

Efficacious people are quick to take advantage of opportunity structures and figure out ways to circumvent institutional constraints or change them by collective action. Conversely, inefficacious people are less apt to exploit the enabling opportunities provided by the social system and are easily discouraged by institutional impediments (Bandura 1997:6).

Shepherd and Kreuger, (2002:171) quote Bandura (1991) and Waung (1995) to describe people with high self-efficacy as those who have a high level belief in their capacity to perform. Self-efficacy refers to the conviction that one can successfully execute the behaviour required or the amounts of faith entrepreneurs have in their own ability to succeed (La Pira and Gillin 2004: 272). Thus it reflects the perception of a personal capability to do a particular job or set of tasks. Self efficacy impacts our perceived control, how much stress, self blame and depression we experience while we cope with taxing circumstances, and the level of accomplishments we realise (Markman et al 2002:152). High self-efficacy leads to increased initiative and persistence and thus improved performance. Indeed people with high self-efficacy think differently and behave differently than people with low self-efficacy.

Entrepreneurship scholars have found that self-efficacy is positively associated with the creation of a new independent organisation (Shepherd and Kreuger 2002:171). It may be argued that the impact of self-efficacy is more related to the intent and opportunity identification phases of the entrepreneurial process but this study attempts to determine the correlation with the decision to exploit the opportunity as well as its correlation to the risk perception. Based on the above, people with higher levels of self-efficacy, might perceive opportunities differently to those with lower levels of self-efficacy.

Entrepreneurial self-efficacy is widely regarded as a moderator of the relationship between individual perceptions and the development of entrepreneurial intent. Demographic characteristics appear to influence perceptions of feasibility, desirability and social support, and entrepreneurial self-efficacy within a complex set of cognitive mechanisms (Shook et al 2003:385). In short, perceived self-efficacy is central to most human functioning, and since actions are based more on what people believe than on what is objectively true, thoughts are a potent precursor to ones level of motivation, affective states and actions (Markman et al 2002:152). They state that self-efficacy impacts on entrepreneurial pursuits.

La Pira and Gillin (2004:272) further suggest that neither education nor training seem to contribute to the level of confidence or faith associated with self-efficacy, thus questioning the direct influence of education and training on this construct. Self-efficacy is rather causal to behaviour than vice versa. Efficacy beliefs therefore operate as a key factor in a generative system of human competence. Hence, different people with similar skills, or the same person under different circumstances, may perform poorly, adequately, or extra ordinarily, depending on fluctuations in their beliefs or personal efficacy (Bandura 1997:37).

### 3.5 *Illusion of control bias and decision making*

Bias is common in mental processing tasks such as diverse as target recognition, heuristic estimation and social judgement. Cognitive biases reflect the silent operation of neural modules that enhance adaptive behaviour and works automatically. Per definition, bias refers to a systematic preference, which primes either the selection of targets or recruitment of operational modes that results in weighted options in cognitive routines. Such weightings usually produces efficient performance but can also lead to false observations or deductions (Tobena, Marks and Dar 1999:1047).

Illusion of control is one such bias in which an individual overemphasises the extent to which his or her skills can increase performance in situations where chance plays a large part and skill is not necessarily the deciding factor. For example, people fail to respond differentially to controllable and uncontrollable events (Langer 1975 reported by Keh et al 2002:131). They report two reasons for this illusion of control namely that people are motivated to control their environment and the feeling of competence will result from being able to control the uncontrollable and secondly that skill and chance factors are closely associated and it is often hard to discriminate between skill and chance factors.

Therefore, individuals exhibiting an illusion of control will underestimate risk because they believe their skills can prevent negative occurrences (Keh et al 2002:131).

### 3.6 *Thinking preferences*

Thinking preferences as based on the Herrmann Brain Dominance Instrument (HBDI) also influence all cognitive activities including conceptualisation in equivocal and complex situations (Maree and De Boer 2003:453). The tendency to be led by one's preference for certain types of information and avoidance for others when perceiving the world around us, therefore supports why individuals frame the same situation differently. When faced with a problem situation, an individual will mostly follow the preference order for information starting with the highest preference first, then second and third most preferred ending with the least preferred type. These preferences are also related to how people frame their perceived environments. The natural preferences of people may also change towards another category when under pressure (Herrmann 1996).

For the entrepreneurship researcher, the question that arises is whether people could learn to change the way they perceive situations to enhance future decisions.

## 4 PROBLEM STATEMENT, HYPOTHESES AND RESEARCH METHODOLOGY

Several authors identify the use of cognitions by entrepreneurs to be different to that of non-entrepreneurs. Prospective entrepreneurs are faced with the same complex situations and lack of experience and previous exposure may force them to use certain thinking biases and heuristics.

### 4.1 *Problem statement*

Cognitions have to do with several complex interrelated systems that may vary over subjects and environments. Although there are several theories about these relationships, few have been tested empirically for the start-up decision. This research is concerned with establishing the strength and direction of these correlations and how they may impact the start-up decision. A better understanding of the difference between entrepreneurially oriented and other groups will help to establish the extent, if any, of such relationships. Secondly the question is asked what the implications of these cognitions and correlation can be on entrepreneurial education and learning. Is it necessary for educators to consider it? To study these potential correlations, the following hypotheses were set to guide the thinking of this article.

### 4.2 *Hypotheses*

To lead the thinking of the research in this process setting, five main hypotheses were set as shown in Figure 2. All the null hypotheses proposed that there is no relationship with the

decision to start while the alternative hypotheses were all proposing a correlation between the factors with the decision to start.

Ho1: Business risk perception has no correlation to the start-up decision (Ha1: there is a correlation)

Ho2: Misconceptions have no correlation to the start-up decision (Ha1: there is a correlation)

Ho3: Illusion of control bias has no correlation to the start-up decision (Ha1: there is a correlation)

Ho4: Self-efficacy has no correlation to the start-up decision (Ha1: there is a correlation)

Ho5: Thinking preferences have no correlation to the start-up decision (Ha1: there is a correlation)

Insert Figure 2 near here

#### 4.3 *Design and process*

Similar to Simon et al, (1999:120) a case was designed that described a revolutionary new concept namely animal fodder manufactured from cut lawn grass. In addition to describing the venture's proposed product and market, processes as well as expected performance and resource requirements. The case provides both encouraging and discouraging information, information covering the four thinking preference types regarding the venture's potential. The case length (8 pages including financials or 240 lines plus financial statement), its ambiguity and complexity required respondents to apply all possible information processes to determine whether they would start the venture or not.

Using the case method eliminated many of the environmental factors that complicate comparison of the individual's thinking and behaviour between situations associated with different entrepreneurs, macro and market environments, industries, competitive levels, venture characteristics etc. Using the case ensured all subjects analysed the same venture and complexities. Korunka, Frank, Lueger and Mugler (2003:26) suggest that the difference in environmental conditions should always be considered in relation to entrepreneurial character, resources and organising activities as it plays a crucial role. This approach allows for "control" of an external variable.

To ensure elimination of potential information framing effects such as attribute framing, goal framing and risky choice framing as described by Levin, Gaeth and Schreiber (2002:412), care was taken with the presentation of the case. Positive and negative information, advantages and disadvantages as well as positive and negative consequences were balanced. During the creation of the case, the distribution of information type was balanced to give equal factual, procedural, affective and experimental information according to Herrmann's (1996) classification. While all four types of information was readily available, the factual information was somewhat more and the affective information somewhat below the average due to the inclusion of financial statements mainly.

Respondents were requested to avail themselves for an hour to participate in the research. Of this, the reading of the case took between 20 – 30 minutes where after the respondents were urged to start with the questionnaire.

#### 4.4 *Instrument*

A questionnaire was designed covering the different aspects related to the problem. It covered questions on: information used for decision-making, information requirements to make an improved decision, self-efficacy, risk perception (Keh, Foo and Lim 2002:141), illusion of control, misconceptions (Simon and Houghton 2002:114) associated with start-up mistakes and how individuals tend to frame their environments.

#### 4.5 *Subjects*

Two hundred and fifty students from a major university in South Africa and 50 entrepreneurs were asked to participate. Respondents were drawn from different groups namely: B Com students majoring in entrepreneurship (representing those who already made a choice for entrepreneurship and starting a business), B Com students not majoring in entrepreneurship (making a choice for a career in the business domain), students from humanity majors (representing a choice “against” entrepreneurship and business), post graduate (M Phil and PhD Entrepreneurship candidates representing a late choice for involvement in the entrepreneurial domain) and entrepreneurs (the real thing) that were willing to participate.

The sample depended on respondents who had previously been assessed with the HBDI™ instrument (Herrmann Brain Dominance Instrument) because part of the overall study investigated thinking preferences as a potential heuristic used in the decision to exploit a business opportunity or not (convenience sampling was used). The cost of the HBDI assessment (R513 = approximately \$90 per assessment) limited the sample size.

#### 4.6 *Statistical Procedures*

Each of the constructs described previously were evaluated by respondents with statements (several items per construct) on a seven point Likert-scale as reported to be used in previous studies namely:

- *Decision to start a venture* was determined by one statement where respondents were asked to state their agreement with starting versus not starting on a seven point Likert-scale.
- *Business Risk perception* was measured by eight items relevant to the case as described by Simon et al (1999:131). Business risk perception refers to risk in the venture but excludes the potential personal risks to self and family associated with the decision to pursue the opportunity or not. Incorporating this element in the measurement would not be possible within the methodology used for this study.
- *Self-efficacy* was measured by eight items scored on a seven point Likert-scale as described by Markman et al 2002:165).
- *Misconceptions* was measured by twelve questions covering issues such as the overestimation of demand, underestimation of competitive response, underestimating resource requirements, misjudging managerial fit, cash flow and profit expectations. The large number of associated variables stems from the initial attempt to identify six misconception elements as constructs with three questions each.
- *Illusion of control bias* was measured by four items (three as described by Keh et al 2002:125). Qualifying questions were used to establish how strongly respondents want to establish their own businesses following the report of Markman, Balkin and Baron (2002:154).

Firstly the data was subjected to a factor analysis (BMDP program) to determine instrument stability, validity and whether it measured the constructs that it was intended for. Thereafter a correlation analysis was done to determine the strength of the correlations if such correlations exist and thirdly, analyses of variance was done to compare construct averages for groupings, language and start-up decision as biographical data.

## 5 FINDINGS

Table 1 reports the line number where the first thought of viability (or not) occurred while reading the case. It is important that over 80% of respondents decided before line 90/240 of the full case (excluding the financial projections at the end of the case). This finding supports the notion that heuristics (shortcuts) and biases were probably used in the decision. There was no significant difference for the mean line of 1<sup>st</sup> viability thought between those who decided to start and those not starting the venture.

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Insert Table 1 near here

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After rotation, four factors were observed in the data set with the factor analysis. These were named as shown in Table 2 and Figure 3.

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Insert Table 2 near here

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## 6 DISCUSSION OF THE FINDINGS

Figure 3 indicates a high negative correlation (-0,58\*\*) between business risk perception and the start-up decision and confirms the correlation reported by Keh et al (2002:19). Ho1 is therefore rejected and the correlation's direction indicates that if higher risk is perceived, support for taking the start-up decision diminishes. High or low business risk perception is, however, not causal to the decision but acts as a moderator of the decision.

The misconceptions showed a high correlation (0.49\*\*) with the start-up decision and therefore Ho2 is rejected. Displaying high misconceptions therefore leads to supporting the start-up decision and vice versa, again acting as a moderator of the decision.

It follows logically that if both risk perception and misconceptions are related to the start-up decision, there should be a correlation between them, which is confirmed by the high negative correlation (-0.49\*\*). Higher business risk perception therefore is associated with less misperception and vice versa. The fact that the factor analysis acknowledged them as separate measurements (constructs) recognises that they are different while the correlation indicated they are strongly related. The reason may be that both have a relationship with a third unknown construct not tested within this specific research questionnaire.

Insert Table 3 near here

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Insert Figure 3 near here

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Illusion of control bias, however, showed significant correlations with the decision to start (0.33\*\*), business risk perception (-0.34\*\*), misconceptions (0.41\*\*) but not self-efficacy (0.10). Ho3 is therefore rejected and it is accepted that such correlations do exist although the causality is not proven. Although the means between start-up and not start-up tended to be different it was not a significant difference.

Insert Table 4 near here

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Insert Table 5 near here

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Although the literature supports that self-efficacy plays an important role in human agency, the correlations between self-efficacy and the start-up decision (0.09), business risk perception (-0.05) and misconceptions (0.05) were all low and not significant. Ho4 is therefore accepted that self-efficacy has no apparent influence on the decision to start the venture. The question arises as to reasons for this? Possible reasons may include whether the instrument is a valid measure of self-efficacy. The measurement used, however, seemed accurate and in line with Kuratko and Whelsch (2001).

Alternatively it may be that no correlation was found because the self-efficacy construct response was not normally distributed as indicated by the mean of 5.927 on a seven-point scale leading to all respondents having a high level of self-efficacy. Kuratko and Whelsch (2001:176) suggest that self-efficacy plays an important role in the “intention” of the individual. Its effect may therefore be found earlier in the start-up process namely during the intent to start phase (see Figure 3). As self-efficacy influences behaviour it may also be more related to the start-up actions during implementation rather than the decision to start or not.

It was expected that the entrepreneurs / own business owners would mostly be the ones not starting the venture based on certain practical difficulties which would probably render the venture not viable. These practical issues (confirmed through expert panel) include the control of raw material quality, practical logistical inefficiencies of the transporting the product and the high dependence on employees who must control these key variables. While the entrepreneurial group reported the lowest misconceptions, highest business risk perception, lowest illusion of control bias and the highest self-efficacy, none of these differences were significant.

From those who chose not to start the venture, 34% reasoned that the opportunity was only a good idea and not really an opportunity while 15% thought the opportunity was not viable. Those who decided to start the venture reported the novel idea (37.5%) and the availability of the raw material (17%) as the main reasons for starting the venture.

## 7 IMPLICATIONS OF THE FINDINGS FOR RESEARCHERS

Can business risk perception and misconceptions, as relevant constructs for decision-making, be taught to potential entrepreneurs? While things like culture, education, previous experience, role models and thinking preferences influence perception; attitudinal aspects and lack of knowledge also influence misconceptions, there is a complex configuration of elements that play a role in the development of these heuristics and biases. Awareness of the impact may sensitise potential entrepreneurs to be on the look out for these potential contributors.

It was expected that business risk perception may be influenced by self-efficacy but this could not be confirmed in this study ( $r = 0.05$ ). The literature supports the role of self-efficacy on intention to start a venture but it appears not to play a role in the decision to start the venture.

The absence of a relation between the start-up decision and dominant thinking preference might be because alternative thinking preferences (application of whole brain thinking techniques) may mask the preferential thinking when faced with a decision of this magnitude. Ho5 could therefore not be tested based on the inability to meaningfully categorising individuals as having single dominant thinking preferences.

Illusion of control is a bias that refers to systematic preferences in cognitive patterning. The main focus of education should be on awareness and understanding of this bias and its impact on different thinking situations. Training in the identification of controllable and uncontrollable factors within the business environment as well as approaches and techniques to evaluate risk situations, can be of value.

## 8 LIMITATIONS AND FUTURE RESEARCH

Markman et al (2002:150) makes a case against the use of students when attempting to understand cognitions of entrepreneurs. In this study, however, the use of students seemed beneficial for the following reasons:

- They were not exposed to the entrepreneurial environment (real world) and few had any previous experiences in the field of entrepreneurship or business.
- Not having experience in the field might enforce the use of use of thinking heuristics, biases and information preferences as determined by thinking preferences.
- Gonzales, Lerch and Lebiere (2003:597) suggest that novices must engage in more thorough information searching to determine the principles that are applicable to the problem situation and that may benefit the study when compared to entrepreneurs with experience.
- Being forced to complete within an hour creates pressure that may enhance the use of heuristics and biases even further.
- Being forced to become entrepreneurs because there are no jobs available may indicate the existence of typical biases and misconceptions during the start-up decision and add to the pressure of the decision.

However, being at university already implies a selection process based on performance of the individual and probably indicates a privileged position within society that may influence the representativeness of the sample for the population. For example, the group representing the choice against entrepreneurship were all candidates with an exceptionally high M-score in matric (Grade 12 in secondary school) to get entrance to their specific course (medical related). They may therefore all have levels of self-efficacy.

Despite these limitations, the confirmed correlations have value for future research. The finding of specific misconceptions is one area that should be investigated further.

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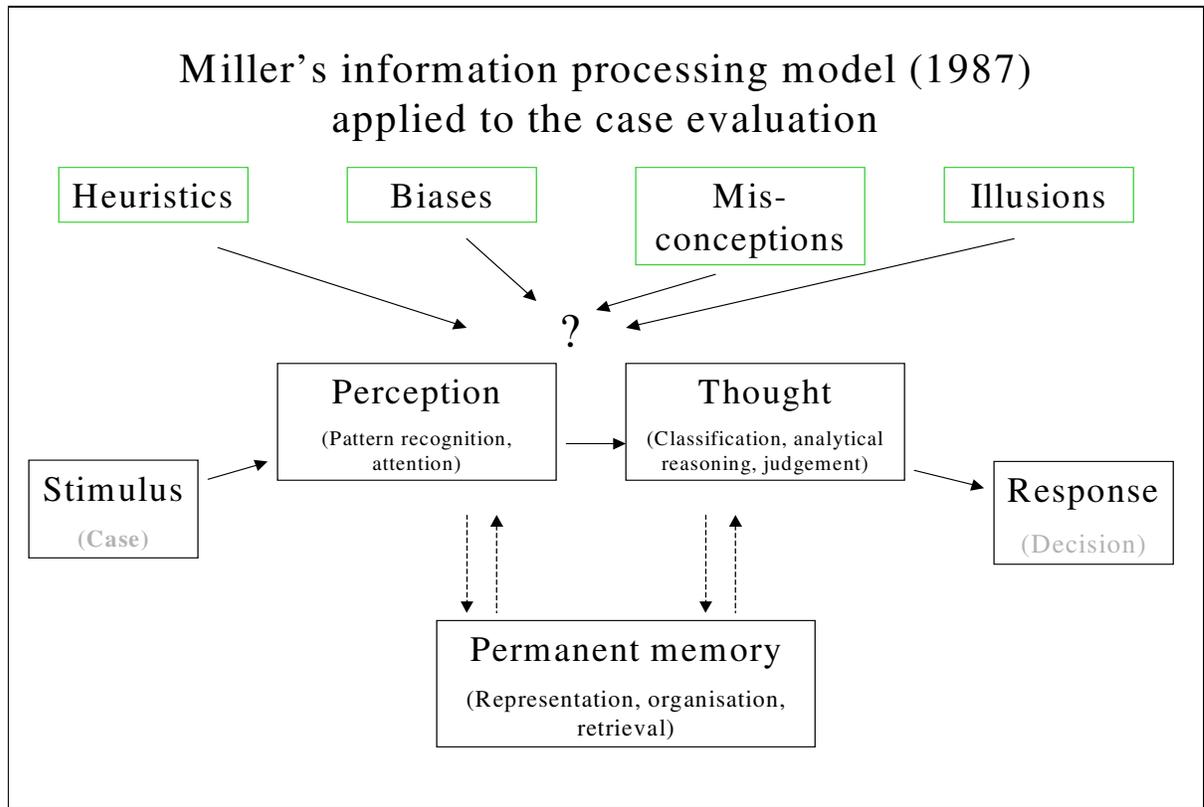


Figure 1 Information processing model (Miller (1987) as quoted by Allison and Hayes (1994).

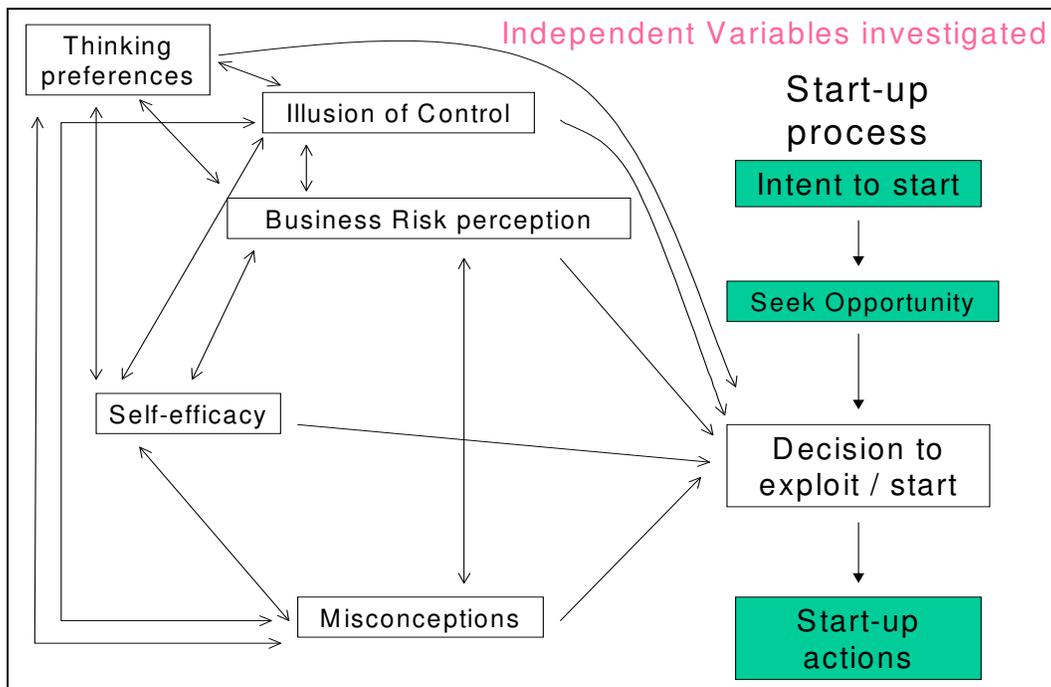


Figure 2 The research focuses of this study as depicted by the independent variables investigated in relation to the decision to start (dependant variable) within the entrepreneurial process.

Table 1 The approximate line where the 1<sup>st</sup> thought whether the venture is viable or not occurred during reading of the case study

| Line where decision was made that concept is viable | Frequency | Percent   | Cumulative Percent |
|---|-----------|---|--------------------|
| 1 – 29  | 39        | 17.33   | 17.33              |
| 30 – 59   | 124       | 55.11   | 72.44              |
| 60 – 89   | 20        | 8.89  | 81.33              |
| 90 – 119  | 17        | 7.56  | 88.89              |
| 120 – 149   | 11        | 4.89  | 93.78              |
| 150 – 179   | 3         | 1.33  | 95.11              |
| 180 – 209   | 6         | 2.67  | 97.78              |
| 210 – 235   | 5         | 2.22  | 100.00             |
| Mean line for not start decision                    | 63.52     | No significant difference<br>t = 1.01 and P > 0.314 |                    |
| Mean line for start decision                        | 55.65     |   |                    |
| Frequency Missing = 6                               |           |   |                    |

Table 2 Spearman Correlation Coefficients (n = 300) between factors and the start-up decisions.

| Factor (number of element per factor) | Cron-bach's Alpha | Mean  | Std dev | Factor   |          |         |      |      |
|---------------------------------------|-------------------|-------|---------|----------|----------|---------|------|------|
|                                       |                   |       |         | 1        | 2        | 3       | 4    | 5    |
| 1 Start-up decision                   | -                 | 5.699 | 1.38    | 1.00     |          |         |      |      |
| 2 Business Risk perception (8)        | 0.891             | 3.614 | 1.08    | - 0.58** | 1.00     |         |      |      |
| 3 Misconceptions (12)                 | 0.855             | 4.447 | 1.02    | 0.49**   | - 0.49** | 1.00    |      |      |
| 4 Self-efficacy (8)                   | 0.754             | 5.927 | 0.76    | 0.09     | - 0.05   | 0.06    | 1.00 |      |
| 5 Illusion of Control bias (3)        | 0.753             | 4.403 | 1.34    | 0.33**   | - 0.34** | 0.41 ** | 0.10 | 1.00 |

\*\* = p < 0.01, \* = p < 0.05, NS = Not significant

Table 3 Comparison between dependent factor means for those who decided to start the business and those who decided against starting (Multi-way analysis of variance) as well as 1<sup>st</sup> viability thought. Cronbach Alphas for the factors are also indicated.

| Factor with              | Don't start<br>Mean (Std Dev)                                      | Start<br>Mean (Std Dev)  | Statistic | Value | Significance<br>Level |
|--------------------------|--|--|-----------|-------|-----------------------|
| N = 300                  | N = 43   | N = 254  | -         | -     | -                     |
| Misconceptions           | 3.442 (0.865)  | 4.613 (0.930)  | F         | 22.13 | < 0.0001**            |
| Business Risk perception | 4.850 (1.180)  | 3.401 (0.908)  | F         | 40.67 | < 0.0001**            |
| Illusion of control bias | 3.566 (1.373)  | 4.533 (1.281)  | F         | 4.26  | 0.0400*               |
| Self-efficacy            | 5.875 (0.901)  | 5.987 (0.740)  | F         | 1.00  | 0.319 NS              |
|                          | <b>1<sup>st</sup> thought is not<br/>viable<br/>Mean (Std Dev)</b> | <b>1<sup>st</sup> thought is<br/>viable Mean (Std<br/>Dev)</b> |           |       |                       |
| N = 300                  | N = 96   | N = 201  | -         | -     | -                     |
| Misconceptions           | 3.881 (0.943)  | 4.707 (0.933)  | F         | 24.44 | < 0.0001**            |
| Business Risk perception | 4.203 (1.126)  | 3.328 (0.933)  | F         | 19.70 | < 0.0001**            |
| Illusion of control bias | 3.753 (1.452)  | 4.698 (1.163)  | F         | 18.40 | < 0.0001**            |
| Self-efficacy            | 5.958 (0.708)  | 5.977 (0.792)  | F         | 0.05  | 0.831 NS              |

\*\* = p < 0.01, \* = p < 0.05, NS = Not significant

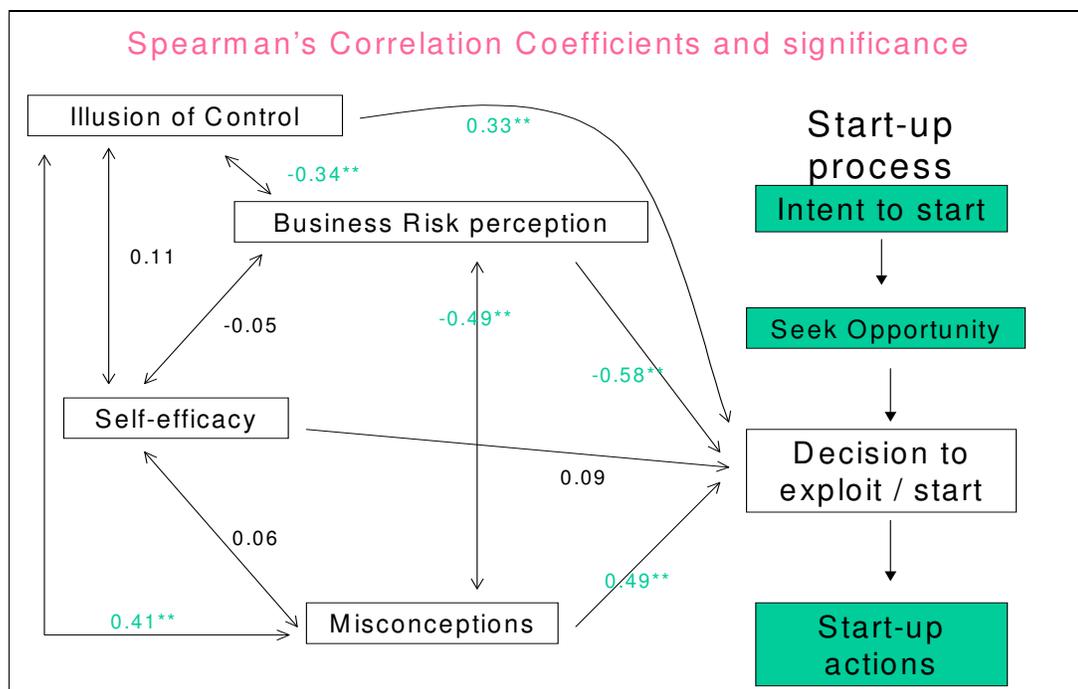


Figure 3 The Spearman's rank correlations between independent variables investigated in relation to the decision to start (dependant variable) within the entrepreneurial process. Inter-correlations between independent variables are also shown where \* = p < 0.05 and \*\* = p < 0.01.

Table 4 Reasons presented for those who decided to start the business and those who decided against starting

| No | First Thought  | Yes | %    |
|----|--|-----|------|
| 1  | Enough detail  | 1   | 0.5  |
| 2  | My instinct / gut feel says its viable   | 5   | 2.5  |
| 3  | Seems novel / good idea / concept / innovative idea, product / secret formula (protection) | 75  | 37.5 |
| 4  | Large scale of production / availability of grass makes it viable and easy to start        | 34  | 17   |
| 5  | I like the way they think / makes sense  | 3   | 2.5  |
| 6  | Financial viable / cheaper / cost effective  | 17  | 8.5  |
| 7  | They did research  | 9   | 4.5  |
| 8  | Supply and demand principle / need in market   | 15  | 7.5  |
| 9  | Can provide jobs for many people   | 9   | 4.5  |
| 10 | Lauricio is positive, dedicated and well educated  | 18  | 9    |
| 11 | Can work if run on basis of “collect a can or paper” an already known business concept     | 4   | 2    |
| 12 | No reason  | 5   | 2.5  |
|    | Total  | 200 |      |
|    | First thought  | No  | %    |
| 1  | Not enough details   | 5   | 5    |
| 2  | Only a good idea not opportunity / too risky / sound too good to be true                   | 34  | 34   |
| 3  | Financially not viable   | 15  | 15   |
| 4  | Not enough grass during the year (Winter) / volume of grass to big                         | 5   | 5    |
| 5  | Too dependant on external factors like people  | 10  | 10   |
| 6  | Logistically to complex  | 9   | 9    |
| 7  | No knowledge of animal industry  | 13  | 13   |
| 8  | Do not address a need in the market / acceptance in market                                 | 7   | 7    |
| 9  | No reason  | 2   | 2    |
|    | Total  | 100 |      |

Table 5 Classification matrixes for the linear discriminant analysis and Logistical regression

| Classification matrix for linear discriminant analysis |                 |                   |                       |                 |
|--|-----------------|-------------------|-----------------------|-----------------|
| Actual   |                 | Predicted         |                       | Percent correct |
|  | Number of cases | Decision to start | Decision not to start |                 |
| Not started  | 44              | 36                | 8                     | 81.3            |
| Started  | 256             | 48                | 208                   | 81.3            |

| Classification matrix for logistical regression |                 |                       |                   |                 |
|---|-----------------|-----------------------|-------------------|-----------------|
| Actual  |                 | Predicted             |                   | Percent correct |
|   | Number of cases | Decision not to start | Decision to start |                 |
| Not started                                     | 44              | 20                    | 24                | 45.45%          |
| Started   | 256             | 9                     | 247               | 96.48%          |

# **RISK MANAGEMENT IN FAMILY ENTERPRISES**

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## **Abstract**

Numerous spectacular company crises in recent years have set off a broad discussion about the improvement of corporate governance, controlling systems and management in companies. In many cases, the crises are led back to internal causes, for example, missing or insufficient risk-controlling or no adjustment of the enterprises to its environment. The crises has not rarely been avoided by an early warning system of threaten developments or at least the negative results could have been weakened. This deficit has caused the action of the legislation in Germany. These considerations are written down in the Corporate Sector Supervision and Transparency Act (CSSTA), and started on may 1998.

More than the half of all german enterprises is established, run and essentially affected by family entrepreneurs. The term of family enterprise is defined different by means of one or more characteristics. It describes enterprises in the different legal forms and size and covers only partly with the term of small and medium-sized enterprises. A family enterprise can be characterized thereby that the majority of the participation is in the possession of a family or a specific number of families. Family enterprises show in comparison to not family-managed enterprises a series of differences. Specific risks of family enterprises which cause existence threatend crises in terms of the CSSTA are of high importance, especially crises of liquidity. The specific risks of family enterprises and the risk management system will be in the focus of the following article.

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## **Introduction**

More than the half of all German enterprises is established, run and essentially affected by family entrepreneurs (Ruter and Thümmel 1994; Klein 2000; Franks and Mayer 2001). In the next years about 70.000 family enterprises with more than 0,51 million Euro annual turnover will be affected by a generation change (Martin and Martin 2002; Habig and Berninghaus 1998). According to experience only half of the enterprises are able to manage a successful transfer from the first to the second generation (Wimmer et al. 1996). But the crises of family enterprises are not only founded in the question of succession.

Numerous spectacular crises of enterprises in the past years have not only started a wide discussion in Germany about the improvement of controlling and management in enterprises. In many cases, the crises are led back to internal causes, for example, no adjustment of the enterprises to its environment or non-working internal controlling-systems. The crises has not rarely been avoided by an early warning of threaten developments or at least the negative results could have been weakened. This deficit has caused the action of the legislation in Germany. The results are written down in the Corporate Sector Supervision and Transparency Act (CSSTA), and started on May 1998 (Ruda and Pfeffer 2003).

The specific risks of family enterprises and the risk management system which was regulated in the CSSTA is in the focus of the following article. The superior goal of this article exists in having a share in the exploration of the features of risk management in family enterprises. Based on the targets of the CSSTA, in the first step risk management relevant legal revisions are worked out. In the second step the special characteristics of family enterprises are analysed because out of these specific threatened risks are resulted. The third step of analysis covers the arrangement of risk management systems in family enterprises. And at final, the risk management system is put in to the crises management and conclusions are derived.

## **The Corporate Sector Supervision and Transparency Act**

The CSSTA pursue the following aims: to correct weaknesses and conduct failure controlling in German supervision system in enterprises and the law of codetermination and to allow for information requirements of international investors. To reach these aims, the CSSTA contains among other things three new regulations. These are the obligation to establish a risk management system, to inform of risks of the future development in the management report as well as the expanse of the annual financial statement (Ruda 2005; Martin and Bär 2002).

The legislator obligates the management of stock-corporations by the new paragraph 2 of the §91 Companies Act to “take the right actions in particular to arrange a monitoring system in order that imperiling developments can be found early”. These are risks which have important influence on the financial situation, the financial position and the result situation. The risk management system consists of internal auditing, (risk) controlling and early warning system (Martin and Bär 2002; Lück 1998a).

Even though the obligation according to § 91 paragraph 2 Companies Act to arrange a monitoring system (risk management system) affects only stock-corporations, the legislator has also referred to the emission effects to the other legal forms, especially limited companies. But these effects are neither closer explained nor clearly concretized. In the result the obligation of risk management systems extends in general to all family enterprises in the legal form of a corporation and a KGaA but also to larger, differentiated limited companies and business partnerships thus to a huge part of the German medium sized enterprises (Hommelhoff and Mattheus 2000).

The second issue alludes to the obligation to respond to the risks of the future development in the management report (so-called risk report). The third reorganisation of the CSSTA affects also with the changes of the annual audit the named legal forms. It aims to an expansion and qualitative advancement of the annual audit and changed the following obligations of the German Commercial Code: the item and size of the audit (§ 317), the audit report (§ 321) as well as the audit certification (§ 322). During the audit it is to secure if the risks of the future development are correctly described in the management report. The § 317 paragraph 4 is of huge importance: The audit of stock quoted corporations checks if the management has made all decisions after § 91 paragraph 2 German Commercial Code correctly and if the arranged monitoring system can achieve its duties.

The risk management should be interpreted as the sum total of all activities to recognize and manage any imminent danger of loss. These might be individual or cumulative risks, including the interaction between these risks. It is the task of risk management to identify latent and potential risks at an early stage and to plan, control, and manage strategies and activities to counter them. The common duties of the risk management can be explained by means of the so-called risk management process which includes according to the general management process the following stages (Ruda and Leonhardt-Jacob 2005; Martin and Bär 2002; Lück 1998b):

- risk identification,
- risk analysis and quantification (e.g. risk portfolio, risk map),
- risk coping and
- risk monitoring.

The risk management process consists not only of a once-off-campaign but is carried out at regular intervals. This forms part of regular operational procedures and of the interplay between the operational units such as sales, marketing as well as the management board and also involves a coordinating risk management department which can be part of the controlling or the internal revision.

The risk management process has been preceded by thinking out a risk strategy, which basically contains the fundamental alignment of risk policy. The risk strategy provides rules of dealing with risks for each of the areas exposed to it. Its starting point is the general corporate strategy, from which the rules can be derived and integrated again into a strategy. Defining a maximum loss limit serves as the starting point for the corresponding risk-categories in the operational company departments.

## **Special structure characteristics of family enterprises**

The term of family enterprises is defined different by means of one or more characteristics and describes enterprises in the different legal forms and size (Klein 2000; Mugler 1998). It covers only partly with the term of small and medium-sized enterprises (SMEs).

A family enterprise can be characterized thereby that the majority of the participation is in the possession of a family or a specific number of families. In literature is also said that a factual critical (significant) effect of family members on the management is enough to speak of a family enterprise (Klein 2000; Gerke-Holzhäuser 1996). According to Ruter and Thümmel (1994) the following attributes characterize a family enterprise: The enterprise should be obtained as the professional/economic basic for family members over several generations, the owners are significantly represented in the management, the management consists of one person or a small group of persons, the personal relationship between owner/management and employees and the size of the enterprise is well manageable.

According to Löwe three characteristics define the term of family enterprise (Löwe 1979):

1. The significant amount of the capital is got together by the family.
2. One or more family deputies exert important effect on the management or they are even themselves in the management.
3. The investors have the target of obtaining the enterprise for the family (problem of succession).

Family enterprises can also be characterized besides the human identity of the management, the ring of shareholders and the alliance of the family by the participation of family members in the form of cooperation, financing, tenancy or leasing (Mugler 1998; Gerke-Holzhäuser 1996; Pichler et al. 1997). The definition happens insofar less on quantitative facts than on qualitative definition components like personality, charisma and emotion.

## **Specific risks of family enterprises**

Family enterprises show in comparison to not family-managed enterprises a series of differences (Duh 2002; Cromie and Stephenson 1995; Daily and Dollinger 1992; Goffee and Scase 1985; Hoy and Verser 1994). According to this article, specific risks of family enterprises which causes existence threatened crises in terms of the CSSTA are of high importance, especially crises of liquidity. In family enterprises the following reasons are existent for these risks: Personal deficits of managers (Ruter and Thümmel 1994; Feltham, Feltham and Barnett 2005), no effective controlling, planning and monitoring, unadjusted profit distributions (Habig and Berninghaus 1998), unregulated or abortive succession (Wimmer et al. 1996; Pichler et al. 1997), family conflicts (Klein 2000) and divergent life cycle of the family and the enterprise (Rosenbauer 1994).

Ruter and Thümmel differentiate in five basic risk fields: occurring gaps of management, unsolvable seeming follow-up regulations, an "aging" family patriarch, different interests between families which are drifting apart and unverified allocation politics. In literature there are mentioned also the lack of commercial orientation of the management, the lack of accomodation of the family enterprise and incomplete deed of association (Ruter and Thümmel 1994).

A central risk relevant characteristic of family enterprises is their specific life cycle. By the closely connection of the owning family (Stehle 1997) and the enterprise a mutual dynamic sampling of the owning family life cycle and the business life cycle can be noticed. There are the following life cycle conditional risk facts mentioned: the in the maturation phase defined growing chances in

common business for the second family generation, an arriving splitting of the enterprise with the effect of divergent objective targets and demands to the enterprise as well as the failure of the revitalisation (Rosenbauer 1994), obsolescence of the organisation, adherence to structures of the establishment phase, declining organisational and individual learning aptitude, declining vitality and innovation of the enterprise, a strong fixation on the maintenance instead on the extension of the lifework as well as the increasing splitting of the property with the danger of impasses and decreasing risk attendance (Goehler 1993).

### **Rating as a specific requirement of family enterprises**

The deregulation of capital markets, globalization, and the cutthroat competition within the banking world characterizes an upheaval in the traditional banking business, and as a result, the demand rises for adequate risk analysis and credit management. Banks must reckon with high bad debt loss and growing write-offs particularly in SMEs as well as family enterprises. The way banks allocate their credit should become more risk oriented with the systematic application of rating methods. The evaluation of the credit status, also known as risk analysis, takes place by a rating. Basel II equally affects, therefore, on the one-hand lenders and on the other creditors. SMEs, especially family enterprises, are not as familiar with the rating process in comparison to companies that are active on the capital markets (Arnold and Ruda 2002).

Special business risk factors that characterize family enterprises in comparison to non-family owned enterprises are reflected creditworthiness results. The following factors should be examined within the framework of the rating process for family enterprises (Martin, Ruda and Pfeffer 2003):

- Rating factor I: Insufficient financial flexibility

Mid-sized family enterprises are often not able to use alternative methods of financing such as those that the capital market offer in addition to the traditional means of financing through bank loans. A relationship of a company to only one financial institution is viewed critically (Ehrhardt and Nowak 2003). When questions arise about the creditworthiness of a company, they often, at least for short-term purposes, do not have further alternatives to financial support.

- Rating factor II: Insufficient transparency

Normally, family enterprises tend to be more restrictive in regards to the information released to other entities. The supply of information to external creditors and investors is in most cases limited to a minimum. Often enough, the partners of a company only have either insufficient or old information at their disposal. The lack of information provided in the rating process results in a negative effect on the rating notation, because not only do rating agencies expect open information and communication policies, so do the banks.

- Rating factor III: Strong personal dependency

A family enterprise is strongly characterized by the owner's characteristics, personality, and mentality, which causes a strong dependency relationship. In the examination from Klein (Klein 2000; Feltham, Feltham and Barnett 2005) it is shown that family enterprises less often have supervisory oversight of management in comparison to non family enterprises of the same size. Making the situation more difficult, family owned businesses tend to resist delegation of authority principles and the owner or management does often not take situations such as illness or death seriously.

- Rating factor IV: Low degree of diversification and company size

The business activity of family enterprises takes place as a rule in relatively small markets and/or market niches. Companies that concentrate on either a small product group, or for example only one product, and whose degree of diversification is small, have a higher risk factor in regards to rating

agencies in comparison to companies that have a wider product group and operate in numerous markets.

- Rating factor V: Disputes within the family or within the circle of partners

The emotional connection between family members or between partners often causes conflicts or disputes that considerably influence a company's business activities. When owners and managers differ in goal and value expectations, an objective analysis of the situation needs to take place in order to arrive at a consensus.

- Rating factor VI: The absence of company succession policy

The primary risk within family enterprises is the lack of a policy which outlines succession when something untowards occurs (Feltham, Feltham and Barnett 2005). Often enough when a successor takes over the company restructuring of the company occurs. Every year in Germany almost 2000 family enterprises go out of business due to the lack of a successor policy, or because an unplanned ownership change was too much for the successor to handle. The transfer of a company, however, is a step that not only has consequences for the previous owner, but also for the successor. Mistakes that can be traced back to bad planning cannot retrospectively be corrected and can have serious consequences for the successor.

- Rating factor VII: Absence of planning and information system

One of the main weaknesses of family enterprises lies within the lack of a strategic plan. Owners and managers of family enterprises are often overworked because they lack qualified personal to accumulate and interpret qualitative and quantitative data in order to adapt and implement new methods. Unlike large companies, family enterprises, in many cases, lack a written strategic plan outlining their visions and divided into long and short term. The strategy usually exists, although unfortunately only in the mind of the owner or manager.

- Rating factor VIII: Absence of an early warning system

Latent crises within partner or management circles such as sickness, old age, or death can only be identified in time with the existence of an early warning system. The recognition and analysis of oportunities and risks often occur too late in family enterprises. Nevertheless, many internal and external rating organizations, such as savings banks, take into consideration whether or not a risk management plan exists for the rating notation. Because of that, family enterprises should implement a formal risk management system as soon as possible in order to secure their credit supply.

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Fig. 1 about here

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## **Designing of risk management systems in family enterprises**

The special implementation of the risk management system depends on different influencing factors. The legislator names explicit the determinantes: "size of the enterprise, branch, structure and complexity of the enterprise and access to the capital market etc." But how must the family enterprise be organized after the CSSTA to confirm to the legal request of the management and the executive board? In doing so, in the foreground stand the components which have to exist as a minimum so if necessary an audit of effectiveness by an auditor which is the case by a stock exchange quotation (§ 317 paragraph 4 German Commercial Code).

In the frame of the risk identification the form of risks are to be systematised and documented. In literature a number of categories can be found such as value-creation, finance and management risks, strategic risks, risks of Corporate Governance, legal risks as well as political/social risks

(Ruda and Leonhardt-Jacob 2005; Martin and Bär 2002). For family enterprises the risks of Corporate Governance and the strategic risks are of high importance because these risks demand a closely monitoring and analysis as well as an evaluation. It can be derived from the personal identification of property and management in family enterprises that the affected family members on the one hand have the duty as a manager to provide a functional risk management system but on the other hand they are themselves a part of the risk management process.

For an objectivation of the risk identification, analysis and monitoring especially by the problem of an “aging” family patriarch a family external advisory board can be arranged to help (Ruda 2005; Ruda 1997; Ruter and Thümmel 1994). In the frame of the risk controlling as well as the risk accomplishment an advisory board can help, e.g. as an improver (Gratz 1997) or a mediator. Family enterprises can use the same strategies like non-family enterprises to accomplish risks: avoidance, decrease, assignment as well as balancing (Martin and Bär 2002). Ruter and Thümmel (1994) abstract the superior target of the risk management in family enterprises: protection for the family and protection of the family.

This crossover of family sphere and enterprise sphere demands in the stage of risk accomplishment specific management effort (Davis and Stern 1988; Mugler 1998): borders between management and family life, organization of resolution instruments of family problems, organization of “self-supporting” enterprise structure irrespective of open family issues and implementation of management systems which are resistant against extraordinary events and crises in the family. Thereto counts e.g. in detailed and customized deeds of association, detailed management agreements, organization charts (Pichler et al. 1997) and the assignment of external managers (Ruter and Thümmel 1994).

## **Conclusion**

The risk management system after CSSTA is an instrument of the preventive crisis management which has the task to early recognize the existence of endangering developments. Therefore the latent and potential risks are subjects of the risk management system. Especially the potential crises have the highest methodical requirements to the early warning system. The management of the crisis is not included in the duty of carrying of the management recording to § 91 paragraph 2 Companies Act.

The crisis management includes the task of taking actions to prevent the occurring crisis and to manage the occurred crises (Krystek 1987). These findings show that the CSSTA is not sufficient for a successful management of crisis in family enterprises because an entire management of crisis runs beyond an early identification and lasts for the stages of risk management and/or risk acceptance.

According to § 317 paragraph 4 German Commercial Code the auditor judges if the management has taken the right form of early risk identification and if the monitoring system can fulfil its tasks. The auditor has to judge the implemented risk management system of its function. This presupposes a written documentation, e.g. in the form of a risk-handbook. Therefore the audit is limited on the risk identification but not on activities for the coping.

Besides the legal requirements the risk management has the task of finding and converting strategies for the management of risks. There are the following alternatives: risk avoidance, risk decrease, risk transfer and risk compensation (Lück 1998).

It is now necessary to extend the risk management system beyond the early identification, so that it can support the entire risk management. The requirements of the detailing and formalisation degree of the risk management system interact with the size of the enterprise. In smaller family enterprises the management have the duty to arrange a functional early risk identification system of controlling,

early warning and internal revision. Regarding the discussions about ratings and risk adequate credit interests in consequence on BASEL II also family enterprises have to think about an implementation of a risk management system if they are not included in the CSSTA.

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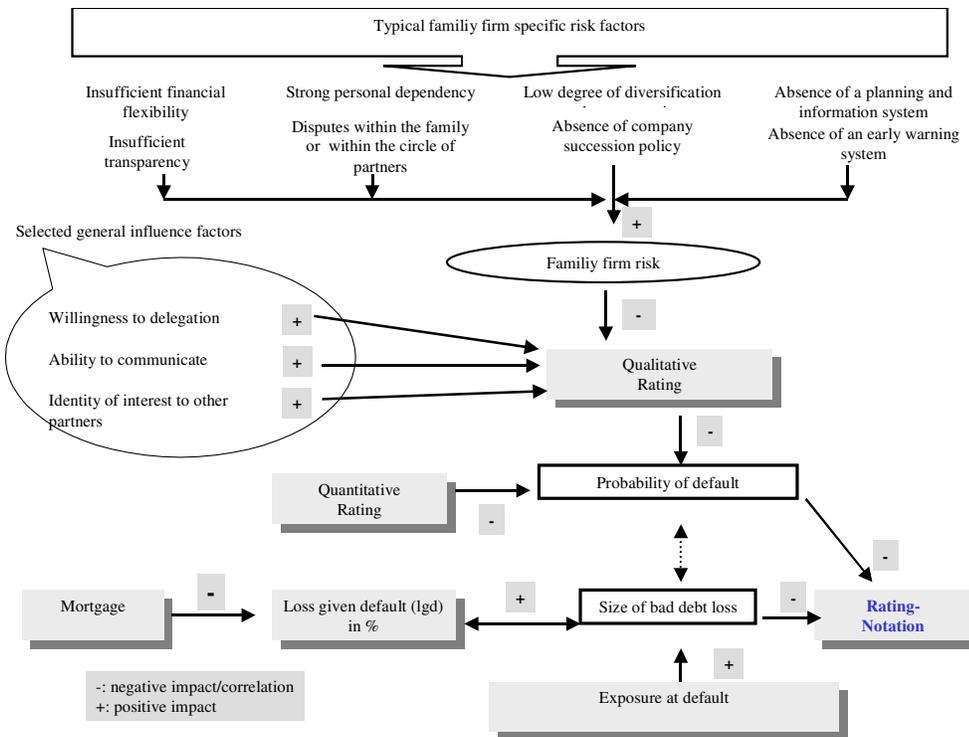


Fig. 1: Family firm specific factors influencing the rating

An Examination of the Legitimacy Lie

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## **An Examination of the Legitimacy Lie**

### **Abstract**

To survive, entrepreneurs in start-up companies must overcome liabilities of newness and smallness to gain legitimacy in the eyes of key stakeholders, primarily customers and financial providers. Prior research and theory suggests that entrepreneurs will likely employ proactive strategies to gain legitimacy with these key stakeholders. These proactive attempts to gain legitimacy may lead to questionable ethical behaviors, including intentional misrepresentations of the facts. In this paper we apply common ethical frameworks to explore the boundaries of what may or may not be acceptable behavior in seeking legitimacy and offer some guidelines for entrepreneurs.

## **INTRODUCTION**

Many researchers have noted that overcoming the liabilities of newness and smallness are the most difficult challenges that a young SME owner/manager encounters (Singh, Tucker, and House, 1986). These challenges can be essentially described as a quest for legitimacy for the SME. Until stakeholders view the SME as a legitimate enterprise, the owner/manager will have great difficulty acquiring the resources (e.g. capital, employees, and supplies) that the enterprise needs to survive. As a result, many owner/managers feel that they must employ whatever strategies and tactics necessary to overcome these liabilities and gain legitimacy. Since most small firms are “opaque” with regard to information—meaning that it is difficult for outside participants to ascertain the quality of a given venture—it is especially tempting and possible for owner/manager’s to mislead social actors. This problem is compounded in many new ventures because entrepreneurs have an advantage of information asymmetry - they know more about certain aspects of the business (e.g., intellectual property) than outside stakeholders.

In this paper, we hold that there exists an initial threshold in most firms where, before the threshold young SMEs have high levels of smallness and newness liabilities, and after this threshold these liabilities have been mitigated significantly. In most firms this threshold occurs when some significant stakeholder has legitimized the firm. At early stages of development, because young SMEs are cash starved, it is most often a key customer or financier that grants this legitimacy. Once this legitimacy has been granted, a signal is sent to other stakeholders that the firm is something more than an untenable collection of resources and is worthy of some level of trust—legitimacy begets legitimacy.

This condition causes most young SME owner/managers to face a simple ethical conundrum: how to send the signal of legitimacy when, by definition, the organization is not legitimate? No social judgment of appropriateness has been made regarding the organization, yet the organization must appear as if it has. Stories abound in which an aspiring entrepreneur set up a “sham” operation to convince a prospective stakeholder that the organization was something more than it, in fact, was. Similarly, stories exist where an entrepreneur makes promises that he or she is not sure can be delivered upon. In a strict interpretation these are lies—misrepresentations of the truth. These lies ultimately result in violations of trust between the owner/manager and his or her stakeholders.

The purpose of this paper is not to solve this ethical debate by playing “morality police”, for there may be no simple answer. However, there are a number of ethical frameworks available to help an owner/manager navigate this potentially slippery slope. We will first address the specifics of the legitimacy lie with both legitimacy and ethics theory bases, along with a number of examples from the literature and our experiences. Next we will explore, broadly, the nature of entrepreneurial ethics with a special focus on the unique nature of ethical issues in the small firm. We then present corresponding ethical frameworks that are appropriate for dealing with this issue. We conclude with some general guidelines for entrepreneurs.

## **THE LEGITIMACY LIE**

The definition of this construct lies at the intersection of legitimacy theory and ethics theory—more specifically, at the intersection of SME legitimacy theory and ethics theory pertaining to

lies. It essentially involves lies told before legitimacy is attained for the purpose of reaching legitimacy. These are generally statements made or actions taken to counteract the liabilities of smallness and newness that most entrepreneurs feel are unfairly placed on them by stakeholders. The legitimacy lie is defined here as an entrepreneur's "knowing misrepresentation of the facts" in an effort to encourage various stakeholders to deem them as a legitimate entity. The most common stakeholders misled at this early stage are customers and financiers. This is simply because these groups are the most critical at the early stage of a SME's life (Jawahar and McLaughlin, 2001).

In finance parlance, this is called moral hazard, and as the term suggests, it is viewed negatively by this stakeholder group. This is relatively straightforward for traditional financiers, such as banks, because they generally quantify this as a credit score based on the owner/manager him or herself (??).

### Legitimacy Threshold

Legitimacy is defined parsimoniously here as: "...a social judgment of acceptance, appropriateness, and desirability, [that] enables organizations to access other resources needed to survive and grow." (Zimmerman and Zeitz, 2002). The legitimacy threshold (LT) is based on punctuated equilibrium theory, which essentially holds that large-scale change in organizations is discontinuous, abrupt, infrequent, and noticeable. An organization being initially legitimized is usually such a change. Punctuation occurs in response to a major environmental change, called a trigger. The trigger is the key component pushing a given system over its threshold of stability (Tushman, Newman, and Romanelli 1986). With regard to the legitimacy threshold, the trigger is usually a major stakeholder (customer, financier) legitimizing the organization. Once the substantial environmental change of legitimization takes place, the organization moves from begging for a certain resource to managing that resource.

Zimmerman and Zeitz (2002) were the first to explicitly use and operationalize the legitimacy threshold. They define the LT as: "[The point] below which the new venture struggles for existence and probably will perish and above which the new venture can achieve further gains in legitimacy and resources." They go on to state: "An organization must achieve a base level of legitimacy that is dichotomous—it either does or does not meet the threshold" (Zimmerman and Zeitz, 2002). In life cycle parlance, the LT can be thought of as a firm moving from the birth stage to at least the potential for the growth stage. Scott and Bruce (1987) term this the "inception to survival crisis".

It is worth mentioning an alternative here. Based on our preliminary research, all SGEs will not encounter a threshold. For example, two entrepreneurs we spoke with did not feel that any one event forced them to restructure. One purchased a number of struggling restaurants and simply "tweaked" the system to grow. Another received venture capital financing in the "pre-birth" stage and was able to grow relatively seamlessly. Relatedly, just because a given firm made to the LT does not mean that cannot or will not fall back below it—an important customer could easily "fire" the company (Rutherford et al????).

### Legitimacy Lies

As noted, we define the legitimacy lie as an entrepreneur's "knowing misrepresentation of the facts" in an effort to encourage various stakeholders to deem them as a legitimate entity. By knowing misrepresentation of the facts, we mean not only the actual conveying of information or other kinds of meaningful communication (e.g., actions) in a manner intended to deceive, but also the deliberate withholding of information or other kinds of meaningful communication that might, if conveyed, lead a stakeholder to correct a mistaken assumption, conclusion or impression. Some examples are shown in Table 1.

### **Ethical Frameworks**

There are a great number of ethical frameworks that can be applied to the legitimacy lie problem. For the sake of parsimony, we will contrast two well-known general theories, *utilitarianism* and *deontology*, and demonstrate how they apply. The following discussion is based on the work of Spitzer, 2000; 2003).

Utilitarianism focuses on harms and benefits associated with certain actions. The general principle can be summarized by the statement: "if the consequences of a particular action produce more harm than benefits, that action should be avoided" (Spitzer, 2000, p. 207). Thus, utilitarians judge the rightness or wrongness of actions based on the outcomes of those actions - whether they lead to more good than harm. They do not see particular actions by themselves as being either intrinsically good or bad. For example, lying or cheating may be acceptable if it can be determined that doing so results in little or no harm relative to its positive consequences.

While utilitarianism has been widely applied in business ethics, there are several potential problems with its use. For example, it is often difficult to evaluate objectively the potential harms and benefits stemming from an action. Moreover, utilitarians' use of quantitative assessment of outcomes tends to focus more on quantity than gravity. There is a great deal of ambiguity and subjectivity in evaluating so-called "objective" outcomes. Thus, utilitarians are often prone to rationalization when weighing harms and benefits.

On the continuum of ethical theories, deontology is the polar opposite of utilitarianism. Deontology posits that there are certain inviolable duties or principles "to promote an intrinsic or objective good, and to avoid an intrinsic or objective evil" (Spitzer, 2000, p. 210). On the positive side, deontologists associate ethical behavior with certain acts like honesty, fairness, and justice; on the negative side, they associate unethical behavior with acts like lying, cheating, stealing, being unfair, or causing unnecessary harm (Spitzer, 2003, p.2). The distinguishing mark of deontology, as opposed to consequentialism, is that actions by themselves are intrinsically good or bad, *regardless* of their consequences. For example, deontologists would say that lying is wrong and should be avoided. Further, they hold that the end does not justify the means. Thus, a person cannot justify using a wrong (e.g., lying) to accomplish a beneficial end (e.g., obtaining financing for a start-up company, and thus creating jobs). Of course, deontologists recognize that there are situations in which a person faces a choice between two evils (e.g., layoffs versus going out of business). In these situations it is permissible to use an evil means to avoid an even greater evil end (Spitzer, 2003, p.3).

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**Table 1 About Here**

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## Ethics and the Legitimacy Lie

Based on the discussion above, we propose the model in Figure 1 as a framework for evaluating the ethics of the legitimacy lie. The framework has two dimensions: misrepresentation of the facts, either knowing (intentional) or unknowing (unintentional) and consequences for stakeholders, either positive or negative. Figure 1 provides frameworks illustrating both the utilitarian and deontological ethical theories. Using these models, there are four general possibilities regarding legitimacy lies:

1. Knowing misrepresentation that leads to positive outcomes for the stakeholder
2. Knowing misrepresentation that leads to negative outcomes for the stakeholder
3. Unknowing misrepresentation that leads to positive outcomes for the stakeholder
4. Unknowing misrepresentation that leads to negative outcomes for the stakeholder

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### Figure 1 About Here

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As shown in both ethical frameworks, unintentional misrepresentation of the facts (quadrants III and IV) is generally not an ethical violation. In these cases, the entrepreneur may unknowingly misrepresent the facts of the company, perhaps through her or his high level of enthusiasm, self-confidence, or the lack of skills or information, or simply due to errors. The historical lore is replete with stories of entrepreneurs who “over promised” and eventually delivered through their supreme self-confidence, hard work, ingenuity, and persistence. Two caveats in these cases should be considered, however. First, overconfidence and the tendency to “over promise” may be rooted in an entrepreneur’s lack of self-knowledge, or an unrealistic assessment of the facts in the situation (e.g., lack of due diligence), or negligence leading to inaccuracies. In these cases, one could argue that the entrepreneur is “out of touch” with reality, or careless, and should therefore should be held ethically accountable for misrepresenting the truth. Second, misrepresenting the truth, even unknowingly, may have implications for trust in the relationship with the stakeholder involved, especially when the consequences are negative. In this case, the stakeholder will likely not trust the entrepreneur who, in his or her exuberance, has misrepresented the facts, unless the stakeholder truly believes that the entrepreneur has acted in good faith. If the stakeholder in the relationship believes the entrepreneur has not intentionally been misleading, she or he may be willing to give the entrepreneur a second chance in the relationship.

With respect to knowing misrepresentation of the facts, the deontological model considers this behavior as unethical in all cases (quadrants I and II). The utilitarian model considers intentional misrepresentation as a violation if it leads to negative outcomes (quadrant II), but not if the consequences are positive (i.e., more benefits than harms, quadrant I). Several caveats should be noted with respect to knowing misrepresentation. First, as noted earlier, evaluating harms and benefits in the utilitarian approach can be very ambiguous and subjective and may lead to rationalization. Second, even though utilitarian logic suggests that an entrepreneur’s deliberate lying to a financier (e.g., company financial status) can be ethical when it leads to more benefits than harms (e.g, financing allows the company to survive and ultimately hire more employees), this situation may have a long-term negative impact on the level of trust between the entrepreneur and a stakeholder. If the stakeholder, a financier in this case, discovers the

intentional deception, and especially, if she or he has a deontological perspective, the stakeholder will likely perceive the entrepreneur as being untrustworthy. Moreover, even if the financier in question does not know about the deception, perhaps other stakeholders do, such as the entrepreneur's partners or employees. These other stakeholders may consider the entrepreneur as untrustworthy, affecting the long-term quality of their relationship with the entrepreneur.

Applying the models in Figure 1 to some of the examples in Table 1 will help illustrate the ethical considerations regarding legitimacy lies. Example E states: "When customers called, I would tell them 'Steve is in the warehouse', which meant the garage." While relatively minor, this intentional deception would be viewed as unethical according to deontological logic. However, assuming that no harm was done by the deception, and that it lead to positive outcomes with customer perceptions and eventual sales, it could be viewed as ethical by utilitarian logic. Example I explains: "No space in the apartment - I always met people at the airport -- said I was leaving on a flight, then waited until they had gone to go back home." Again, this rather minor misrepresentation would be viewed as being unethical from a deontological perspective, but acceptable using utilitarianism, provided that the benefits to stakeholders outweighed the harms. Several other examples (A, B, C, G, and H) are ambiguous as stated. It is not clear in these attempts to make ones' company "look bigger than it is" are actually deceptions. There is nothing inherently wrong with an entrepreneur or a new venture "putting their best foot forward." For example, using glossy brochures and a company logo are not necessarily misrepresentative, but rather could be considered as wise investments in demonstrating the quality, professional approach, and potential of the company. However, under deontological theory, any deliberate misrepresentation of the facts, however communicated, is unethical, while under utilitarianism, deliberate misrepresentations of the company could be seen as ethical so long as the results for stakeholders are more positive than negative.

## Conclusions

In this paper we have argued that entrepreneurs in start-up companies must overcome liabilities of newness and smallness to gain legitimacy in the eyes of key stakeholders, primarily customers and financial providers. Such legitimacy is crucial if start-ups are to survive and have the potential for moving into the growth stage. Further, descriptive stakeholder theory (Jawahar and McLaughlin, 2001) suggests that entrepreneurs will likely employ proactive strategies to gain legitimacy with these key stakeholders. These proactive attempts to gain legitimacy may lead to questionable ethical behaviors. The academic literature regarding ethics and entrepreneurship, especially with respect to legitimacy issues, is not well-developed. We have attempted to apply common ethical frameworks of utilitarianism and deontology to explore the boundaries of what may or may not be acceptable behavior in seeking legitimacy.

Our analysis concluded that, regardless of which ethical framework is used, unknowing misrepresentation of the facts in seeking legitimacy is generally ethical. There may be some ethical questions in cases where the entrepreneur has not done adequate due diligence in gathering the facts, has made careless errors, has "overpromised" due to an unrealistic self-understanding. However, many entrepreneurs have high levels of self-confidence and enthusiasm and do ultimately achieve goals that many stakeholders might deem as unattainable.

Indeed, this outcome is one of the attributes that we associate with and endear people to successful entrepreneurs. Knowing misrepresentation of the facts, on the other hand, is always unethical from a deontological perspective because such acts are intrinsically wrong. From a utilitarian perspective, knowing misrepresentation is clearly unethical when it leads to more harm than benefits, but may be acceptable when it can be determined that the benefits of doing so outweigh the costs. Of course, we have pointed out that utilitarian logic can be problematic because evaluation of harms/benefits is often subjective and there is a tendency to rationalize and justify unethical behavior. We have also argued that deliberately misrepresenting a company's products or finances, even when this leads to positive outcomes, may cause a lack of trust between an entrepreneur and various stakeholders.

We believe that the models in Figure 1 can provide a useful framework for examining the ethical ramifications of an entrepreneurs' attempts to gain legitimacy. First, entrepreneurs should make every effort to gather appropriate and accurate information (e.g. product, financial, operations, etc.) as they represent their venture to various stakeholders. Second, entrepreneurs would benefit by careful reflection about their own and their company's strengths and weaknesses. Realistic self-awareness and more thorough knowledge of the company and its capabilities may moderate the tendency of entrepreneurs to over sell or over promise. Of course, we are not suggesting that entrepreneurs tone down their vision, enthusiasm, and self-confidence. We argue only that entrepreneurs can potentially make more ethical choices if they are more consciously aware of themselves and their ventures. Third, we argue that, while possibly acceptable under utilitarianism, deliberate misrepresentations of the facts to stakeholders may be problematic. Entrepreneurs should exercise caution in assessing costs and benefits of their actions and be cognizant of the tendency for rationalization. Even when these so called "white lies" produce more benefits than harms, they may ultimately undermine the trust in relationships with stakeholders. In addition, prior to taking action, it would be useful for entrepreneurs to consult with advisors or others about potential ethical issues. It may also be beneficial to establish a core set of values and ethical principles to guide the new venture from its inception. In the final analysis, the entrepreneur is responsible for both the ethics of the choices she or he makes in attempting to gain legitimacy and also for the long-term consequences of those decisions.

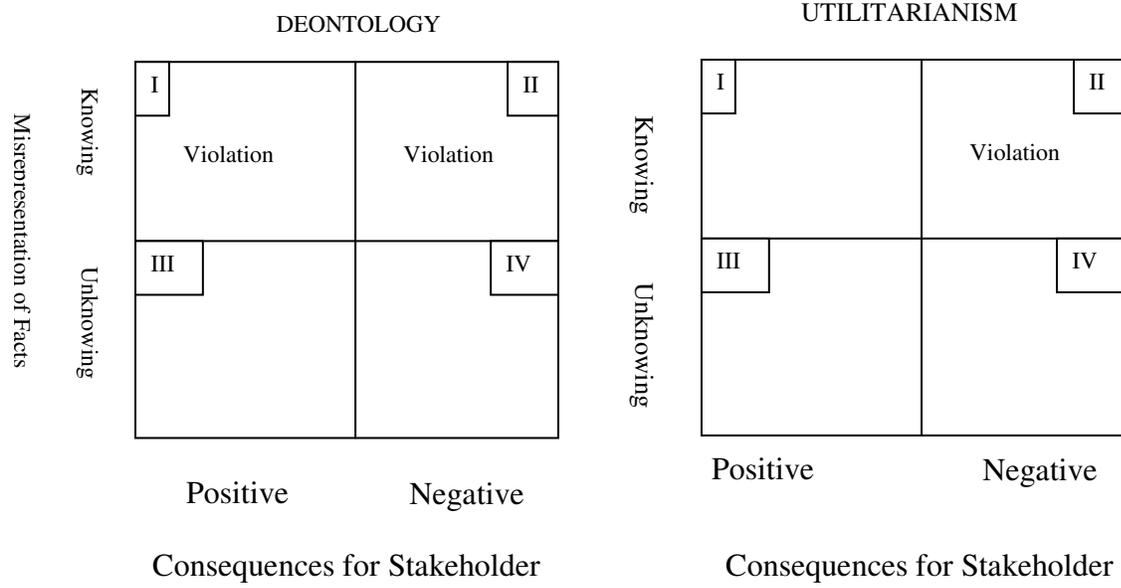
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**Table 1. Examples of Possible Legitimacy Lies** (Quotations by entrepreneurs taken from Amar H. Bhide, 2000)

- A. “You have to create an image that you exist. Use “we” instead of “I” when talking about the company. I hired an answering service with a live person to take messages. No answering machine.”
- B. “Used a lot of smoke and mirrors to get people to think we were bigger than we are. We used consultants all over the place. They were experienced in how to do business and how to project to companies.”
- C. “We described the future of the company as if it were the present and maintained an air of being bigger than we were by producing quality brochures and sales materials and a professionally designed logo.”
- D. “We moved to an office suite so that we could have an office sounding address.”
- E. “When customers called, I would tell them ‘Steve is in the warehouse’, which meant that he was in the garage.”
- F. “Hewlett and Packard named their first product the Model 200A ‘because we thought the name would make us look like we’d been around for a while. We were afraid that if people knew that we’d never actually developed, designed, and built a finished product, they’d be scared off.”
- G. “Accentuate the positives – provide customers with as glossy and pretty a picture as possible – provided the facts but with lots of glitz.”
- H. “We promised employees substantial opportunities in terms of personal growth and sold them a future. But we did not tell them that they had to live up to that future.”
- I. “No space in the apartment – I always met people at the airport, said I was leaving on a flight, then waited until they had gone to go back home.”

Figure 1. Legitimacy Lie Framework



# ENTREPRENEURSHIP AND ECONOMIC DEVELOPMENT; EVIDENCE AND EXPLANATIONS

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## **Abstract:**

For most of the 20<sup>th</sup> century entrepreneurial activity declined in almost all Western countries. However, by now it is a well established fact that entrepreneurship has increased in many of the modern economies since the 1970s onwards. Some authors have identified a U-shaped relation between entrepreneurial activity and economic development. Several phenomena explain this reversed trend. Arguably the most important explanation for the rise in entrepreneurship at higher levels of development is a shift in the technology regime. In this paper we develop a theoretical model that explains the U-shaped relationship in a formal way as the result of a technology regime shift that is brought about by the introduction of a new general purpose technology (GPT). The derivation of the theoretical model is followed by some preliminary empirical exercises which introduce a new direction of research trying to identify when these regime shifts manifest themselves in different countries. The preliminary exercises also try to identify which countries are technological leaders and which countries are technological followers.

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## INTRODUCTION

Kuznets (1971), Schultz (1990) and Yamada (1996) have shown that a negative relationship between economic development levels (usually proxied by time or GDP per capita) and entrepreneurship (proxied by private business ownership) exists for a large cross-section of countries. Lucas (1978) and more recently Chandler (1990), Schaffner (1993), and Iyigun and Owen (1998) have provided models that generally explain this stylised fact as the result of increasing opportunity costs to entrepreneurial activity. Wages in employment rise and become less risky, asymmetric information problems decline and economies of scale and scope become more important as an economy grows.

Recent empirical evidence for the OECD, however, (Carlsson (1989), Loveman and Sengenberger (1991), Acs et. al. (1994), Acs (1996), Thurik (1999)) has shown that that negative correlation may have been reversed recently and Carree et. al. (2002) argues that the relationship may in fact be U-shaped. Carree et. al. (2002) presents some loose theoretical considerations to explain such a pattern in the data.

The rise in entrepreneurship at higher levels of development is attributed to a shift in the technology regime, from accumulative to radical innovation, from Schumpeter Mark II to Schumpeter Mark I. That shift increases the risks (unemployment, job displacement) in established industries and the returns to entrepreneurship in new sectors. In addition technological, institutional and cultural factors all seem to have shifted in favour of entrepreneurship, although it is unclear that these trends are inextricably related to economic development. Finally the authors also cite Schiller and Crewson (1997) and Kirchoff (1996) who argued that part of the revived interest is an income effect. They base their claim on the argument that entrepreneurship can be regarded as consumption because it allows persons to achieve self-realisation at the top of the Maslowian (1970) hierarchy.

In this paper we develop a model that explains the U-shaped relationship in a more formal way as the result of a technology regime shift that is brought about by the introduction of a new GPT (general purpose technology). We then test the predictions of that model using the COMPENDIA dataset which includes 23 OECD countries. The model builds on the model of skill bias in Sanders (2004). In that model the introduction of a new GPT allows entrepreneurs to quickly develop new ideas and consequently more effort is allocated to entrepreneurial R&D. Economic growth, predominantly resulting from variety expansion, is then the result of higher entrepreneurial activity. Under the Schumpeter Mark I regime the causality therefore runs from entrepreneurship to growth.

Under the Mark II regime, when the effect of the GPT has petered out and innovative efforts switch (back) to the development of cheaper and more efficient production methods, entrepreneurial R&D declines. Further economic growth is now caused by higher efficiency in the production of existing varieties, which drives up wages and returns to firm based R&D, causing a negative correlation between entrepreneurship and income. Here the causality runs the other way, from income levels to entrepreneurial activity.

The empirical analysis in this paper will focus on the relationship between income and entrepreneurial activity. The exercises are meant to illustrate how the theoretical concepts developed in the model may manifest themselves in economic reality.

## THE MODEL

Before turning to the actual modelling of entrepreneurial activity it is useful to set up a standard general equilibrium model with consumers and producers. Such a model sets the stage. The role of entrepreneurs in our model is then to develop and commercially introduce new goods and services. As producers they then start producing these new products. We assume a product life cycle, which implies that in the initial stages the new product can only be produced using skilled labour (see Audretsch (1987) and Xiang (2002) for evidence). The producer may then decide to develop the production process in such a way that cheaper resources, i.e. low skilled labour, can be employed. As both start-up firms and established firms need engineers to develop their prototype and new production lines respectively, we assume for simplicity that entrepreneurs and incumbents compete for the same R&D resources. The share of total R&D resources allocated towards new goods creation then corresponds one for one with the level of entrepreneurial activity properly defined. The next section will then translate the theoretical predictions of the model into testable hypotheses and confront the model with the data.

### Consumers

The model presented below will follow standard variety expansion endogenous growth models closely.<sup>1</sup> First infinitely lived consumers save and consume in a standard fashion to maximise lifetime utility subject to a budget constraint. The problem is given by:

$$\max_{C(t)} : U = \int_0^{\infty} e^{-\rho t} \log C(t) dt \quad \text{s.t.} \quad Y(t) + rA(t) = C(t) + \dot{A}(t) \quad (1)$$

where  $\rho$  is the subjective discount rate and  $C(t)$  is a consumption index to be defined below. Defining  $E(t)$  to be the expenditure on consumption at time  $t$  and  $P(t)$  the minimum price of one unit of the index, we obtain the standard Ramsey optimal savings rule:

$$\frac{\dot{C}(t)}{C(t)} \equiv \frac{\dot{E}(t)}{E(t)} - \frac{\dot{P}(t)}{P(t)} = r - \rho \quad (2)$$

Utility maximisation implies maximisation of the consumption index for any given level of expenditure in any period. A Dixit-Stiglitz love of variety consumption index is therefore maximised in every period subject to the intratemporal budget constraint:

$$\max_{c(i)} : C = \left( \int_0^n c(i)^\alpha di \right)^{1/\alpha} \quad \text{s.t.} \quad \int_0^n p(i)c(i)di \leq E \quad (3)$$

where  $c(i)$  is the volume and  $p(i)$  is the price of variety  $i$  consumed and time arguments have been dropped to save on notation. The first order conditions to this problem show that the intra-temporal consumption index is maximised by setting demand for an individual variety equal to:

$$c^D(i) = \left( \frac{p(i)}{P} \right)^{\frac{1}{\alpha-1}} \frac{E}{P} \quad (4)$$

where  $P$  is again the price index, earlier defined as the minimum price of a unit of the index:

$$P \equiv \frac{E}{C^*} = \left( \int_0^n p(i)^{\frac{\alpha}{\alpha-1}} di \right)^{\frac{\alpha-1}{\alpha}} \quad (5)$$

where  $C^*$  is the maximum value of the consumption index given expenditure  $E$  and prices  $p(i)$ . Consumers therefore save and consume yielding an iso-elastic demand curve for all varieties. This set-up allows for variety expanding R&D investments as they can be financed up front out of savings and are worthwhile to undertake as new goods face a positive demand at any price.

## The Producers

Now we turn to the producers in the model. Assume monopolistic competition between firms that produce one variety each. Their profit maximisation problem is now given by:

$$\max_{p(i)} : \pi(i) = y(i)p(i) - tc(i) \quad \text{s.t.} \quad y(i) = c^D(i) \quad (6)$$

where  $y(i)$  is the volume and  $tc(i)$  the total costs of production for variety  $i$ . It can easily be verified that to maximise profits producers must set prices equal to a fixed mark-up,  $1/\alpha$ , over marginal costs. To introduce the product life cycle at this stage assume that at any point in time there is a range of new,  $n_H$  and a range of mature goods,  $n_L$ , that are produced with high and low skilled labour, respectively. Assume in both ranges the production function is given by:

$$y_S^D(i) = b_S l_S(i)^\beta \quad \forall i \in n_S \quad (7)$$

where  $S=\{H, L\}$  indexes high and low skilled varieties. Facing the same demand function, competing for the same labour and restricted by the same production technology, within ranges firms will choose to employ the same quantity of labour and supply the same amount of products. That also implies that prices are set equal within ranges, as marginal costs are a function of the wage and employment levels. Setting production equal to consumption at profit maximising prices, inverting the production

function and aggregating over the two goods ranges yields the aggregate labour demand functions:

$$L_S^D = \frac{\alpha\beta}{w_S} E_S \quad (8)$$

where  $E_S$  is the total expenditure on varieties in range  $n_S$ . Using  $-S$  to signify “not- $S$ ” these expenditures can be written as:

$$E_S \equiv \left( 1 + \left( \frac{n_{-S}}{n_S} \right) \left( \frac{w_{-S}}{w_S} \right)^{\frac{-\alpha\beta}{1-\alpha\beta}} \left( \frac{b_{-S}}{b_S} \right)^{\frac{\alpha}{1-\alpha\beta}} \right)^{-1} E \quad (9)$$

From Equation (8) one can then derive relative labour demand in function of relative wages. It is given by:

$$\frac{L_H}{L_L} = \frac{n_H}{n_L} \left( \frac{b_H}{b_L} \right)^{\frac{\alpha}{1-\alpha\beta}} \left( \frac{w_H}{w_L} \right)^{\frac{-1}{1-\alpha\beta}} \quad (10)$$

And profits per variety are given by:

$$\pi_S(i) = (1 - \alpha\beta) E_S / n_S \quad \forall i \in n_S \quad (11)$$

Note that stable market shares imply that profits per variety fall with the number of varieties in a given range. Cost minimisation yields iso-elastic aggregate demand curves for both types of labour in the model while imperfect competition allows producers to make positive profits and repay their up front R&D investments that are discussed below.

### Labour Market Equilibrium

For given relative employment levels Equation (10) can be rewritten to trace out a concave upward sloping curve in  $n_H/n_L$ - $w_H/w_L$ -space. With inelastic exogenous labour supplies this curve represents the labour market equilibrium in the short run and therefore also in the steady state. Below it will be referred to as the Product Market Arbitrage or *PMA*-curve as it equates the relative marginal product of labour in production to the relative wage. This curve is constructed graphically in Figure 1.

[Figure 1 about here]

In the right panel the labour market is depicted. An exogenous relative supply is equated to a relative demand that is conditional on  $n_H/n_L$ . Two relative demand curves have been drawn and were labelled  $Z_1$  and  $Z_2$ , where  $Z_2$  represents a higher ratio of  $n_H/n_L$ . By plotting the equilibrium wages against the corresponding values for  $n_H/n_L$  one obtains the

*PMA*-curve in the left panel. Intuitively this curve is upward sloping as the employment level *per variety* is negatively related to the relative number of varieties per range and therefore positively to the relative marginal value product.<sup>2</sup> The figure also illustrates the impact of an increase in relative labour supply. For every  $n_H/n_L$  the relative wage now drops. Consequently an increase in relative supply,  $L_H/L_L$ , will cause the *PMA*-curve to rotate down and to the right as is illustrated in the left panel.<sup>3</sup>

So far the model has closely followed the models by for example Grossman and Helpman (1991a) and Acemoglu (2002). As in these models we can now introduce entrepreneurial activity in the form of adding new varieties to the range of new goods. Also firms are allowed to invest in maturing their production process such that low skilled labour can be employed.

### The Value of Innovations

Assume that innovations can be patented and patents are perfectly enforced or alternatively secrecy or tacit knowledge prevent others to copy a new product or process. In general the value of an innovation is then equal to the discounted (expected) real profit flow that can be generated by it:<sup>4</sup>

$$\frac{v_S(t)}{P(t)} = \int_t^{\infty} e^{-r(t-\tau)} \frac{\pi_S(\tau)}{P(\tau)} d\tau \quad (12)$$

where  $v_S$  denotes the value of the patent establishing a new good in variety range  $n_S$  and argument  $i$  has been dropped due to symmetry within the ranges. Equation (12) can be rewritten if we assume constant (expected) growth rates for profits and the price index:

$$v_S(t) = P(t) \frac{\pi_S(t)}{P(t)} \int_t^{\infty} e^{-(r-\dot{\pi}/\pi+\dot{P}/P)(t-\tau)} d\tau = \frac{\pi_S(t)}{r - G_{\pi_S} + G_P} \quad (13)$$

where  $G_X$  is the growth rate of  $X$ . When there is a product life cycle, however, the pricing of patents is a bit more complex. New products become mature when the production process is changed to allow low skilled labour to step in. I will assume, however, that the product specifications do not change in that transition. For future reference I therefore label the invention of a new product “product innovation”, while referring to the creation of a new process that matures an existing product as “process innovation”. The former activity is entrepreneurial R&D, the latter is incumbent R&D.

When a process innovation now moves a variety from the high to the low skilled range of goods, the profit flow for the incumbent firm increases. The value of a process innovation therefore equals the positive *difference* between the present value of the new and that of the mature product’s flow of rents. The value of a product innovation remains given by (13). One thus obtains:

$$v_H(t) = \frac{\pi_H(t)}{r - G_{\pi_H} + G_P} \quad \text{and} \quad v_L(t) = \frac{\pi_L(t)}{r - G_{\pi_L} + G_P} - \frac{\pi_H(t)}{r - G_{\pi_H} + G_P} \quad (14)$$

## The Production of Innovations

To close the model we need to specify how Entrepreneurial and Incumbent Firms' R&D results in actual product and process innovations, respectively. Consider the following production functions for Entrepreneurial and Incumbent Firms' R&D:

$$\begin{aligned}
 \dot{n} &= n a_E R_E^\gamma \\
 \dot{n}_L &= n_H a_I R_I^\gamma \quad \text{where} \quad 0 < \gamma \leq 1 \\
 n_H &\equiv n - n_L \\
 \dot{n}_H &= \dot{n} - \dot{n}_L
 \end{aligned} \tag{15}$$

Note that in a product life cycle specification any addition to range  $n_L$  implies a reduction in range  $n_H$  and only Entrepreneurial R&D can increase the total number of varieties,  $n$ .  $R$  is the amount of R&D labour allocated to Entrepreneurial,  $R_E$ , and Incumbent Firms',  $R_I$ , R&D, respectively.<sup>5</sup> The number of total and new varieties proxy for knowledge that is productive in Entrepreneurial and Incumbent Firms' R&D activity, respectively. Such knowledge spillovers are what drive any endogenous growth model.<sup>6</sup> Note also that, despite the aggregate increasing returns to scale, this specification allows for diminishing returns to R&D resources by allowing for  $\gamma \leq 1$ .

A competitive R&D sector now allocates the available R&D workers,  $R^*$ , between entrepreneurial and incumbent activities to maximise profits by setting:

$$\frac{R_E}{R_I} = \left( \frac{n_H}{n_L} \right)^{\frac{1}{\gamma-1}} \left( 1 + \frac{n_H}{n_L} \right)^{\frac{-1}{\gamma-1}} \left( \frac{v_L}{v_H} \right)^{\frac{1}{\gamma-1}} \left( \frac{a_E}{a_I} \right)^{\frac{1}{1-\gamma}} \tag{16}$$

The R&D sector thus produces a flow of product and process innovations by employing all available R&D resources and using the public knowledge base accumulated in the past. R&D can be financed using savings as long as the return on R&D investments exceeds or equals the subjective discount rate.

## The Steady State Equilibrium

Now consider the conditions for a steady state equilibrium. For a given relative supply of high over low skilled labour Equation (10) shows that a stable ratio  $n_H/n_L$  implies stable relative wages. Stable relative wages imply stable relative profits, which in turn imply stable relative patent values. Stable relative patent values and a stable ratio  $n_H/n_L$  yield a stable allocation of R&D resources that can produce stable growth rates for the two ranges of goods. Hence a stable ratio  $n_H/n_L$  is the first condition for a steady state equilibrium. That implies:

$$\frac{\dot{n}}{n} = \frac{\dot{n}_H}{n_H} = \frac{\dot{n}_L}{n_L} \tag{17}$$

using Equation (15) that condition also implies for the steady state allocation of R&D labour that it must satisfy both Equation (16) and:

$$\frac{R_E}{R_I} = \left( \frac{n_H}{n_L} \right)^{\frac{1}{\gamma}} \left( \frac{a_E}{a_I} \right)^{\frac{-1}{\gamma}} \quad (18)$$

Setting this expression equal to Equation (16) and solving for relative wages yields a steady state relationship between relative wages and  $n_H/n_L$  that, together with the *PMA*-curve, determines all feasible steady state equilibria:<sup>7</sup>

$$\frac{w_H}{w_L} = \left( \frac{b_H}{b_L} \right)^{\frac{1}{\beta}} \left( 1 + \left( \frac{n_H}{n_L} \right)^{\frac{-1}{\gamma}} \left( 1 + \frac{n_H}{n_L} \right) \left( \frac{a_E}{a_I} \right)^{\frac{1}{\gamma}} \right)^{\frac{1-\alpha\beta}{\alpha\beta}} \quad (19)$$

This relationship can be labelled the Research and Development Arbitrage curve or *RDA*-curve as it traces out the combinations of relative wages and  $n_H/n_L$  for which the R&D sector has no incentive to reallocate resources and both goods ranges grow at the same rate. Relative wages enter this relation through relative profits, which affect the relative value of innovations. This in turn changes the optimal allocation of available R&D resources over Entrepreneurial and Incumbent Firms' R&D. The relative range,  $n_H/n_L$ , also enters through profits but in addition the knowledge spillovers assumed in the innovation function. Figure 2 shows the *RDA*-curve, which is convex downward sloping over the entire domain (see Appendix). The intuition is that at larger  $n_H/n_L$  it is ceteris paribus more attractive to invest R&D resources in expanding  $n_L$  because of larger intratemporal knowledge spillovers. To offset this tendency and be in equilibrium a lower relative wage is required.

The arrows indicate the direction in which  $n_H/n_L$  will change when one starts in a point off the *RDA*-curve. Below the *RDA*-curve  $n_H/n_L$  will grow. The intuition is once more quite straightforward. In that situation relative wages are, given the available knowledge stocks, too low. Consequently relative profits are too high and this provokes too much entrepreneurial activity, causing  $n_H/n_L$  to rise.<sup>8</sup> Hence the equilibrium is only stable if the *RDA*-curve intersects the *PMA*-curve from above as has been verified more formally in the Appendix.

[Figure 2 about here]

Combining Figures 1 and 2 yields the complete model in Figure 3.

[Figure 3 about here]

Starting from a point such as *A* in the right panel, the corresponding position on the *PMA* relative to the *RDA*-curve determines that  $n_H/n_L$  will grow. As  $n_H/n_L$  increases, the relative labour demand curve in the right panel shifts out and relative wages increase. In the left

panel the economy moves up along the *PMA*-curve. This process stops and the model is in steady state equilibrium when the intersection of *PMA* and *RDA* is reached at points *B*.

### PREDICTIONS AND HYPOTHESES

Now consider how the model responds to the introduction of a new GPT. As was argued above a new GPT opens up new opportunities for entrepreneurs to develop new products and processes. The best way to introduce such a shock in the model is to analyse the impact of a sudden increase in the productivity of R&D workers in generating new ideas. In terms of the model we should therefore consider an increase in  $a_R$ . It can easily be verified in equation (10) that the *PMA* will not shift. Instead equation (19) shows that the *RDA* shifts out. This puts the old equilibrium below the new *RDA*-curve and  $n_H/n_L$  will start to rise. This pushes relative wages up along the *PMA*-curve. When the GPT is fully absorbed the initial shift in  $a_R$  will be reversed and with a lag  $n_H/n_L$  and relative wages will come down again. But for our purpose we should analyse what happens to per capita income and entrepreneurial activity over this cycle. From equation (16) we can derive the impact on the allocation of R&D resources. The initial upward shift in  $a_R$  obviously causes an increase in entrepreneurial R&D. Then the rise in  $n_H/n_L$  and in relative wages moves the allocation in the opposite direction.

The model allows for the exact measurement of economic growth in terms of utility. In the data, however, one must realise that new products enter with a lag. In addition they frequently face price reductions and quality increases in the early stages of the product life cycle. This implies that the contribution of new goods in economic growth is underestimated in the data on production value and price indexes. Real GDP therefore underestimates the impact of Entrepreneurial R&D. The effects of Incumbent Firms' R&D on the other hand is accounted for more adequately as cost reductions reduce the price index and thereby show up in real GDP. We expect a drop in measured productivity growth at given aggregate R&D levels when entrepreneurial activity increases. Measured productivity should pick up once the R&D is reallocated towards Incumbent Firms' R&D and measurements are adjusted to the changes in the consumption bundle. Hence we can formulate Hypothesis 1:

*The relationship between entrepreneurial activity and measured economic growth is negative but turns positive with a lag following the introduction of a new GPT.*

### DATA AND ANALYSIS

To analyse the dynamic relationship between entrepreneurial activity and GDP we use the COMPENDIA-data set that includes 23 OECD countries and contains information on entrepreneurial activity, measured as the bi-annual ratio of non-agricultural business owners to the total labour force, and GDP for the period 1972-2002.<sup>9</sup>

*Identifying the cycles*

First consider the relationship between GDP/Cap-growth and Entrepreneurial activity. Figures 4-7 present this relationship over time for the United States, Germany, Japan and the United Kingdom. A 4<sup>th</sup> order polynomial has been fitted to eliminate the many other external factors that affect the GDP/Cap growth rate over time.

[Figure 4-7 about here]

In the four selected countries the cycles in Entrepreneurial activity and GDP/Cap growth are clearly visible. It should also be noted that these cycles seem to be out of phase by as much as 10 years. Especially in the United States, arguably the technology leader in the world, the lag is long and the sustained rise in entrepreneurial activity since the mid-seventies yields growth at a lag of more than 10 years. In Germany, a less entrepreneurial economy by all measures, the level of entrepreneurial activity only starts to pick up in the mid-eighties but growth follows in the early nineties. In the UK we observe two cycles in GDP/Cap growth for 1 full cycle in Entrepreneurship. Japan, with its sustained recession in the nineties, sees the effects of a continued fall in Entrepreneurship since the early seventies. Growth in GDP/Cap, however, only starts falling in the early eighties, a lag of about 10 years.

### **Identifying technological leaders and followers**

Countries go through the various stages of the cycles identified above at different points in time. Following the introduction of a GPT, technological leaders will go through the early phase of more entrepreneurial activity at earlier points in time than followers do. To identify which countries are leaders and which are followers we analyse the development over time (period 1972-2002) of our entrepreneurial activity measure, the business ownership rate, for the 23 countries in our data set.

As described earlier business ownership rates fell in most of the 20<sup>th</sup> century. However, following the ICT revolution and increasing uncertainty from the 1970s onwards, business ownership rates increased in several countries. Those countries that experienced this shift earlier in time may be labeled technological leaders while those experiencing this shift at a later point in time may be labeled technological followers. However, in trying to identify leaders and followers also the *levels* of business ownership should be taken into account. Carree et al. (2002) found that countries with very high business ownership rates experience a growth penalty in the form of growth foregone. This is probably because there are too many marginal entrepreneurs who could be more productive for the economy if they would work as a wage-earner in a bigger firm. Too high business ownership rates may also point at a lack of R&D investments. This implies that it is not likely that a country with a high level of business ownership experiencing even further increases in business ownership rates is a technological leader. Also, a certain minimum economic development level is probably required in order for the labor force to produce sufficient numbers of entrepreneurs that are able to generate innovative activity.

Combining formal quantitative analysis (regressions of entrepreneurial activity on a constant, time and time squared), and qualitative assessment of the data (taking into account the level of GDP per capita and the level of business ownership), we may identify four groups of countries, ranked by the extent to which they may be labeled leaders or followers:<sup>10</sup>

#### 1. United States

Our data confirm that the United States is the technology leader in the world. It is the country where the rise in business ownership rate came earliest, from the early 1970s onwards. Also, our regression analysis reveals a downward pattern again from 1991 onwards. This may reflect that entrepreneurial activity declines in the later phase of the cycle following the introduction of a new GPT, as described above.

#### 2. Ireland, Switzerland and Canada

The development over time of the business ownership rate suggests that these three countries are the closest followers of the United States. Like the US they have an upward pattern of business ownership since the 1970s. However, the difference is that the later phase of the cycle (levelling off of the rise) is reached only recently, around the year 2000. Hence these countries have reached the later phase at a later point in time compared to the US. Also, in the early 1970s GDP per capita levels were far behind the US, especially for Ireland which was clearly not a leader in those times. In other words the rise for Ireland in the 1970s and 1980s is probably to a certain extent a 'catch-up' effect and hence of a different nature than the rise in business ownership in the US.

#### 3. Austria, Belgium, Denmark, Finland, Germany, Netherlands, Sweden, United Kingdom, Iceland, New Zealand

These countries reached the bottom of the U-shaped relation in the mid-1980s. Hence the rise in business ownership came later than for the countries in the first two groups.

#### 4. France, Luxembourg, Norway, Japan

These countries have an ever decreasing business ownership rate over the whole period of the data set, until 2002. The phenomenon of more entrepreneurial activity following the introduction of a GPT cannot be detected for these countries.<sup>11</sup>

5. A final group of countries does not seem to fit in this analysis. The development of business ownership is too different from the other countries. For Portugal and Spain the business ownership rate is more or less constant over the whole period. Three other countries (Greece, Italy, Australia) have an increasing business ownership rate. However, the rise is combined with a high *level* of business ownership which makes them uncomparable with the countries in group 2. Moreover, it may reflect that there are too many marginal entrepreneurs in these three countries.

## DISCUSSION

Various authors have identified a reversal of the downward trend in business ownership rates in modern economies since the 1970s, implying a U-shaped relation between entrepreneurial activity and economic development (e.g. Carree et al., 2002). In this paper we develop a model that explains the U-shaped relationship in a formal way as the result of a technology regime shift that is brought about by the introduction of a new GPT. The theoretical model is illustrated with some empirical exercises making use of the COMPENDIA data base which contains data on business ownership rates and per capita income for 23 OECD countries from 1972 onwards.

The empirical exercises seem to identify considerable lags between increased entrepreneurial activity and economic growth, suggesting that the exploration activities performed by the entrepreneurs results in economic growth only at later phases of the product life cycle when the new products are exploited and developed further in incumbent firms. Also, by analysing the development over time of the business ownership rates we identified four groups of countries, in terms of the extent to which the countries might be labeled as leaders or followers. Not surprisingly, the United States came out as the technology leader of the world.

Our empirical work has several limitations. *First*, we use the business ownership rate as measure of entrepreneurial activity. The business ownership rate contains many shopkeepers or 'mom-and-pop' businesses. Innovative entrepreneurs are only a small fraction of the business owners (Wennekers and Thurik, 1999). Both high-tech and low-tech firms are treated as the same. It is likely that the high business ownership rates in, for instance, Greece and Italy reflect many 'marginal' entrepreneurs, and hence they do not fit in the theoretical model developed in this paper. *Second*, and related to the first limitation, we do not make a distinction between sectors, the cycles may be more clearly visible for high-tech economic activity compared to low-tech economic activity. *Third*, several non-technology related reasons may account for developments in business ownership as well. For instance, in the United Kingdom government policy has been directed toward small firms while in France policy was focused on large firms for a long time. This certainly explains some of the upward trend in the UK in the 1980s and the downward trend in France. *Fourth*, and perhaps most important, efforts allocated to R&D activity play a vital role in our theoretical model. However, our empirical exercises do not take account of the differences that exist between countries in the relative amount of R&D investments.

For all the above reasons our empirical results should be regarded as exploratory. Our exercises are meant to give the reader some clue as how these cycles may come about in practise. However, to gain more insight in these processes we should build more sophisticated empirical models incorporating R&D levels and formally assessing the lags involved in the relationship. Also, to identify leaders and followers, more detailed information should be taken into account. This is the subject of future empirical research.

Once these type of exercises are performed, important policy conclusions may be drawn. For instance, if it would be obvious that Europe is about to move to a later phase in the technology life cycle, then we may conclude that the stimulation of entrepreneurial activity seems a good idea in Europe if implemented swiftly but might actually be wasteful if the current Schumpeter Mark I technology regime ends quickly. Similarly for the US we may then conclude that current levels of entrepreneurial activity need not be stimulated, especially if a regime switch is imminent. However, as indicated, more empirical work is required to be able to draw this type of conclusions.

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Figure 1: **Graphical Construction of the PMA-curve**

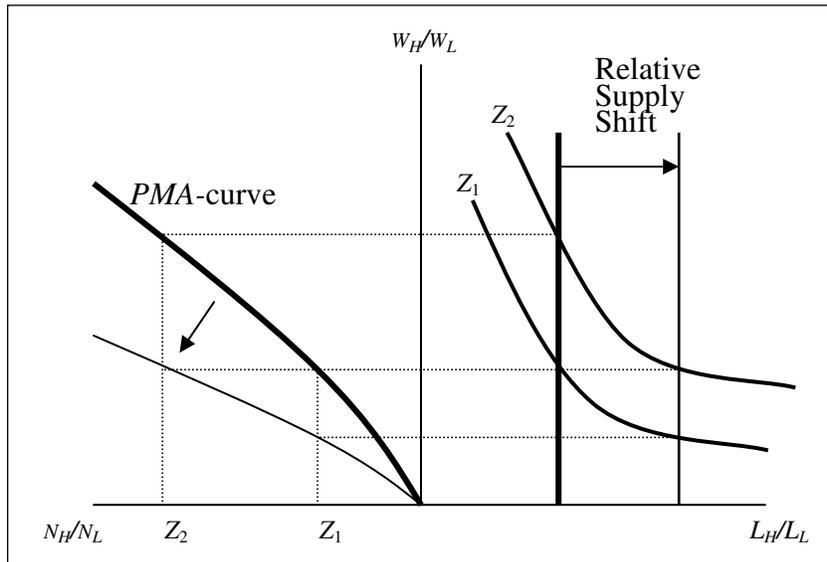


Figure 2: **The RDA-curve**

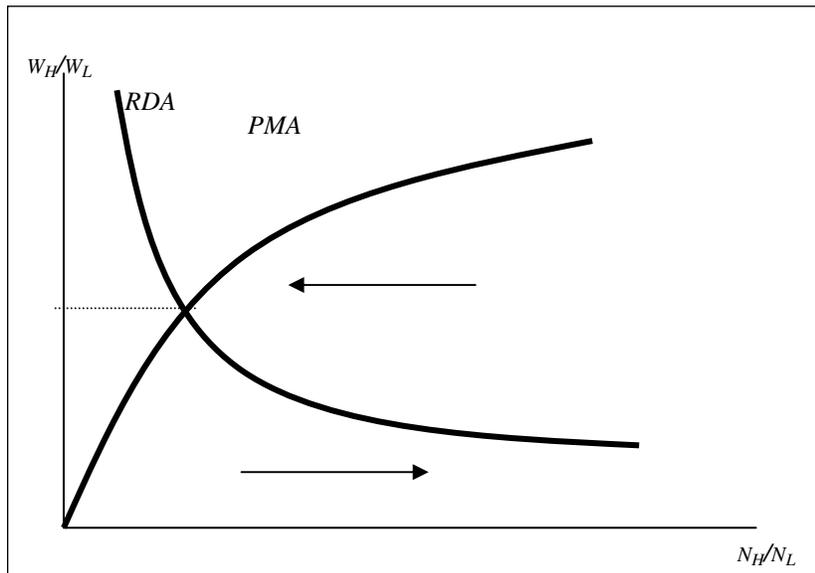


Figure 3: **Steady State Equilibrium**

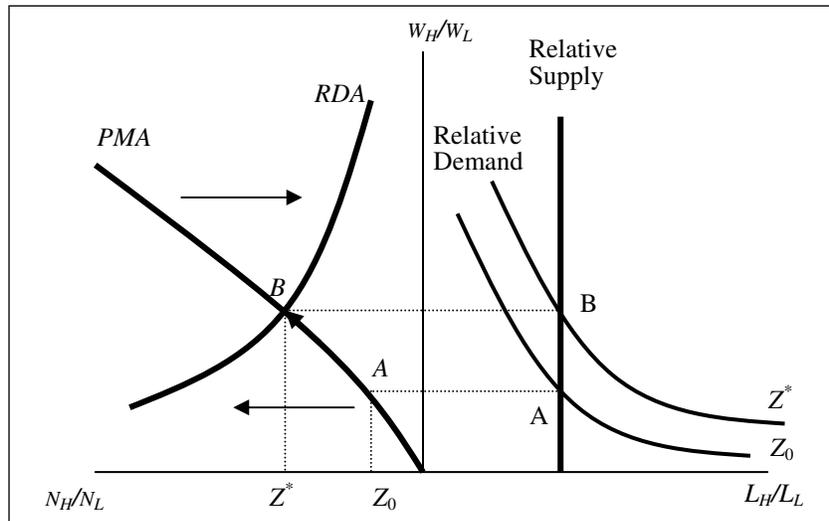
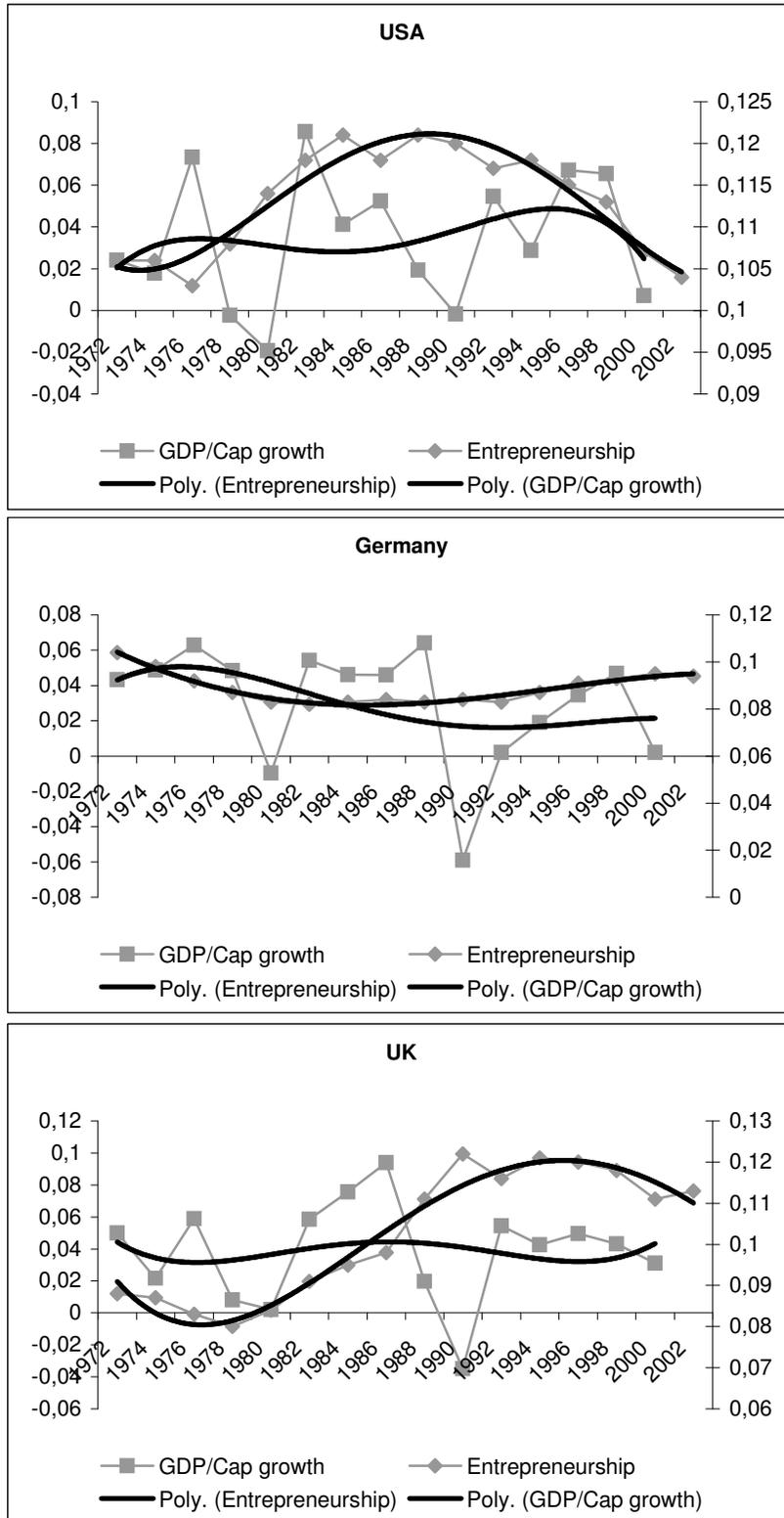
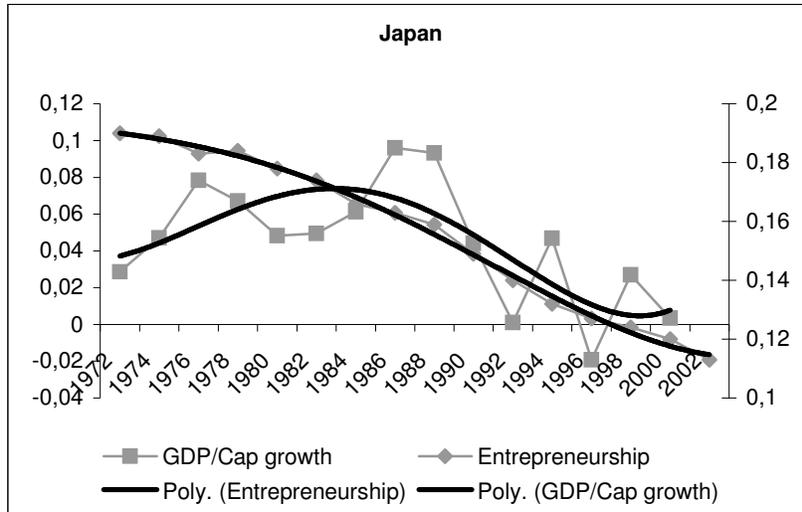


Figure 4-7: **GDP/Cap growth and Entrepreneurial Activity**





## Endnotes

<sup>1</sup> The structure is closest to that presented in Grossman and Helpman (1991b) chapter 4.

<sup>2</sup> It is concave because demand is convexly downward sloping in the relative wage. Hence an ever-larger increase in  $n_H/n_L$  is required to push relative demand out and relative wages up by the same percentage.

<sup>3</sup> Note that the short-run elasticity of substitution between high and low skilled labour can be derived and is strictly negative. Its absolute value is given by,  $\sigma_{SR} \equiv 1/(1-\alpha\beta)$ .

<sup>4</sup> The usual way of thinking about innovation in these models is to assume perfect patent protection. The patent then yields a return in the form of future profit flows and the R&D investment required can be financed by selling such assets. One could also think of an entrepreneur who needs to finance the initiation of a new firm. In that case R&D can be interpreted as non-production labour required for starting up a firm and finding a niche in the market. To finance such up-front investments the entrepreneur must sell his future profits as assets, yielding at least  $r$  in equilibrium for consumers to be willing to finance investment.

<sup>5</sup> The mathematics are much more complicated and little insight is gained by requiring the R&D sector to compete for high skilled labour with production. It would allow for an interpretation of Research as truly entrepreneurial activity as that generally requires skills. See Sanders (2004) for a digression in that direction.

<sup>6</sup> See Jones (1995, 2005) for an elaboration of the role of knowledge spillovers in endogenous growth theory. The proportional specification was chosen for convenience and empirical support is weak. Jaffe and Caballero (1993) for example suggest that the assumed constant returns to accumulated knowledge may be too optimistic and depreciation rates of knowledge, in particular in the 80s, may be high. A more general spillover structure was analysed in Sanders (2004).

<sup>7</sup> Note that the fact that profits grow at the same (negative) rate in both ranges in the steady state was used to eliminate the ratio of discount rates from the ratio of patent values.

<sup>8</sup> Krugman (1998) uses and refers to this intuitive type of dynamics analysis as ad-hoc dynamics. Proofs and derivations are left for the Appendix.

<sup>9</sup> See for details Van Stel (2005).

<sup>10</sup> Details of this analysis are available on request by the authors. The current empirical analysis should be marked as preliminary.

<sup>11</sup> This is not to say that these countries are technological laggards as institutions may hamper entrepreneurial activity in these countries.

# **SERIAL ENTREPRENEURSHIP: AN EXPLORATORY ANALYSIS OF AUSTRALIAN FIRMS**

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## **ABSTRACT**

Serial entrepreneurs are business owner-operators who commence, operate and dispose of a number of business ventures. This paper draws on data from 199 micro firms in New South Wales, Australia to explore the background and characteristics of a cohort of serial entrepreneurs, identify some aspects of their current operations, and assess whether the businesses of these serial entrepreneurs are more likely to grow than other entrepreneurial ventures.

The results indicate that serial entrepreneurs tend to be male, relatively well educated, aged between 30-49, and Australian-born. Many (just under half) come from a family with a prior background in business ownership. A third of them concurrently operate another business, and a majority has a strong growth orientation.

Analysis of data between serial and other entrepreneurs reveal some statistically significant differences between the two cohorts. Compared to other entrepreneurs, serial entrepreneurs are more likely to concurrently operate another business; less likely to operate their current venture as a home-based enterprise; and more likely to want to expand their business in future. Serial entrepreneurs, when compared to other entrepreneurs, also tend to be slightly older, are more likely to be male, and are more inclined to buy a business as a going concern.

## INTRODUCTION

Many studies of entrepreneurship examine the business venture, or the entrepreneurial individual, at a particular point and often overlook the fact that, for many people, entrepreneurship may as much be an on-going way of life as it is a particular business project. For these individuals, enterprising activity may mean undertaking several different projects over the course of a working life. The end result is the creation, expansion and termination of a series of different business ventures over many years.

In recent years, this notion of so-called “habitual,” “serial” or “continual” entrepreneurship has begun to be explored in some detail within the academic community. However, the body of knowledge about such operators is still limited. Much more remains to be known about serial entrepreneurs. What are the particular personal characteristics and demographic features of such businesspeople? How do they operate their businesses? And do they differ in any substantive way from other entrepreneurs?

The purpose of this paper is to attempt to shed some further light on serial entrepreneurs. It examines some recent evidence concerning the personal background and business operating features of such business owners, and compares them to other entrepreneurs, drawing on data from a recent large-scale survey of micro-enterprises in New South Wales, Australia.

## LITERATURE REVIEW

The notion that some entrepreneurs may engage in multiple business ventures, either simultaneously or sequentially, has been explicitly recognised by a number of researchers. Early contributors to the field included MacMillan (1986) and Donckels, Dupont & Michel (1987). However, despite MacMillan’s (1986) challenge to learn more about habitual entrepreneurs, Wright, Westhead and Sohl (1998) argue that little had been achieved prior to 1998. A search of the literature since that time also reveals only a small handful of new research contributions.

A first issue to be dealt with in this field is semantic: what exactly is a serial, habitual, repeat or continuous entrepreneur? All of these terms have been employed at one stage or another, yet different authors have occasionally ascribed different interpretations to each of them. For example, Hall (1995) developed a dichotomous classification of definitions, which were further refined by Kolvereid and Bullvag (1993), Westhead and Wright (1998), and later by Westhead, Ucbasaran, and Wright (2003). Included in these definitional discussions is the related concept of the portfolio entrepreneur (Hall 1995). This refers to an individual who concurrently operates two or more enterprises (Westhead *et al.*, 2003). The differentiating characteristic between serial and portfolio entrepreneurs is the timing of business ownership, namely whether two or more businesses are operated at the same time. The serial entrepreneur only ever operates one business after another, whilst the portfolio entrepreneur owns multiple businesses at the same time. Not surprisingly, the two categories frequently overlap (Hall 1995).

Whilst the terms are sometimes said to be quite different, the phrases “habitual” and “serial” entrepreneur are also frequently used as interchangeable terms, and can be regarded most simply as an individual who starts one enterprise and then later begins another (Wickham 2004). For the purpose of this paper we focus on serial entrepreneurs as individuals who currently own and operate a business and who have previously owned another enterprise. We also discuss the number of serial entrepreneurs who may also be portfolio entrepreneurs.

Serial entrepreneurs are frequently juxtaposed against novice entrepreneurs. The latter category represents most entrepreneurs and includes current business owners who have no prior experience in creating or owning a business venture (Westhead *et al.*, 2003).

Most research into this phenomenon to date has employed a qualitative case research methodology (eg Rosa, 1998) with limited quantitative analysis (eg Alsos and Kolvereid, 1998). This makes it difficult to generate valid, generalisable findings. Even when quantitative methodologies have been employed, the data and subsequent analysis has frequently been highly aggregated such that detailed information about serial entrepreneurs has been difficult to ascertain (Wright *et al.*, 1998). However, some entrepreneurial demographics appear to have emerged, although the findings are sometimes contradictory. Birley and Westhead (1993) found that the proportion of habitual entrepreneurs to total entrepreneurs tended to be quite small, ranging from 12% to 36%. In contrast, Schollhammer (1991) in a US study found that 51% of entrepreneurs had two or more ventures. Most habitual entrepreneurs appear to be men, and they tend to have higher educational qualifications than novice entrepreneurs (Kolvereid and Bullvag, 1993; Westhead and Wright, 1998).

At the same time, many characteristics of habitual entrepreneurs appear to be either highly heterogeneous or quite variable. It appears that they do not always tend to remain in the same industry (Wright, Robbie, and Ennew, 1997), and that their motivations, the type of venture they operate, and the way they manage may in fact vary significantly between their first and subsequent ventures (Wright, Westhead & Sohl, 1998).

Environmental considerations and contextual frameworks, such as enterprise location and stage of the business life cycle, are some issues that seem to have an impact on serial entrepreneurship (Wright, Westhead and Sohl, 1998). The motivations for habitual entrepreneurship can be quite diverse, and include a desire for independence, monetary security, the belief that it ‘adds to the excitement of life’ (Westhead and Wright, 1998), a sense of duty, and the desire to contribute to local communities (Mankelov and Merrilees, 2001; Rosa, 1998).

Serial entrepreneurs conceivably also have some skills and resources that other, novice entrepreneurs will not. It might reasonably be supposed that they will have gained greater experience in launching and operating a business, and thus overcome many of the “learning curve” problems typically experienced by first-time business venturers. However, this does not always appear to be the case: neither Kolvereid nor Bullvag (1993) or Birley and Westhead (1993) could find any evidence to support this contention. On the other hand, there is some evidence to suggest that serial

entrepreneurs are able to better access sources of funding for their next start-up, arguably because of a 'better track record' (Alsos and Kolvereid, 1999; Westhead and Wright, 1998).

Wright *et al.* (1998) identified a number of areas in which future research into habitual entrepreneurship was seen as desirable. These included the background characteristics of the entrepreneur, their management practices, and their behaviour within specific segments of the business population. Identifying the characteristics, firm behaviour and growth orientation of habitual entrepreneurs is also an important issue for policy makers (Westhead *et al.*, 2003). Such research may help in determining if serial business ownership is a reliable indicator of future business performance, and whether or not specific programs should be targeted towards this entrepreneurial subset.

While concern with, and understanding of, this group of individuals is growing; the phenomenon of serial entrepreneurship appears to have received only minor analysis so far amongst one part of the business population: the microfirm sector. Microfirms represent the majority of firms operating in most nations today, yet their role and impact is often overlooked or poorly understood. Traditionally they have been treated as a phenomenon with limited relevance to the wider economy, even though they are in fact a major structural force in almost all societies. In Australia, for example, a business enterprise is deemed to be a micro-firm if it has less than five employees (Australian Bureau of Statistics, 2002). In June 2001, there were an estimated 1.1 million small and medium-sized business enterprises (SMEs) in the country, of which 80% were regarded as micro-sized (Australian Bureau of Statistics, 2002).

## METHODOLOGY

Information on respondents was collected during 2003, as part of a study examining the structure and operating practices of employing micro-businesses within the state of New South Wales (NSW), Australia. The study was undertaken by the NSW Department of State and Regional Development, and was based on a survey instrument employed in a prior study of micro-businesses undertaken by the Canadian Government in 2000 (Industry Canada, 2001; Papadaki and Chami, 2002). The NSW survey was restricted to the population of employing firms who had been in existence for at least four years, and stratified to account for proportionate variations in population distribution between regional and metropolitan areas, as well as differences between the goods and services sectors of the economy. The survey was limited to the owner-operators of firms, and conducted through a telephone interview.

The data was collected as part of a larger study into established micro-firms that imposes some potential limitations on the generalisability of the results. For example, the findings cannot be regarded as representing all small enterprises, since they specifically relate to micro-firms; there is also a survivorship bias in that only firms that have existed for four or more years were included. Caution is therefore essential in interpreting the results. Despite these limitations, the results do provide some important understandings of serial entrepreneurs and how they differ from other owner-operators.

As discussed in the preceding literature review, there are a number of ways in which to define a “habitual entrepreneur.” For the current study, a simple and easily operationalised definition was employed, in which a serial entrepreneur was taken to be any person who currently owns and operates a business, and who has previously owned and managed another enterprise.

For the data set examined in this paper, a total of 753 responses were available, of which 199 respondents (26%) indicated that they had previously owned and operated a business before their current venture. The proportion of total respondents who fell into the serial entrepreneur category supports the earlier arguments of both Birley and Westhead (1993) and Alsos and Kolvereid (1998) that serial business venturers exist in substantial numbers amongst the general business community.

## **RESULTS**

In any exploratory analysis of entrepreneurship in applied situations, two sets of factors are often equally important: the personal characteristics and background of the entrepreneurial individual, and the characteristics of the firms that they own. Both aspects were examined in this study. This section starts with a descriptive summary and is followed by a comparison of results between serial and novice entrepreneurs. These comparisons are intended to give an insight into questions such as: Are serial entrepreneurs, and the firms that they operate, different from those run by other entrepreneurs? Are the activities of serial entrepreneurs merely an interesting sideshow, or can it be inferred that there are substantive differences that set them apart from other owner/operators? As most of the data was collected using categorical responses, a Chi-squared test for independence was used to compare groups.

### **Background Characteristics**

As a group, serial entrepreneurs in the survey tend to be male, well educated, aged between 30-49, locally born (Australian), and slightly less likely to have come from a family background of business ownership. More detailed results are included in Table 1, which also forms the basis of comparisons with non-serial entrepreneurs that are presented later in the paper.

-----  
Insert Table 1 about here  
-----

Overall, firms owned by serial entrepreneurs in the survey tend to have been started from scratch, be family owned, have operated for over ten years, are run as independent firms (that is, they tend not to be franchises), and are based in premises separate to the entrepreneur’s residence. Only a minority continues to concurrently operate another business. They tend to have experienced positive sales growth (but not growth in employee numbers) and express a likelihood that they will expand in the short term. As was the case for personal characteristics, more detailed results are included in Table 2, which also forms the basis of comparisons with non-serial entrepreneurs that are presented later in the paper.

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Insert table 2 about here  
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### **Differences In Characteristics**

Table 1 identifies differences in personal characteristics between serial entrepreneurs and other entrepreneurs. From this perspective there are statistically significant differences (at  $p \leq 0.05$ ) between serial entrepreneurs and other entrepreneurs in respect of gender distribution (with serial entrepreneurs more likely to be male than the overall respondent cohort), and age (continuous entrepreneurs tended to be slightly older than other respondents). In contrast, no significant differences could be found between the two groups on the grounds of educational attainment, country of origin, or early family business involvement.

The fact that serial entrepreneurs tend to be slightly older than other respondents should not be surprising; as Westhead and Wright (1998) and Wright *et al.* (1998) have suggested, prior business experience is accumulated over time, producing a cohort that is usually older than novice entrepreneurs. The relatively low proportion of female habitual entrepreneurs supports the earlier suggestion of Kolvereid and Bullvag (1993) that most serial venturers are males. However, the current findings do conflict with their suggestion that serial entrepreneurs are more likely to have obtained higher educational qualifications than other entrepreneurs; no such difference could be found in this study.

Table 2 identifies differences in business characteristics between businesses owned by serial entrepreneurs and other entrepreneurs. From this business perspective there are statistically significant differences (at  $p \leq 0.05$ ) associated with five characteristics. Compared to other respondents, serial entrepreneurs are: more likely to buy a going concern than other entrepreneurs; less likely to operate their current venture as a home-based enterprise; more likely to concurrently operate another business; more likely to have higher levels of sales growth; and more likely to want to expand their business in future. No significant differences are evident in respect of the family business ownership, duration (years of operation) of the current business venture, franchise operation, or employee growth. While not reflected in the tables, serial entrepreneurs were also asked why they left their previous business. Interestingly only 33 indicated a profitable sale while 23 indicated a lack of profitability. Another 67 cited other reasons that were not available.

These results lend support to the arguments of Wickham (2004), who suggests that the prior experience of serial entrepreneurs means they are likely to operate their business in a somewhat different manner to novice entrepreneurs. They are more likely to engage in portfolio entrepreneurship as a means of spreading or diluting their business risks, and are more comfortable with the notion of operating simultaneous enterprises than are novices. In addition, prior commercial success may provide them with greater financial assets (accumulated capital and access to lenders), which gives them a greater opportunity to buy a going concern than is possible for other business venturers. Their high growth orientation may also reflect a different set of priorities and motivating factors to those of novice entrepreneurs (Wright *et al.*, 1998).

## CONCLUSION

This paper has presented some descriptive statistics and exploratory analysis about serial entrepreneurship within the employing micro-firm sector, a group that has not previously been extensively examined. It has confirmed that, for this cohort, the unique differences in personal characteristics and business attributes associated with habitual entrepreneurs do indeed exist. Serial entrepreneurs in the micro-firm sector are more likely to concurrently own another business, more likely to have higher sales growth and be more inclined to expand than other owner-managers. These latter differences compared to the non-serial business cohort suggest that there may be a policy advantage in focusing on serial entrepreneurs as a group more likely to generate greater economic growth and wealth than novice venturers.

Although this paper has identified some important characteristics about serial entrepreneurs, much more still remains to be revealed. For example, why are serial entrepreneurs motivated to start a second or subsequent business? And why do they exit a venture? Does exit reflect a desire to start another business because of 'boredom' with the existing business or a need to experience the thrill of starting another business? Does the overlap with portfolio entrepreneurs suggest preplanning of habitual activities? Alternatively, do serial entrepreneurs exit because they lack the managerial skills to grow a business? Is there a particular point in the business lifecycle at which they are more inclined to exit? These, and many other issues relating to serial entrepreneurship, need to be investigated in more detail by the research community, and may help build a much more complete picture of this sector.

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**Table 1 – Differences in Personal Characteristic Between Serial and Other Entrepreneurs**

|   | Serial Entrepreneurs (N = 199)* | Other Entrepreneurs (N = 554)* | Statistical Analysis Results |      |       |
|---|---------------------------------|--------------------------------|------------------------------|------|-------|
|   |                                 |                                | $\chi^2$                     | d.f. | P     |
| <b>Gender</b>                                 |                                 |                                |                              |      |       |
| Male  | 145                             | 329                            |                              |      |       |
| Female  | 54                              | 225                            | 11.403                       | 1    | 0.001 |
| <b>Education</b>                              |                                 |                                |                              |      |       |
| Post-graduate qualification                   | 24                              | 50                             |                              |      |       |
| Bachelors degree                              | 29                              | 74                             |                              |      |       |
| College/trade certificate or diploma          | 52                              | 149                            |                              |      |       |
| School certificate or equivalent              | 42                              | 140                            |                              |      |       |
| Up to year 10 school certificate              | 40                              | 114                            |                              |      |       |
| Other   | 11                              | 24                             | 3.084                        | 6    | 0.798 |
| <b>Age (years)</b>                            |                                 |                                |                              |      |       |
| < 30  | 5                               | 18                             |                              |      |       |
| 30-39   | 33                              | 101                            |                              |      |       |
| 40-49   | 50                              | 199                            |                              |      |       |
| 50-59   | 73                              | 160                            |                              |      |       |
| 60+   | 37                              | 72                             |                              |      |       |
| No response                                   | 1                               | 4                              | 11.798                       | 5    | 0.038 |
| <b>Born in Australia</b>                      |                                 |                                |                              |      |       |
| Yes   | 139                             | 414                            |                              |      |       |
| No  | 60                              | 140                            | 1.787                        | 1    | 0.191 |
| <b>Family owned business during childhood</b> |                                 |                                |                              |      |       |
| Yes   | 93                              | 252                            |                              |      |       |
| No  | 106                             | 302                            | 0.092                        | 1    | 0.804 |

\* Except where missing values excluded

**Table 2 – Differences in Business Characteristic Between Serial and Other Entrepreneurs**

|                                      | Serial<br>Entrepreneurs<br>(N = 199)* | Other<br>Entrepreneurs<br>(N = 554)* | Statistical Analysis Results |      |       |
|--------------------------------------|---------------------------------------|--------------------------------------|------------------------------|------|-------|
|                                      |                                       |                                      | $\chi^2$                     | d.f. | P     |
| <b>Business entry method</b>         |                                       |                                      |                              |      |       |
| Started from scratch                 | 124                                   | 370                                  |                              |      |       |
| Bought as going concern              | 62                                    | 122                                  |                              |      |       |
| Other                                | 13                                    | 62                                   | 8.636                        | 2    | 0.013 |
| <b>Owned by one family</b>           |                                       |                                      |                              |      |       |
| Yes                                  | 179                                   | 504                                  |                              |      |       |
| No                                   | 20                                    | 50                                   | 0.182                        | 1    | 0.671 |
| <b>Years operating</b>               |                                       |                                      |                              |      |       |
| 4-10                                 | 88                                    | 207                                  |                              |      |       |
| 11-15                                | 42                                    | 107                                  |                              |      |       |
| 15+                                  | 69                                    | 149                                  | 4.663                        | 2    | 0.097 |
| <b>Franchise</b>                     |                                       |                                      |                              |      |       |
| Yes                                  | 11                                    | 18                                   |                              |      |       |
| No                                   | 188                                   | 536                                  | 2.053                        | 1    | 0.195 |
| <b>Home based</b>                    |                                       |                                      |                              |      |       |
| Yes                                  | 61                                    | 237                                  |                              |      |       |
| No                                   | 138                                   | 317                                  | 9.003                        | 1    | 0.003 |
| <b>Own other businesses</b>          |                                       |                                      |                              |      |       |
| Yes                                  | 76                                    | 51                                   |                              |      |       |
| No                                   | 123                                   | 503                                  | 87.727                       | 1    | 0.000 |
| <b>Sales growth (% over 4 years)</b> |                                       |                                      |                              |      |       |
| Declined                             | 18                                    | 67                                   |                              |      |       |
| No increase                          | 26                                    | 113                                  |                              |      |       |
| < 20                                 | 49                                    | 125                                  |                              |      |       |
| 20-49                                | 52                                    | 127                                  |                              |      |       |
| 50-99                                | 17                                    | 56                                   |                              |      |       |
| 100+                                 | 34                                    | 45                                   |                              |      |       |
| Refused                              | 3                                     | 21                                   | 20.346                       | 6    | 0.002 |
| <b>Employee growth</b>               |                                       |                                      |                              |      |       |
| Decline                              | 36                                    | 98                                   |                              |      |       |
| No change                            | 89                                    | 289                                  |                              |      |       |
| Increase 1 – 4                       | 62                                    | 145                                  |                              |      |       |
| Increase 5+                          | 12                                    | 22                                   | 4.326                        | 3    | 0.228 |
| <b>Expanding next two years</b>      |                                       |                                      |                              |      |       |
| Not likely                           | 81                                    | 299                                  |                              |      |       |
| Somewhat likely                      | 42                                    | 103                                  |                              |      |       |
| Very likely                          | 67                                    | 121                                  |                              |      |       |
| Don't Know                           | 9                                     | 31                                   | 141.108                      | 3    | 0.003 |

\* Except where missing values excluded

# **EXAMINING THE CAUSES OF JOB SATISFACTION FOR SMALL BUSINESS EXECUTIVES: A TEST OF THE SITUATIONAL, DISPOSITIONAL, AND INTERACTIONAL JOB SATISFACTION MODELS**

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## **ABSTRACT**

Three recognized job satisfaction models (situational, dispositional, and interactional) are used to examine the job satisfaction of executives in small businesses. Based on a cross-sectional sample of 65 male executives, the three job satisfaction models are compared. Among the three job satisfaction models, the interactional model accounted for the most unique job satisfaction variance followed by the situational model and, lastly, the dispositional model.

## **INTRODUCTION**

Studies have shown that entrepreneurs (Cooper & Artz, 1995), executives (Judge Boudreau, & Bretz, 1994), and self-employed (Blanchflower and Oswald, 1998, Bradley & Roberts, 2004, Hundley, 2001, and Naughton, 1987) are very satisfied with their job/work. What is not clear from the literature is how and why executives of small businesses are satisfied.

There are two predominate reasons why these studies do not explain how and why small business executives are satisfied. First, the studies have not tested job satisfaction models per se. Cooper and Artz (1995) found results that contradicted the theoretical model (discrepancy theory) they used as a framework for their study. Despite a well executed study of executives by Judge and associates (1994), these researchers did not use recognized job satisfaction models in their study. Second, the studies used less than appropriate samples or data collections in explaining how and why small business executives are satisfied. Judge and associates used subjects identified from the fifth largest national executive search firm in the United States. Most, if not all, studies addressing self-employed individuals' job satisfaction have been based on secondary data, e.g., Naughton (1987) and Hundley (2001) used data from the 1977 Quality of Employment Survey for their studies; Blanchflower and Oswald (1998) used the National Child Development Study; and Bradley and Roberts (2004) used the National Survey of Families and Households. Studying entrepreneurs, Cooper and Artz (1995) used data from a data set collected by the National Federation of Independent Businesses. The use of secondary data limit the opportunity to test recognized job satisfaction models as these studies only examined individual variables of job satisfaction, e.g., autonomy (Hundley, 2001; Naughton, 1987), not job satisfaction models. As this shows, little, if anything, is known about how and why executives of small businesses are satisfied. This is despite the job satisfaction literature has established three models that have successfully accounted for job satisfaction. These are the situational,

dispositional, and interactional models. The three models have been used extensively to predict the job satisfaction of employed individuals in organizations. Due to the variety of samples used in the literature, some may assume that these job satisfaction models apply to small business executives. This, however, has not been empirically tested. Thus, the purpose of this study is to account for job satisfaction of executives of small businesses using the situational, dispositional, and interactional job satisfaction models.

## **LITERATURE REVIEW AND HYPOTHESES**

### **The Situational Model**

The situational model suggests that job satisfaction is derived from the job characteristics. This approach is based on the implicit assumption that all persons have similar needs and are, therefore, satisfied by the same job characteristics. The most recognized situational model is the Job Characteristics Model (JCM; Hackman & Oldham, 1980). Even though the JCM includes individual differences (*growth need strength*) in association with the job characteristics, it has for the most part been used as a content model where job dimensions are correlated directly with job satisfaction (Loher, Noe, Moeller, & Fitzgerald, 1985; Fried & Ferris, 1987). Thus,

*H1: Task variety will be positively associated with job satisfaction.*

*H2: Autonomy will be positively associated with job satisfaction.*

*H3: Task identity will be positively associated with job satisfaction.*

*H4: Feedback will be positively associated with job satisfaction.*

### **The Dispositional Model**

The dispositional job satisfaction model argues that certain relatively stable characteristics of a person influence job satisfaction independently of the job characteristics and situation (Judge, Heller, & Mount, 2002). In 1976, Locke suggested that the dispositional approach may be useful in explaining job satisfaction and, since then, the dispositional model has made important contributions to the OB literature (House, Shane, & Harold, 1996). Many of these contributions have been made using the five personality factors (Big Five, Goldberg, 1990) as a framework representing the dispositional approach.

The Big Five provides a useful taxonomy for the personality (dispositional) construct (Ozer & Reise, 1994) and has been generalized across measures, cultures, and sources of ratings (Barrick & Mount, 1991). Despite the Big Five provides a useful personality model, dispositional job satisfaction research has focused on isolated personality factors of the Big Five, e.g., neuroticism. This practice continues even that the use of individual personality factors does not provide an appropriate dispositional model, or as pointed out by Shaver and Scott, “*don’t send a scale to do an inventory’s job*” (1991: 32). As the Big Five provides a more comprehensive taxonomy of personality, using all five personality factors as a dispositional model improves conclusion validity relative to the practice of focusing on one or two *a priori* selected personality factors. In spite of these positive aspects of the Big Five as a personality model, it has received limited attention in job satisfaction literature (Judge et al, 2002). Thus, it is deemed appropriate

to examine all five personality factors of the Big Five in this study. Further, in accordance with the meta-analytic findings of Judge and associates (2002), it is hypothesized that

*H5: Neuroticism will be negatively associated with job satisfaction.*

*H6: Extraversion will be positively associated with job satisfaction.*

*H7: Openness to experience will be negatively associated with job satisfaction.*

*H8: Agreeableness will be positively associated with job satisfaction.*

*H9: Conscientiousness will be positively associated with job satisfaction.*

### **The Interactional Model**

The interactional model states that the fit between the person and environment influences job satisfaction (Chatman 1989). This approach is known as the Person-Environment Fit (P-E Fit) model. Spokane (1985) reviewed the P-E Fit literature and concluded that the P-E Fit is positively related to job satisfaction. Also, in their empirical meta-analysis, Assouline and Meir (1987) found support for a positive relation between P-E Fit and job satisfaction. Thus,

*H10: P-E Fit will be positively associated with job satisfaction.*

## **METHODOLOGY**

A survey instrument was administered to 406 executives of small companies selected from the Rocky Mountain High Technology Directory using a two-contact procedure (Salant & Dillman, 1994) yielding gross response rate of 21 percent. Seven surveys from female respondents and three surveys from non-Caucasian respondents were eliminated due to the potential for generating background noise. Additionally, two surveys were eliminated – one with minus 400 percent in sales growth and one with 700 employees. The later was eliminated to focus on small firms with 350 or less employees. This reduced the sample to 65 usable surveys from male executives. A test for non-response bias showed no significant differences at the .05 level between respondents and non-respondents.

### **Measures**

Job satisfaction, the dependent variable, was measured using the Minnesota Satisfaction Questionnaire (MSQ; Weiss, Dawis, England, & Lofquist 1967). The MSQ was modified by eliminating three items that address satisfaction with supervisors since the subjects typically do not have a supervisor in the traditional understanding. The reliability coefficient for the modified MSQ used in the present study was 0.91.

The four job characteristics variables were measured using the Job Characteristics Inventory (JCI; Sims, Szilagyi, & Keller, 1976). The JCI was used because it has been recommended for use with MSQ (Pierce, McTravish, & Knudsen, 1986), it mirrors the job characteristics-construct (Pierce et al., 1986), it has been found to be psychometrically better than Hackman and Oldham's (1975) Job Diagnostic Survey (Aldag, Barr, & Brief, 1981; Pierce & Dunham, 1978),

it has four to six items per job dimension which is necessary to achieve adequate validity (Idaszak, Bottom, & Drasgow, 1988), and it does not have any reversed-scored items introducing additional variance (Harvey, Billings & Nilan, 1985; Idaszak & Drasgow, 1987). Further, the coefficient alpha reliability estimate for the JCI has been referred to as “sufficiently high for research purposes” (Fried, 1991: 691). In this study, the reliability coefficient for the JCI was 0.81.

The five personality variables were measured using the NEO-Five Factor Inventory Form S (NEO-FFI; Costa & McCrae, 1991). Validity for the five factors of the NEO-FFI has been examined across a large number of studies providing strong evidence of convergent and discriminant validity (McCrae & Costa, 1987; Costa & McCrae, 1991).

The person-environment fit (P-E Fit) variable was measured using lack of stress as a proxy. The use of lack of stress as a proxy for P-E Fit was chosen based on this quote: “*stress is defined as a lack of person-environment fit*” (Eulberg, Weekley, & Bhagat, 1988: 337). These researchers also pointed out that lack of P-E Fit can be identified only by an individual’s experience of stress. Stress was measured using a 16-item measure, which has been used in another study of executives’ job satisfaction (Judge et al., 1994). Judge and colleagues (1994) reported that the stress measure had a reliability estimate of 0.84; in the present study, it was 0.87.

The control variables included age, education, job tenure, firm size (number of employees), and firm performance (sales growth).

## Data Analysis

Ordinary least squares hierarchical regression analyses were used to test the hypotheses. These were performed in two steps with the control variables entered first and the independent variables second making it possible to determine the amount of unique variance accounted for by each of the three models. By calculating the change in the adjusted coefficient of determination (adjusted  $\Delta R^2$ ), it was possible to compare the amount of unique variance accounted for by each model as the number of independent variables included in the regression equation and the sample size were taken into account in the adjusted coefficient of determination (Hair, Anderson, Tatham, & Black, 1998).

## RESULTS

Table 1 shows the means, standard deviations, and correlations for the variables used in models. The mean for the job satisfaction measure was 3.94 which suggest that the respondents were *very satisfied* with their jobs. All independent variables, except for openness to experience and agreeableness, were positively correlated with job satisfaction at the 0.05 level.

[Table 1 about Here]

Table 2 presents the regression results. Model 1 displays the regression results for the control variables only. The adjusted  $R^2$  for the control variables (model 1) was 0.190 ( $F = 3.996^{**}$ ). The results for situational, dispositional, and interactional approaches are shown in models 2-4, respectively. The situational variables (model 2) explained 19 percent of unique variance (adjusted  $\Delta R^2 = 0.192$ ,  $F = 5.381^{***}$ ). Hypotheses 1 (task variety), 2 (autonomy), and 4

(feedback) were supported at the 0.10-level of significance. The dispositional variables (model 3) accounted for 14 percent of unique variance (adjusted  $\Delta R^2 = 0.139$ ,  $F = 4.132^{***}$ ). Hypotheses 5 (neuroticism), 6 (extraversion), and 9 (conscientiousness) were supported at the 0.10-level of significance. The interactional variable (model 4) accounted for 17 percent unique variance (adjusted  $\Delta R^2 = 0.166$ ,  $F = 6.876^{***}$ ). Model 4 shows that hypothesis 10 (P-E Fit) was supported.

[Table 2 about Here]

Additional regression analyses were performed where the not-significant variables were eliminated from consideration. The regression results for a model that considered task variety, autonomy, and feedback showed similar support for hypotheses 1, 2, and 4 as model 2 (Table 2) and had a marginally improved fit with the data (adjusted  $\Delta R^2 = 0.189$ ,  $F = 5.873^{***}$ ). The regression results for a model that considered neuroticism, extraversion, and conscientiousness showed similar support for hypotheses 5, 6, and 9 as model 3 (Table 2). This model accounted for more job satisfaction variance and had better fit with the data (adjusted  $\Delta R^2 = 0.162$ ,  $F = 5.344^{***}$ ) than model 3 (Table 2).

## DISCUSSION

The results of the present study show that the interactional model predicts job satisfaction best among the three individual job satisfaction models as it accounted for 17 percent of job satisfaction variance (adjusted  $\Delta R^2 = 0.166$ ,  $F = 6.879^{***}$ ). Even that the situational model accounted for more job satisfaction than the interactional model, it did not fit the data as well as the interactional model as shown by the F-scores for models 2 and 4 (Table 2). The dispositional model accounts for less job satisfaction variance and fits the data less well than either of the two other job satisfaction models. This was also the case when the not-significant dispositional variables were excluded from consideration.

The results of the present study were compared with meta-analyses on the job characteristics (Behson, Eddy, & Lorenzet, 2000; Fried & Ferris, 1987), and the Big Five (Judge et al., 2002); where as for P-E Fit, the results of the present study were compared with the findings of Judge and associates (1994) as no meta-analysis is available based on the measure used. For the situational model, it appears that the correlations for the four job characteristic variables found in the present study were in line with the meta-analytic study by Fried and Ferris (1987) with one noticeable difference. The feedback-job satisfaction correlation had a larger magnitude than the correlation found by Fried and Ferris (1987) and the direct correlation found by Behson and associates (2000). For the dispositional model, the regression results found in the present study were in line the regression coefficients found in the meta-analysis by Judge and associates (2002). For the interactional model, the magnitude of the P-E Fit and job satisfaction relationship in the present study was similar to the results reported by Judge and colleagues (1994). Thus, it appears that the results of the present study were in line with the literature with one exception: feedback.

The results found in the present study regarding feedback suggest that feedback is an important antecedent for small business executives' job satisfaction. It also illustrates that research which

focuses on autonomy only, like Hundley (2001) and Naughton (1987), is limited in consideration of important situational factors influencing job satisfaction.

Comparing the interactional (P-E Fit) and dispositional (Big Five) job satisfaction models using the same sample, Tokar and Subich (1997) provided one of the very rare studies that directly compare job satisfaction models. These researchers found that neuroticism and extraversion were significantly related to satisfaction but P-E Fit was not. This is surprising as the commonly held assumption that the P-E Fit model is a superior model because it simultaneously considers both the person and situation was challenged by their empirically findings. Consistent with the findings by Tokar and Subich (1997), the present study showed that neuroticism and extraversion were significantly related to job satisfaction. However, in the present study the correlations between job satisfaction for neuroticism and extraversion, respectively, was larger in magnitude than found by Tokar and Subich (1997). Further, support was found, in the present study, for a significant correlation between conscientiousness and job satisfaction. The relationships between job satisfaction and neuroticism, extraversion, and conscientiousness, respectively, were also substantiated by the regression results in the present study. Unlike the findings by Tokar and Subich (1997), the present study found support for a strong and significant relationship between job satisfaction and P-E Fit; shown by the zero-order correlation and the regression coefficient. Further, the data fit the P-E Fit model better than the dispositional model (regardless of all five personality variables or only the three significant variables were considered) shown by the larger F-score for the interactional model in Table 2. Additionally, when the number of variables was taken into consideration, the P-E Fit model accounted for 16.6 percent of job satisfaction variance (adjusted  $\Delta R^2 = 0.166$ ,  $F = 6.876^{***}$ ) where as the dispositional model accounted for 13.9 percent of unique job satisfaction variance (adjusted  $\Delta R^2 = 0.139$ ,  $F = 4.132^{***}$ ). As this shows, the interactional (P-E Fit) model is superior in explaining job satisfaction than the dispositional model. This is consistent with the argument made in favor of the interactional model (Chatman, 1989). However, the results of the present study challenge the findings from the study by Tokar and Subich (1997).

Unlike the study by Tokar and Subich (1997), the present study also included the situational model. By finding that the situational model is also superior to the dispositional model, in terms of fit with the data and unique job satisfaction variance account for by the model, the present study moves beyond the study by Tokar and Subich (1997).

In sum, the present study makes important steps in advancing the literature by providing theory-driven explanations of small and medium-sized business executives' job satisfaction, by empirically challenging controversial findings found in an important study by Tokar and Subich (1997), and by providing empirical evidence on which of the three most recognized job satisfaction models is best at explaining job satisfaction.

## **Limitations**

Self-reported data are suspect of common method variance (Podsakoff & Organ, 1986). Thus, a Harman's One-Factor Test and a visual inspection of the correlations were conducted (Podsakoff & Organ, 1986). The Harman's One-Factor Test returned four factors accounting for 71 percent of variance. Further, no correlation was in excess of 0.58 between the independent variables. Thus, common method variance was not considered a serious threat to the present study.

Another limitation is the models tested in the present study were content models meaning that no mediators or moderators were included. Content models were used to make it possible to compare the three approaches to one another. Considering that it is the purpose of a study that should determine whether it is a process or a content model that needs to be examined (Behson et al., 2000), it was deemed appropriate to use content models for the present study. The last limitation considered here is the small sample size. As with all research, generalizing results must be done with care. As this study generated interesting findings based on a small sample size, additional research is called for to verify (or reject) the findings of the present study.

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**TABLE 1**  
**Means, Standard Deviations, and Correlations <sup>a</sup>**

|                      | Mean  | s.d.  | 1                    | 2                   | 3                 | 4                  | 5                   | 6                  | 7                   | 8                   | 9                   | 10                 | 11                   | 12                | 13                 | 14                | 15                 |
|----------------------|-------|-------|----------------------|---------------------|-------------------|--------------------|---------------------|--------------------|---------------------|---------------------|---------------------|--------------------|----------------------|-------------------|--------------------|-------------------|--------------------|
| 1 Job Satisfaction   | 3.94  | 0.57  |                      |                     |                   |                    |                     |                    |                     |                     |                     |                    |                      |                   |                    |                   |                    |
| 2 Age                | 3.48  | 1.11  | 0.28 <sup>*</sup>    |                     |                   |                    |                     |                    |                     |                     |                     |                    |                      |                   |                    |                   |                    |
| 3 Education          | 5.00  | 1.39  | 0.25 <sup>*</sup>    | 0.26 <sup>*</sup>   |                   |                    |                     |                    |                     |                     |                     |                    |                      |                   |                    |                   |                    |
| 4 Job Tenure         | 9.82  | 8.71  | 0.30 <sup>**</sup>   | 0.38 <sup>***</sup> | -0.15             |                    |                     |                    |                     |                     |                     |                    |                      |                   |                    |                   |                    |
| 5 Firm Size          | 43.45 | 74.42 | -0.13                | 0.28 <sup>*</sup>   | 0.22 <sup>*</sup> | -0.15              |                     |                    |                     |                     |                     |                    |                      |                   |                    |                   |                    |
| 6 Firm Performance   | 22.22 | 44.58 | 0.11                 | -0.21 <sup>*</sup>  | 0.05              | -0.17 <sup>†</sup> | 0.04                |                    |                     |                     |                     |                    |                      |                   |                    |                   |                    |
| 7 Task Variety       | 3.67  | 0.42  | 0.42 <sup>***</sup>  | 0.23 <sup>*</sup>   | 0.12              | 0.15               | -0.07               | 0.24 <sup>*</sup>  |                     |                     |                     |                    |                      |                   |                    |                   |                    |
| 8 Autonomy           | 4.47  | 0.51  | 0.40 <sup>***</sup>  | 0.20 <sup>†</sup>   | 0.12              | 0.24 <sup>*</sup>  | -0.35 <sup>**</sup> | 0.00               | 0.29 <sup>**</sup>  |                     |                     |                    |                      |                   |                    |                   |                    |
| 9 Task Identity      | 4.28  | 0.76  | 0.30 <sup>**</sup>   | 0.20 <sup>†</sup>   | 0.07              | 0.11               | -0.26 <sup>**</sup> | 0.00               | 0.35 <sup>**</sup>  | 0.58 <sup>***</sup> |                     |                    |                      |                   |                    |                   |                    |
| 10 Feedback          | 3.22  | 0.85  | 0.49 <sup>***</sup>  | 0.08                | 0.20 <sup>†</sup> | 0.04               | -0.02               | 0.28 <sup>*</sup>  | 0.35 <sup>**</sup>  | 0.12                | 0.38 <sup>***</sup> |                    |                      |                   |                    |                   |                    |
| 11 Neuroticism       | 2.57  | 1.02  | -0.48 <sup>***</sup> | -0.16 <sup>†</sup>  | -0.14             | -0.17 <sup>†</sup> | 0.18 <sup>†</sup>   | -0.02              | -0.31 <sup>**</sup> | -0.30 <sup>**</sup> | -0.20 <sup>†</sup>  | -0.21 <sup>*</sup> |                      |                   |                    |                   |                    |
| 12 Extraversion      | 3.52  | 0.95  | 0.42 <sup>***</sup>  | 0.16                | 0.15              | 0.12               | 0.04                | 0.09               | 0.22 <sup>*</sup>   | 0.01                | 0.10                | 0.33 <sup>**</sup> | -0.47 <sup>***</sup> |                   |                    |                   |                    |
| 13 Openness          | 3.20  | 0.89  | 0.13                 | -0.13               | 0.13              | -0.01              | -0.32 <sup>**</sup> | 0.08               | 0.08                | 0.25 <sup>*</sup>   | 0.43 <sup>***</sup> | 0.23 <sup>*</sup>  | 0.01                 | 0.08              |                    |                   |                    |
| 14 Agreeableness     | 2.86  | 1.12  | 0.13                 | 0.18 <sup>†</sup>   | 0.15              | 0.09               | -0.04               | -0.23 <sup>*</sup> | 0.02                | 0.20 <sup>†</sup>   | 0.29 <sup>**</sup>  | -0.12              | 0.00                 | 0.22 <sup>*</sup> | 0.15               |                   |                    |
| 15 Conscientiousness | 3.09  | 1.04  | 0.42 <sup>***</sup>  | 0.21 <sup>*</sup>   | 0.17 <sup>†</sup> | 0.24 <sup>*</sup>  | -0.06               | -0.13              | 0.24 <sup>*</sup>   | 0.23 <sup>*</sup>   | 0.33 <sup>**</sup>  | 0.20 <sup>†</sup>  | -0.42 <sup>***</sup> | 0.23 <sup>*</sup> | 0.30 <sup>**</sup> | 0.19 <sup>†</sup> |                    |
| 16 P-E Fit           | 3.70  | 0.55  | 0.52 <sup>***</sup>  | 0.20 <sup>†</sup>   | -0.01             | 0.23 <sup>*</sup>  | -0.25 <sup>*</sup>  | -0.06              | 0.25 <sup>*</sup>   | 0.46 <sup>***</sup> | 0.43 <sup>***</sup> | 0.07               | -0.48 <sup>***</sup> | 0.17 <sup>†</sup> | 0.06               | 0.29 <sup>*</sup> | 0.35 <sup>**</sup> |

Note: All correlations are one-tailed. † p ≤ 0.10; \* p ≤ 0.05; \*\* p ≤ 0.01; \*\*\* p ≤ 0.001

<sup>a</sup> n = 65.

**TABLE 2**  
**Hierarchical regression results on Job Satisfaction**

| Variable/Model           | 1                   | 2                    | 3                    | 4                    |
|--------------------------|---------------------|----------------------|----------------------|----------------------|
| Age                      | 0.21 <sup>†</sup>   | 0.09                 | 0.14                 | 0.10                 |
| Education                | 0.27 <sup>*</sup>   | 0.14                 | 0.16 <sup>†</sup>    | 0.26 <sup>**</sup>   |
| Job Tenure               | 0.26 <sup>*</sup>   | 0.18 <sup>†</sup>    | 0.17 <sup>†</sup>    | 0.22 <sup>*</sup>    |
| Firm Size                | -0.22 <sup>*</sup>  | -0.08                | -0.15                | -0.08                |
| Firm Performance         | 0.19 <sup>*</sup>   | 0.00                 | 0.18 <sup>†</sup>    | 0.18 <sup>*</sup>    |
| Task Variety             |                     | 0.18 <sup>†</sup>    |                      |                      |
| Autonomy                 |                     | 0.28 <sup>*</sup>    |                      |                      |
| Task Identity            |                     | -0.15                |                      |                      |
| Feedback                 |                     | 0.41 <sup>***</sup>  |                      |                      |
| Neuroticism              |                     |                      | -0.19 <sup>†</sup>   |                      |
| Extraversion             |                     |                      | 0.19 <sup>†</sup>    |                      |
| Openness                 |                     |                      | -0.01                |                      |
| Agreeableness            |                     |                      | 0.02                 |                      |
| Conscientiousness        |                     |                      | 0.21 <sup>†</sup>    |                      |
| P-E Fit                  |                     |                      |                      | 0.44 <sup>***</sup>  |
| R <sup>2</sup>           | 0.253               | 0.468                | 0.433                | 0.416                |
| ΔR <sup>2</sup>          |                     | 0.215 <sup>***</sup> | 0.181 <sup>**</sup>  | 0.163 <sup>***</sup> |
| Adjusted R <sup>2</sup>  | 0.190               | 0.381                | 0.329                | 0.355                |
| Adjusted ΔR <sup>2</sup> |                     | 0.192                | 0.139                | 0.166                |
| F                        | 3.996 <sup>**</sup> | 5.381 <sup>***</sup> | 4.132 <sup>***</sup> | 6.876 <sup>***</sup> |
| Df                       | 59                  | 55                   | 54                   | 58                   |

† p ≤ 0.10; \* p ≤ 0.05; \*\* p ≤ 0.01; \*\*\* p ≤ 0.001

<sup>a</sup> n = 65.

**“I’LL HAPPILY TELL YOU WHAT I THINK (NOW)”:  
A METHODOLOGICAL ISSUE IN ENTREPRENEURSHIP RESEARCH**

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**ABSTRACT**

To elucidate the processes involved in the creation of new businesses, entrepreneurship researchers often turn first to the business founders. In principle, entrepreneurs possess information (especially concerning motivation and intentions) often unavailable to others. Because entrepreneurs are frequently contacted years after the business was being organized, there is risk that retrospective biases will adversely affect the data collected. One challenge is that events themselves change in the early days: entrepreneurs develop expertise, markets expand, strategic plans are modified. When the target of inquiry changes, it makes little sense to describe a correspondingly changed description as a “bias.” Another challenge is that entrepreneurs are typically not interviewed for several years running. Both of these difficulties are reduced in the Panel Study of Entrepreneurial Dynamics (PSED). One important item asked respondents to indicate their level of satisfaction with the job they held immediately *prior to* initiating their ventures. It is reasonable to assume that this inquiry target – the last job you had prior to starting your venture – remains stable. In the PSED there were four waves of data in which satisfaction with that job was assessed. The pattern of data over this four-year period showed a slight increase in satisfaction from Wave 1 to Wave 4. More importantly, recollections of satisfaction were also related to participant sex and nascency status (partially autonomous or fully autonomous). These results argue for more caution in the interpretation of entrepreneurial recollections: What they say now is not always what they would have said then.

**INTRODUCTION**

Researchers have often relied on entrepreneurs’ retrospective accounts as a means of reconstructing the entrepreneurial process or parts of the process (e.g., Bhava, 1994; Brockhaus, 1980; Hisrich & Brush, 1986) on the assumption that such accounts are reliable and valid. Entrepreneurs certainly have important information about the entrepreneurial process, often including details known only to them. Their retrospective reports are typically thought to establish facts, attitudes, beliefs, activities, and motives related to venture formation. These

retrospective accounts are often the basis for model testing and advancing our understanding of entrepreneurship.

Unfortunately, retrospective reports may not have shoulders broad enough to carry the burden they currently bear, although the potential problems have not been examined adequately in the entrepreneurship literature. Is what I tell you *now* about what it was like *then* really the way it was, or is it the way I would now like for it to have been? In the strategic management literature the impact of retrospective bias has been critically reviewed (Huber & Power, 1985; Schwenk, 1985) and empirically examined (Bukszar & Connolly, 1988; Golden, 1992), but in entrepreneurship the issue has been addressed (if at all) primarily as a potential limitation of prior research (e.g., by Carter, Gartner, Shaver, & Gatewood, 2003). Thus, the purpose of our study is to draw attention to the issue of retrospective bias in entrepreneurship research. Part of the difficulty, of course, is that in most cases “then” and “now” are collected at the same time. With four waves of data collection from the same nascent entrepreneurs, the Panel Study of Entrepreneurial Dynamics (PSED, data and descriptions available from the Institute for Social Research at the University of Michigan, at <http://projects.isr.umich.edu/pсед>) provides allows us to obtain a “then” that was really then, and a “now” that is really now.

## LITERATURE REVIEW

Four primary reasons for entrepreneurs to provide inaccurate or biased data were identified by Huber and Power (1985):

1. The entrepreneurs are motivated to do so.
2. The entrepreneurs’ perceptual and cognitive limitations and biases.
3. The entrepreneurs lack information about the issue of interest.
4. Inappropriate data elicitation procedure has been used.

Huber and Power (1985) point out that the first two data distortions are linked, because motivation influences perception and cognition, and perception and cognition set the stage for motivation. Motivationally influenced biases may be intentional or unintentional. Need for achievement and social acceptance may be reasons for providing inaccurate or biased data. Although no finding can be considered etched in stone, researchers beginning with McClelland (1965) have noted that entrepreneurs have a high need for achievement (more recently, a review by Johnson (1990) showed the relationship in 20 of 23 studies conducted with entrepreneurs. Thus, entrepreneurs may be motivated to show others that they are successful. As they report the successes to others they are also confirming their high achievement to themselves. This motivation to distort the data may also be due to social desirability (March & Feldman, 1981).

Entrepreneurs’ cognitive and perceptual limitations and biases (Baron, 1998; March & Simon, 1958) also play an influence in retrospective reports. People have imperfect recall of the past. For example, Wilson, Meyers and Gilbert (2003) found that recollection of positive events was subject to a focal bias where people think about the event in isolation and neglect to consider other aspects influencing the event. These researchers also found that a retrospective bias in recollection of negative events depended on whether the individual continued to rationalize the negative outcomes at the time of recall. Also, entrepreneurs may be susceptible to hindsight bias (Fischhoff, 1975). In three experiments, Fischhoff examined whether people could make the

empathic leap into the past when they knew the actual outcome. Not only did knowledge of the outcome increase the postdicted likelihood of events, the research participants were largely unaware that it had done so. Bukszar and Connolly (1988) examined hindsight bias in strategic decision making and found support for presence of hindsight bias. Especially in an arena – business – where success is very important, entrepreneurs are likely to be susceptible to the well-known self-serving attributional bias (Bradley, 1978). Indeed, this sort of bias has already been shown among participants in the PSED (Gartner & Shaver, 2002). Other perceptual distortions may influence recall that stem from the need for cognitive consistency which may affect recollection by removing or reducing inconsistencies between information and beliefs and from the need for simplification, condensation, and rationalization (Schwenk, 1985).

Few will contend that the new venture creation is not a complex process. Also, few will contend that the entrepreneur has full information regarding the new venture creation process and all its aspects, including ever changing market forces. As a result, entrepreneurs experience information overload in some areas and lack information in other areas. As discussed earlier, the experience of information overload is reduced through simplification and retaining information that is consistent with previous beliefs which in itself creates potential for recall bias. Also, lack of information may result in recall of unintentional inaccuracies. For example, second-hand information and imagination may fill information gaps that, in turn, may lead the entrepreneur unintentionally to report inaccurate information.

The data elicitation procedures may also cause unintended inaccuracies by limiting or biasing the information collected. Kahneman and Tversky (1979) speculated that the framing of questions may produce a recall bias. Their speculation was supported (e.g., Sprangers & Hoogstraten, 1989; Sudman & Bradburn, 1983). In a multiple-wave design, however, where the data collection procedures are identical across waves, question framing is a constant that will not affect responses from one wave to the next.

The biases and inaccuracies unique to the individual are of critical importance when studying entrepreneurship because, many times, the number of respondents who can report on the entrepreneurial process for a venture is limited. Thus, inaccurate or biased information introduced by one respondent is unlikely to be offset by another respondent in the same venture. So, how predominant is retrospective bias in accounts reconstructing the past? The strategic management literature may provide a first clue.

In a study of 259 CEOs of hospitals, Golden (1992) found that 58 percent of the respondents recollected incorrectly strategies they had reported two years earlier. What is most interesting is the extent of the retrospective bias found by Golden – nearly 60 percent of the respondents were influenced. Golden further examined the causes for the retrospective bias. He found that faulty memory or a desire for past behavior to look good could account for the retrospective bias, which is consistent with the work by Huber and Power (1985). Yet, to our knowledge, no study in the entrepreneurship literature has examined whether entrepreneurs are inclined to bias their retrospective accounts.

Fortunately, the body of entrepreneurship data now contains an excellent way to test for the presence of retrospective bias, the PSED. Because of its longitudinal design, participants in the

PSED were asked a number of questions concerning personal motivation once per year for as many as four years. The first interview occurred in the very early stages of business creation, subsequent interviews obviously occurred later in the organizing process. Many of these items might be expected to change over time, as the entrepreneurs gain experience, and success. On the other hand, there is one item that deals with something that does not change as time goes forward. That is the respondent's last job prior to beginning the entrepreneurial organizing. Because that job was effectively defined as over in the first wave of measurement, the *job itself* will not change as time goes forward. The respondent's *recollection* of it might change – indeed, we trust that it will. Because the stimulus is constant, alterations in the perception of it can be taken as evidence for changes in memory through time. .

## METHOD

The sample for the PSED was identified in random-digit dialing calls made by Market Facts (a national marketing company) to 64,622 U.S. households. These initial screening calls, made in successive waves of 1000 between July 1998 and January 2000, identified potential nascent entrepreneurs by their responses to two questions:

- Are you, alone or with others, now trying to start a business?
- Are you, alone or with others, now starting a new business or a new venture for your employer?

An affirmative answer to the first question identified potential nascent entrepreneurs, an affirmative answer to the second identified potential nascent intrapreneurs. Before being included in the sample, people were also asked whether (a) they expected some degree of ownership of the new venture, and (b) they had been active in organizing the business within the preceding 12 months. The screener identified a pool of individuals who were then approached by the University of Wisconsin Survey Research Laboratory (UWSRL) who conducted a full telephone interview with willing respondents, then sent a follow-up mail questionnaire. Participants were paid \$25 for the phone interview, and another \$25 for returning the mail questionnaire. Complete details concerning the PSED can be found in a recent book by Gartner, Shaver, Carter, and Reynolds (2004).

The numbers of respondents present in the sample at every stage have been described in detail by Shaver, Carter, Gartner, & Reynolds (2001) and will not be repeated here. The entire pool of respondents consisted of 830 potential nascent entrepreneurs and 431 people in a comparison group. Consensus among researchers investigating psychological variables in business creation is that the more appropriate sample is the 1,216 people (715 fully autonomous entrepreneurs, 102 partially autonomous entrepreneurs, and 399 members of the comparison group) identified by Shaver, et al. (2001).

The job satisfaction item used as our indicator of possible retrospective bias was included in the mail survey, not the telephone interviews, so our effective sample was limited to the 871 who had returned the mail questionnaire (an impressive 71.63% of those who completed the phone interviews). Questions about the respondent's job history began with mail survey item Qi2, "The last time you had a job working for someone else or in an established organization, what was

your job title?” After items about what the respondent did, how many years and months the respondent had held the job, and three items about the organizational structure, Qi8 asked “How satisfied were you with this job?” with answers scored as a 5-point Likert-type scale with response alternatives ranging from Very Dissatisfied (scored as 1), to Very Satisfied (scored as 5).

Now because we are interested in the backward-looking impressions of *entrepreneurs*, we next restricted the sample to the 545 people who were in the process of starting businesses and had answered the question about job satisfaction in the first wave of the research. This group included 472 fully autonomous entrepreneurs (241 females, 231 males) and 73 partially autonomous entrepreneurs (41 females, 32 males)

## RESULTS

One advantage of the PSED dataset is that it includes post-sampling stratification weights (based on such things as education, region, and age) that permit the aggregate data to be generalized to the U.S. population as a whole. Not only did the weighting procedures (described in detail in the Gartner, et al., 2004, book) take demographics into account, they also corrected for sampling biases and differential non-response within the first wave. Specifically, for example, half of the initial prescreening calls were made (with support from the National Science Foundation) to oversample people whose absolute numbers of business starts might not otherwise have been sufficient to permit detailed analysis. A grant to Nancy M. Carter (SOC 9809841 provided support for an oversampling of women, and a grant to Patricia G. Greene (SOC 9905255) provided support for an oversampling of minorities. By the very nature of these projects, there were alterations in selection probabilities (e.g., the process to oversample women was designed to produce essentially no male respondents). Again, consensus among the researchers directly involved in the PSED is that all analyses should use weighted data. Moreover, the weights should be renormalized whenever the whole sample is “cut” (e.g. into cells that involve nascency status and respondent sex). We have followed these recommendations, so all the analyses reported here are based on weighted data. (It should be noted that the weights are to correct for potential biases in *sampling*, not for attrition, so even where we report data from waves 2-4, the variables involved are weighted by renormalized versions of the wave 1 sampling weights.

Perhaps the most direct test of whether perceptions of one’s former job change over time is a 2 x 2 x 4 (Respondent Sex x Nascency Status x Wave) repeated-measures analysis of variance with Wave being the repeated measure. Remember that job satisfaction was measured on a 5-point scale with 5 representing “very satisfied.” The mean scores for respondent groups by PSED waves are shown in Figure 1. Two things are immediately apparent. First, there was greater

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Insert Figure 1 about here

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variation over time among partially autonomous females than among any other group of respondents. Second, with the exception of those partially autonomous females, the general trend was for recalled job satisfaction to increase slightly over time. Together, these outcomes produced a three-way interaction that was just a shade away from being significant,  $F(3, 537) = 4.80, p = .052$ . In other words, with the exception of the partially autonomous females, the view of one's prior job became a little more rosy as the job faded into the distance.

The difficulty with a repeated measures design, of course, is that it assesses the responses of only those people who were present for all four waves. In the first wave there had been 545 respondents, but by the fourth wave the number of always-present respondents was down to 183. Some respondents could be contacted in one wave, but not the next, and some who had been missed in a wave were contacted the next time around. As a result, the total numbers of respondents who answered the job satisfaction item were 545 (wave 1), 332 (wave 2), 290 (wave 3) and 334 (wave 4). To make use of as much data as possible, we did univariate 2 x 2 (Respondent Sex x Nascency Status) analyses of variance separately for each wave. The first three of these showed no significant differences based on sex or nascency status. Overall mean scores for remembered job satisfaction were 3.55, 3.63, and 3.63 (for waves 1-3, respectively). The overall remembered job satisfaction for wave 4 was 3.94, despite the fact that partially autonomous females had an average score nearly a point lower than that of the other three groups. This interaction was nearly significant,  $F(1, 330) = 3.47, p = .06$ . The picture provided by these separate analyses complements the one from the repeated measures analysis – by the fourth year away from it, one's prior job looks better and better.

## DISCUSSION

Under almost the best of circumstances, researchers find their way to existing entrepreneurial companies several years after the initial organizing effort. By the time an entrepreneurial company has created a niche for itself, generated positive cash flow for a year or two, and come to the attention of researchers interested in its organizing process, questions about “the beginnings” will necessarily be retrospective. As we noted earlier, both the general psychological literature and the strategic management literature provide reasons to be wary of such retrospective reports.

In entrepreneurship, by specific comparison to strategic management, there are often two structural reasons why it is exceedingly difficult to separate biased memories from accurate reflections. First, an existing firm that has a corporate *strategy* may very well have that strategy written down. Or might be of a sufficient size that the recollections of one respondent could be compared with those of another respondent also present at the time the strategy was devised. At the very least, the firm might be able to produce documents (or, increasingly, internal emails) that could serve as a form of contemporaneous record. Second, although no strategy is completely impervious to events, it does serve as a way for the firm to deal with those events. Thus, in the normal course of business, the strategy is likely to be “refreshed” from time to time. By contrast, in an entrepreneurial firm, the *organizing events* typically occur only once, early in the life of the firm. There might have been very few people there to observe them, they are

unlikely to have been refreshed through the years, and their interpretation is highly subject to modifications based on the current success of the business.

The challenge for entrepreneurship has been to find some “target” known to be stable, and then to ask entrepreneurs about that target over a period of several years. Because an entrepreneur’s *prior* job, the last one held before beginning the organizing activities, does not change, it can serve as a very stable target. And thanks to the longitudinal nature of the PSED, respondents were asked to recall their satisfaction with that prior job in each of four succeeding years. Whether the results we obtained show a cup that is half full or half empty may depend on who is making the judgment. True, during the first three years of organizing, reflections on one’s prior job were relatively stable, with a slight upward trend. In the fourth year, however, our respondent groups parted company. Partially autonomous females now viewed their prior job with decreased satisfaction; fully autonomous females and males in both autonomy categories now expressed increased satisfaction for their prior jobs. Thus, at least by the fourth year, one’s view of a constant past depended on both one’s sex and on the nature of one’s business organizing activity. People in the sample were still happy to tell us what they thought. It just wasn’t quite the same as what they had previously thought. The PSED was obviously not designed as a test of the existence of retrospective biases among entrepreneurs. But at the very least, these PSED data suggest that the problem of retrospective bias in entrepreneurship research deserves much more concerted attention than it has received to date.

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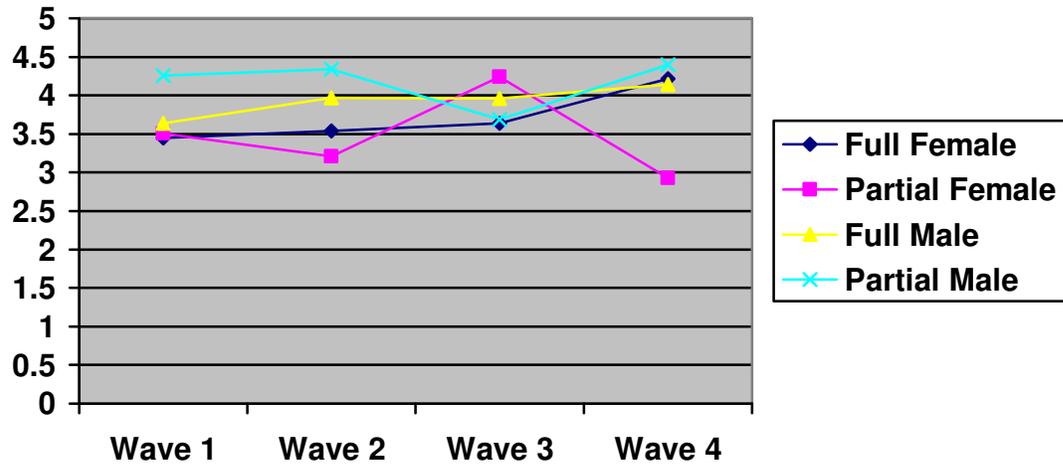


Figure 1: Remembered satisfaction with the last job one held prior to beginning to organize the new venture. Data are classified by whether the current effort is fully autonomous or partially so, and by whether the respondents were female or male.

# INFORMATION SYSTEMS IN SMALL AND MEDIUM ENTERPRISES (SMES) IN INDIA

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**Abstract:** Intention to use Information Systems (IS) and perceived expertise in Information Technology (IT) can drive businesses in the SME world. An empirical study of knowledge entrepreneurs in India is done through an online questionnaire survey, which got responses from a heterogeneous sample of SMEs. Necessity is rated as a prime motivator for entrepreneurship by about 50% of the respondents. We found support to our hypothesis that external stimuli like lack of funding sources (negative stimulus) and stake holder's expertise in Information Technology (positive stimulus) motivate use of IS and Internet in small businesses. We also found a positive relationship between the measures of index of entrepreneurship and perceived use of IS in SMEs. Respondents who rated their products/services high on innovation also rated their expertise in IS and their utility for websites as high.

**Key words:** Information Systems, Small Medium Enterprises, Knowledge Entrepreneur

## Introduction

Use of computer based information systems (IS) in the business world and corporate world in India, has been growing at a momentum higher than that of other industries in the country. During 2002-03, the Information Technology (IT) -enabled services segment grew by 65 percent and revenues from this sector rose from around Rs. 71 billion in 2001-02 to approximately Rs. 117 billion in 2002-03. Has the use of IS and the resulting empowerment of the individual also resulted in a new brand of entrepreneurs who are essentially knowledge workers? Will there be a mushrooming of IT-enabled small businesses in the near future? These are some of the questions we address in our study.

The Small & Medium Enterprises (SME) sector is one of the fastest growing industrial sectors all over the world. However, the Global Entrepreneurship Monitoring Index (April 2003) rated India just above South Africa with an index of 0.04 in the high potential entrepreneurship area. Innovation and technology transfer leverage SME competitiveness in the global knowledge based society. India currently spends less than 2 percent of its GDP on IT, which is very low when compared to the US which spends 5 percent of its GDP on IT or France, which spends 2.7 percent of its GDP on IT. IT is more of an enabler in India than the cause for innovation. Knowledge is increasingly becoming, the world over, the most important factor determining our standard of life, more than land, tools and labour. Our study focuses on the knowledge entrepreneurs of India.

## **Literature Review**

Peter Drucker defines a 'knowledge worker' as- "Someone who knows more about his or her job than anyone else in the organization". Knowledge is the ability to transform our resources to our advantage.

The adoption and use of IT to achieve competitive advantage has received a great deal of attention in IS literature, but essentially in large corporations. Research dealing with just the large corporations creates a potential bias in substantive conclusions about IT because firm size can affect several crucial organizational processes. Most of the SMEs are controlled by individuals, unlike large firms where decisions of IT adoption are relegated to an IT expert. The IT expert and owner merge into one in the SME world. Our paper addresses the scarcity of research dealing with IS in SMEs -especially the lack of research on the contribution of online presence to growth and competitive edge in SMEs. Most IT adoption research dealing with small firms has been exploratory.

IS researchers have suggested that intention models from social psychology can provide a foundation for research on IT adoption by firms and IT usage by individuals. Ajzen's (1991) Theory of Planned Behaviour (TPB) is a well- researched intention model in predicting an important behaviour in a wide variety of domains. As the theory describes an active, deliberate decision process within the constraints of social expectations and limited resources, it is especially useful for studying the strategic adoption of IT in small businesses. In our paper, we empirically examine the capabilities of TPB to predict and explain how small businesses decide to adopt IT to grow and compete as entrepreneurs.

## **Methodology**

Harryson et.al (1997) write that research on IT adoption in small business should be flexible enough to involve a wide variety of ITs, especially when the sample is drawn from a heterogeneous population of SMEs. SME sector is defined as firms with less than 200 employees and whose turnover is less than RS 250 million, a definition acceptable to the funding agencies including banks in the country. Our study examines the responses to a questionnaire survey from a sample population of entrepreneurs in the SME sector drawn from India.

The questionnaire is administered online. Our instrument of survey consist of 12 questions, which measure entrepreneurial index, and ten questions on use and adoption of IT in general. In all, about 2000 emails were sent to SME addresses collected online from the Small Scale Industry website of the Govt. of India, the SME forum at the website of NASSCOM (National Association of Software and Service Companies) and from websites featured in yellow pages. The survey link was also posted on SME related yahoo groups online. We received 79 responses online and 19 offline. While sending emails, which are collected from the websites of the firms, care was taken to avoid back offices of foreign firms and subsidiaries of firms incorporated abroad. The sample of SMEs is thus made up of indigenous and independent entities, not belonging to any large corporate group. When we talk of adoption of IT/IS, we are not looking at a simple task oriented software package or application but a technology designed to meet immediate operational needs and technology as a long term strategic competency.

## Research question

The broad research question we address is “ Does the use of IS motivate knowledge entrepreneurs?” The following hypotheses associate the degree of adoption with a measure of entrepreneurship.

### Hypothesis 1

In SMEs, decisions (intentions) to use IS are a positive linear function of External stimuli and perceived control over adopting IS.

### Hypotheses 2

The degree of adoption of IT in SMEs is a degree of the measure of entrepreneurship of the chief executive.

### Hypotheses 3

Perception of risk/threat is a deterrent in adopting new technology in the case of SMEs.

### Hypotheses 4

Infrastructure bottlenecks cost and hygiene factors are deterrents to use of IS

## Results and analysis

Out of the 88 responses received 31 are from manufacturing, 29 from services, 18 from IT services and 10 from traders. The locations of the firms are widely spread covering major cities of India, having a population of more than 1 million. 70% of the respondents claimed average and good expertise in use of computers. 25% claimed good to professional expertise. 60% of the respondents had no IT training. 80% of the respondents employed less than 50 people. Only 4.5% employed more than 200 people. 50% of the respondents agreed to necessity being the motivator for becoming an entrepreneur. 74% of the responses came from profit making concerns.

The 22 questions in the survey (**Appendix I**) assess the entrepreneurial index of the respondent and the perceived and actual usage of IT in the firm. While all SMEs are run by entrepreneurs, the motivation for becoming an entrepreneur can vary. The first ten questions assess the motivational causes for becoming an entrepreneur on a Likert scale of 1-5. Seven questions refer to the perceived and actual use of IT. Five questions measure the entrepreneurial index of the respondent. For formulating the questions on entrepreneurial index we borrowed heavily from the First Annual Global Entrepreneurial Symposium held on April 29, 2003 at United Nations Headquarters. The responses we received are from owners/stakeholders. Only 11% of the respondents reported having no stake in the firm.

A bi-variate correlation matrix of the variables using Pearson's correlation coefficient and two-tailed significance test is given in **Appendix III**. Correlation coefficients where where  $p < .05$  are shown in red. **Appendix II** lists out the variables used in the matrix.

The major findings of our empirical study are given below.

1. 50% of the respondents had agreed to necessity being the motivator for becoming an entrepreneur. Necessity showed strong positive correlations with seeing an opportunity and opening up of the market. More than 74 % of the respondents started their business after 1991 when the Indian economy started opening up. Necessity and stake of the entrepreneur also showed strong correlations significant at .016, but in the opposite direction. ( $r=-.2573$ ,  $p=.016$ )
2. Those who rated IT training as a major motivator to become an entrepreneur, rate the possibility of their business depending on high speed internet high. ( $r=.2567$ ,  $p=.016$ )
3. Those who rated the availability of funding as least important motivator to become an entrepreneur, rate their expertise on usage of IT as high. ( $r=-.2881$ ,  $p=.006$ )
4. Those who rated the availability of funding as the least important motivator to become an entrepreneur, rate the maximum usage for IS in their firm. ( $r=-.3860$ ,  $p=.000$ )
5. Those who rated the availability of funding as the least motivator to become an entrepreneur, rate usefulness of website beyond a mere 'web presence' as high. ( $r=-.3255$ ,  $p=.002$ )
6. Entrepreneurs who perceived innovation of product/services high also rate dependence on high speed internet high. ( $r=.3333$ ,  $p=.002$ )
7. Entrepreneurs who rate innovation of product/services high also rate their expertise in IT high. ( $r=.3820$ ,  $p=.000$ ). Their perception of website going beyond a mere presence was also high ( $r=.3144$ ,  $p=.003$ )
8. Those who rate high on entrepreneurial index also rate high on expertise in IT ( $r=.3504$ ,  $p=.001$ ) and use of IS ( $r=.3580$ ,  $p=.001$ )
9. Those who rate high on entrepreneurial index also tend to allocate more funds for IT. ( $r=.3475$ ,  $p=.001$ )
10. Those who rate their expertise in IT high also rate use of IS high ( $r=.2829$ ,  $p=.008$ ), also rate IT allocation as high ( $r=.4192$ ,  $p=.000$ ) and also rate the percentage of IS staff in the firm high ( $r=.3286$ ,  $p=.002$ ).

### **Hypotheses revisited**

Results 2-6 support our first hypothesis namely, in SMEs, decisions (intentions) to use IS are a positive linear function of

- a) External stimuli
- b) Perceived control over adopting that IS.
- c) Learning curve of the executive who takes decisions.

Funding for small enterprises and startups are hard to come by in India. Interestingly, this lack of external funding seems to spur individuals to start IT enabled businesses.

Result 7 gives indirect support to the first hypothesis – The more the perception of innovative products and services in the CEO's mind, the more the rating for his expertise on IT and for using the website of the firm as more than an online presence. Since innovation is a strong index of an entrepreneur, this supports our broad research question namely, use of IS motivates knowledge entrepreneurs.

Results 8, 9 and 10 support our second hypothesis, namely the degree of adoption of IT in SMEs is a degree of the measure of entrepreneurship of the chief executive.

Hypotheses 3 and 4 are not supported.

### **Limitations of the study**

- The questionnaire is attempted online. This presupposes availability of good internet access to the respondent. About a third of the responses were collected offline to offset this limitation to some extent.
- The sample size could be bigger. The decay rate for online responses is normally as high as 98%. (Terri C. Albert et. al.) In our case the responses are about 3% of the mails sent, which resulted in our using a fairly small sample in testing our hypotheses.
- The study can be enriched by getting the figures for actual increase in entrepreneurial SMEs over the last, say five years in India- the period when adoption of IT use of IS has increased. . However public records for SMEs are difficult to come by especially for tiny and micro enterprises.
- There is need to have a common definition of SMEs applicable universally.

### **Research Directions**

It will be interesting to extend the research to impact of IT/IS on clusters of micro enterprises and on the social entrepreneurs in particular. Further insight can be obtained by extending the survey to the Asia Pacific region as a whole. The region as a whole is characterized by necessity driven entrepreneurship and the role of IT/IS in realizing the full potential of the knowledge entrepreneur needs to be examined.

### **Conclusions**

Intention to use Information Systems (IS) and perceived expertise in Information Technology(IT) of individuals can drive businesses in the SME world. In our study, IS use is examined at a micro level, one that involves users or decision makers - this is a context in which the diffusion of technology is paramount. In today's environment, many applications that become strategically important can begin as standalone programs designed and used by end users. Eventually, through initiatives by management or by the users themselves, these applications are identified as being important to the success of the firm, not just to the individual user. Leveraging this technology, many an individual user goes on to expand the level of operations - and an entrepreneur is born. Our empirical study lends support to this theory. We have identified some variables, which influence this migration from an individual to an entrepreneur; IT training, availability of high speed internet and funding or lack of it- are some of them. How prevalent is this phenomenon in present day India where IT adoption is still in transitional stage? This needs to be further examined in the light of secondary data available with SME forums and associations. Empirical

evidence supporting the research question can be extended further with the help of TPB to arrive at deliverables to foster entrepreneurship in the country.

According to NASSCOM, IT industry contributes about 3% to the country's Gross Domestic Product (GDP). Approximately 15% of the contribution to this revenue comes from SMEs. They expect the percentage of contribution by SMEs to grow upto 60% by 2008. Our research will help to plan this growth in a structured way.

The CEO whose expertise in IT is high also allocates more funds to IT (Result No.11). The advantage of the IT expert and CEO merging into one is immediately translated into action. This is corroborated by the fact that 48 percent of total tech spending of IBM South in India comes from the small and medium scale enterprises. (Figures 2004).

Understanding the distinct behaviours that entrepreneurs practice in developing decision processes and information systems provides a conceptual framework for further academic research on the SMEs. The study also provides a practical framework for use by individuals involved in startups.



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|    |  |   |  |  |   |   |  |
|----|--|---|--|--|---|---|--|
| 10 | My business is dependent on high speed internet connectivity                             | <input type="checkbox"/>                        | <input type="checkbox"/>                         | <input type="checkbox"/>                                       | <input type="checkbox"/>  | <input type="checkbox"/>  | <input type="checkbox"/>                                   |
| 11 | Fear of failure/low return prevents me from investing in technology                      | <input type="checkbox"/>                        | <input type="checkbox"/>                         | <input type="checkbox"/>                                       | <input type="checkbox"/>  | <input type="checkbox"/>  | <input type="checkbox"/>                                   |
| 12 | Infrastructure bottlenecks, cost and hygiene factors are deterrent to use of IS          | <input type="checkbox"/>                        | <input type="checkbox"/>                         | <input type="checkbox"/>                                       | <input type="checkbox"/>  | <input type="checkbox"/>  | <input type="checkbox"/>                                   |
| 13 | You will rate your expertise in IT related products as                                   | <input type="checkbox"/><br>Nil                 | <input type="checkbox"/><br>Average              | <input type="checkbox"/><br>Good                               | <input type="checkbox"/><br>Very Good   | <input type="checkbox"/><br>Expert User   | <input type="checkbox"/><br>Professional                   |
| 14 | As a CEO you take decisions on   | <input type="checkbox"/><br>operations          | <input type="checkbox"/><br>finances             | <input type="checkbox"/><br>Strategy                           | <input type="checkbox"/><br>Purchase of technology                                  | <input type="checkbox"/><br>Marketing   | <input type="checkbox"/><br>All the above                  |
| 15 | Use of IS helps you  | <input type="checkbox"/><br>Retain control      | <input type="checkbox"/><br>Grow and compete     | <input type="checkbox"/><br>Innovate                           | <input type="checkbox"/><br>With accounts   | <input type="checkbox"/><br>In marketing  | <input type="checkbox"/><br>With all the above             |
| 16 | Approx. allocation of resources toward IT as a percentage of total capital investment is | <input type="checkbox"/><br>5%                  | <input type="checkbox"/><br>15%                  | <input type="checkbox"/><br>25%                                | <input type="checkbox"/><br>45%   | <input type="checkbox"/><br>65%   | <input type="checkbox"/><br>More than 70%                  |
| 17 | The financial performance of my firm   | <input type="checkbox"/><br>losses              | <input type="checkbox"/><br>break-even           | <input type="checkbox"/><br>profits growing @10% annually      | <input type="checkbox"/><br>profits growing @20% annually                           | <input type="checkbox"/><br>profits growing @30% annually                                       | <input type="checkbox"/><br>profits growing @+30% annually |
| 18 | My firm is a -----<br>---player  | <input type="checkbox"/><br>local               | <input type="checkbox"/><br>regional             | <input type="checkbox"/><br>national                           | <input type="checkbox"/><br>Asian market  | <input type="checkbox"/><br>Asia-Pacific  | <input type="checkbox"/><br>Global                         |
| 19 | Is the objective of your website   | <input type="checkbox"/><br>a mere web presence | <input type="checkbox"/><br>to attract customers | <input type="checkbox"/><br>to attract customers and employees | <input type="checkbox"/><br>to attract prospective clients, customers and employees | <input type="checkbox"/><br>an intranet connecting customers, employees, products and marketing | <input type="checkbox"/><br>web based firm                 |

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|    |   |   |  |  |  |  |   |
|----|---|---|--|--|--|--|---|
| 20 | Over the last twelve months have you                            | <input type="checkbox"/> looked for new equipment /location | <input type="checkbox"/> organized a start-up team | <input type="checkbox"/> worked on a business plan | <input type="checkbox"/> began to save money | <input type="checkbox"/> or any other activity that would help launch a business | <input type="checkbox"/> done at least two of the above |
| 21 | Your stake in the firm is                                       | <input type="checkbox"/> no stake in the firm               | <input type="checkbox"/> between 1% -5%            | <input type="checkbox"/> between 6% -25%           | <input type="checkbox"/> between 26%- 50 %   | <input type="checkbox"/> between 51%-75%   | <input type="checkbox"/> between 75%-100%               |
| 22 | Among the staff employed by the firm -----% are using computers | <input type="checkbox"/> none                               | <input type="checkbox"/> upto 10%                  | <input type="checkbox"/> upto 25%                  | <input type="checkbox"/> upto 50%            | <input type="checkbox"/> upto 75%  | <input type="checkbox"/> upto 100%                      |

|                                      |  |
|--------------------------------------|--|
| <b>Your Name&amp; Designation</b>    |  |
| <b>Name of the firm</b>              |  |
| <b>Location</b>                      |  |
| <b>No. of Employees in your firm</b> |  |
| <b>Year of Incorporation</b>         |  |
| <b>Nature of enterprise</b>          |  |

**Thank you for giving your valuable input to our research**

## Appendix II

## Variables

|    |   |             |
|----|---|-------------|
| 1  | Did you become a knowledge entrepreneur because of necessity?                                 | Necessity   |
| 2  | Did you become a knowledge entrepreneur because you saw an opportunity?                       | Opportunity |
| 3  | Did you become a knowledge entrepreneur because of available infrastructure/family business?  | Family      |
| 4  | Did you become a knowledge entrepreneur because of your training in IT?                       | IT training |
| 5  | Did you become a knowledge entrepreneur because of availability of equity/debt funding?       | Funding     |
| 6  | Did you become a knowledge entrepreneur because of opening up of the market economy in India? | Market      |
| 7  | Did you become a knowledge entrepreneur because of export opportunities?                      | Export      |
| 8  | Your customers find your products/services innovative?  | Innovation2 |
| 9  | My business is dependent on high speed internet connectivity                                  | Internet    |
| 10 | As a CEO you take decisions on  | Decision    |
| 11 | The financial performance of my firm  | Fin perform |
| 12 | Over the last twelve months have you  | Index Ent   |
| 13 | Your stake in the firm is   | Stake       |
| 14 | Fear of failure/low return prevents me from investing in technology                           | Fear        |
| 15 | Infrastructure bottlenecks, cost and hygiene factors are deterrent to use of IS               | Hygiene     |
| 16 | You will rate your expertise in IT related products as  | Expertise   |
| 17 | Use of IS helps you   | IS use      |
| 18 | Approx. allocation of resources toward IT as a percentage of total capital investment is      | Allocation  |
| 19 | Among the staff employed by the firm -----% are using computers                               | IS staff    |
| 20 | Is the objective of your website  | Website     |

**Appendix III**

**Bivariate Correlation matrix of Variables with two tailed significance( N=88)**

|                     | Necessity      | Opportunity   | Family        | IT training   | Funding | Market        | Export | Innovation2   | Internet speed | Decision | Fin Perform   | Index Entr | Stake | Fear | Hygiene | Expertise | IS use | IT allocation | IS Staff | Website |  |
|---------------------|----------------|---------------|---------------|---------------|---------|---------------|--------|---------------|----------------|----------|---------------|------------|-------|------|---------|-----------|--------|---------------|----------|---------|--|
| Necessity           | 1              |               |               |               |         |               |        |               |                |          |               |            |       |      |         |           |        |               |          |         |  |
| Opportunity         | .2685<br>.011  | 1             |               |               |         |               |        |               |                |          |               |            |       |      |         |           |        |               |          |         |  |
| Family              | NS             | NS            | 1             |               |         |               |        |               |                |          |               |            |       |      |         |           |        |               |          |         |  |
| IT training         | NS             | .2373<br>.027 | NS            | 1             |         |               |        |               |                |          |               |            |       |      |         |           |        |               |          |         |  |
| Funding             | NS             | NS            | .5198<br>.000 | NS            | 1       |               |        |               |                |          |               |            |       |      |         |           |        |               |          |         |  |
| Market              | .3292<br>.002  | .3438<br>.001 | NS            | NS            | NS      | 1             |        |               |                |          |               |            |       |      |         |           |        |               |          |         |  |
| Export              | NS             | NS            | .2164<br>.043 | NS            | NS      | .3321<br>.002 | 1      |               |                |          |               |            |       |      |         |           |        |               |          |         |  |
| Innovation2         | NS             | .2439<br>.022 | NS            | NS            | NS      | NS            | NS     | 1             |                |          |               |            |       |      |         |           |        |               |          |         |  |
| High speed internet | NS             | NS            | NS            | .2567<br>.016 | NS      | NS            | NS     | .3333<br>.002 | 1              |          |               |            |       |      |         |           |        |               |          |         |  |
| Decision making     | NS             | NS            | NS            | NS            | NS      | NS            | NS     | NS            | NS             | 1        |               |            |       |      |         |           |        |               |          |         |  |
| Fin perform         | NS             | NS            | NS            | NS            | NS      | NS            | NS     | .2772<br>.009 | NS             | NS       | 1             |            |       |      |         |           |        |               |          |         |  |
| Index Entr          | NS             | NS            | NS            | NS            | NS      | NS            | NS     | NS            | NS             | NS       | .2790<br>.008 | 1          |       |      |         |           |        |               |          |         |  |
| Stake               | -.2573<br>.016 | NS            | NS            | NS            | NS      | NS            | NS     | NS            | NS             | NS       | NS            | NS         | 1     |      |         |           |        |               |          |         |  |
| Fear                | NS             | NS            | NS            | NS            | NS      | NS            | NS     | NS            | NS             | NS       | NS            | NS         | NS    | 1    |         |           |        |               |          |         |  |

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|               |    |    |                |               |                |    |               |               |               |               |    |               |               |               |    |               |               |               |    |   |
|---------------|----|----|----------------|---------------|----------------|----|---------------|---------------|---------------|---------------|----|---------------|---------------|---------------|----|---------------|---------------|---------------|----|---|
| Hygiene       | NS | NS | NS             | NS            | NS             | NS | NS            | NS            | NS            | NS            | NS | NS            | NS            | .3518<br>.001 | 1  |               |               |               |    |   |
| Expertise     | NS | NS | -.2827<br>.016 | .2247<br>.036 | -.2881<br>.006 | NS | NS            | .3820<br>.000 | .2610<br>.014 | NS            | NS | .3504<br>.001 | NS            | NS            | NS | 1             |               |               |    |   |
| IS use        | NS | NS | NS             | NS            | -.3860<br>.000 | NS | .3264<br>.005 | NS            | NS            | .2877<br>.007 | NS | .3580<br>.001 | NS            | NS            | NS | .2829<br>.008 | 1             |               |    |   |
| IT allocation | NS | NS | NS             | NS            | NS             | NS | .2401<br>.042 | .2992<br>.005 | NS            | NS            | NS | .3475<br>.001 | NS            | NS            | NS | .4192<br>.000 | NS            | 1             |    |   |
| IS staff      | NS | NS | NS             | NS            | NS             | NS | NS            | NS            | NS            | NS            | NS | NS            | .3339<br>.001 | NS            | NS | .3286<br>.002 | NS            | .4886<br>.000 | 1  |   |
| Website       | NS | NS | NS             | NS            | -.3255<br>.002 | NS | NS            | .3144<br>.003 | .2699<br>.011 | NS            | NS | NS            | NS            | .2395<br>.025 | NS | NS            | .2815<br>.017 | .2157<br>.044 | NS | 1 |

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# **CREATING INNOVATIVE SMES: IS COPYING THE SINCEREST FORM OF FLATTERY?**

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Much of the literature on innovation and entrepreneurship assumes that innovative smaller companies are essentially start-ups, where an entrepreneurial individual has seen a business opportunity and created a business to meet this opportunity. On the other hand, research on larger companies has examined the factors that promote innovation and entrepreneurial activity, including extrinsic issues (ranging from government policy to the competitive environment), internal systems and processes, and the development of staff and managerial capability. Case study research in Australia supports findings for larger companies. Moreover, in the case of smaller companies many of the same factors are important, and SMEs appear to face the same challenges as larger companies in developing new or entrepreneurial areas of activity. This paper compares findings from research on larger companies to the characteristics of the SME sector. It identifies those factors that are comparable between large and smaller companies in affecting the propensity to be innovative and entrepreneurial, and highlights two key areas where there differences exist.

## **Introduction**

Research on innovation and new venture creation confronts a literature that has grown exponentially in recent years. As a result, terms and concepts have elaborated, and there are increasing definitional challenges, as a number of writers have commented (eg. Hitt et al, 2002; Shane and Venkatamaram, 2000; and Garcia and Calantone, 2002). In many cases the word 'innovation' is restricted to ideas that have been realised in the form of a product or service for which there is a potential market. However, others have taken a broader view, where innovation is also taken to include changes in the processes and systems of the organisation itself, (Innovation Summit Implementation Group, 2000). Following this more recent general practice, the term 'innovation' will be used in this paper to include product innovations, process innovations (which may be internally focussed or relate to customer service processes), and business model innovations, (see Hamel, 2000). Further, where appropriate a distinction will be drawn between those innovations that may be described as incremental (or sustaining, continual improvement), as opposed to those termed radical (discontinuous, revolutionary or disruptive) (see, among many others, Christensen, 1997, Christensen and Raynor, 2003; Tushman and O'Reilly, 2002).

A further definitional issue relates to entrepreneurship. For some writers the definition of innovation includes not only a new product, service or process, but also

encompasses the development of a business around that innovation. Again, following what appears to be the dominant practice, the word innovation will be restricted to the opportunity, and the term 'entrepreneurship' will be used to encompass the process of building a new business, irrespective of whether or not that business is based on an innovation, or on an existing product or service, (cf. Timmons, 1999; Stevenson et al, 2000). In particular, the focus will be on entrepreneurial capabilities, and the factors that seem to influence these in both large and small organisations. This paper reports on work in progress, and is based on a series of case studies of both large and small organisations (some of these case studies have been previously described – see Sheldrake, 2004, Sheldrake and Fazzino, 2003)

### **Corporate innovation and venturing**

As noted above, there is a growing and important literature on innovation and entrepreneurship, and considerable attention has been paid to the development and practice of these capabilities in larger organisations, particularly in relation to:

- structural issues that face larger companies seeking to be innovative;
- different approaches to innovation in relation to the life cycle of the product or service a company offers; and
- the importance of organisational culture, and the extent to which the nature of the systems and processes inside organisations are themselves an inhibitor in relation to innovative thinking.

Interestingly, rather less attention has been paid to the characteristics of innovative and entrepreneurial people in large organisations, although there is a long research tradition in looking at the management and support of research and development staff (e.g., for example, the key research of Pelz, in Pelz and Andrews, 1966).

In relation to structural issues, the major issue that has drawn attention has been whether it is more effective to establish separate innovation units or project teams (see, for example Mintzberg and Quinn, 1991, Tushman and O'Reilly, 2002), or to establish innovation as an organisational compatibility that should be found throughout the organisation (Christensen and Raynor, 2003, Hamel, 2000; Utterback, 1994). A particularly helpful overview of various structural models is given in the work of Leifer et al (2000). Case studies of successful innovation reveal that to a significant degree organisational structures are more important in inhibiting innovation, rather than promoting it, and this has led writer like Hamel to comment on the importance of what he calls 'activists' (Hamel, 2000; cf related work on the concept of the organisational 'Ronin', Sheldrake, 2003).

The second theme, looking at the relationship between innovation and the life-cycle of products and services has seen considerable development in recent years – especially with the work of Christensen and Raynor looking at the factors that seem to influence the successful opening up of new markets (Christensen and Raynor, 2003).

However, it is the third area, research on the culture of organisations and the impact of that culture on innovative and entrepreneurial thinking, which has been a major area of interest over the past decade. One dominant approach has been the rationalistic strategic model, where organisations are seen as a portfolio of resources and competencies (Hamel and Prahalad, 1994), and business planning is concerned with assessing environmental and industry requirements, competition and the

alternative uses of resources and competencies to achieve maximally effective competitive positioning. Drawing on Porter (1980), there has been an extensive development of systematic approaches to competition and the use of competencies (see, for example, Christiansen, 2000; Zack, 2002; Shapiro, 2001: and Brown and Eisenhardt, 1998).

While this approach has led to sophisticated strategic analysis models, a second approach has been to look at culture in a broader framework, as a basis for establishing the values, ways of behaving and values that characterise the priorities and focus of the organisation. This has led to a number of studies looking at the 'internal environment' of innovative companies, ranging from seminal work by Drucker (1985), through to more recent studies by Tushman and O'Reilly (2002), Collins and Porras (1996), Clarke and Clegg (1998), and Seely Brown and Duguid (2000).

A particularly important study was undertaken by Kuratko et al (1990), which surveyed a number of leading firms and identified five actors that appeared critical in establishing a climate conducive to innovation:

- senior management commitment
- a willingness to take risks
- structure
- incentive and rewards
- resourcing.

In a similar fashion, Tushman and O'Reilly conclude that both structure and culture must be aligned to ensure effective innovation (1997). Again, while these are clearly important factors, they sidestep the question as to who is going to make use of this environment, and the challenges facing a creative and innovative person working within a well-structured organisation: activists seem to flourish in spite of (and sometimes in opposition to) organisation cultures that are far from conducive to creative thinking and ideas, (Hamel, Sheldrake, *op cit*).

More recently Garvin has tried to summarise the range of issues explored in recent research under 10 propositions that summarise the challenges facing the company that wants to become innovative. These propositions are:

1. Growth means starting new businesses
2. Most new businesses fail
3. Corporate culture is the biggest deterrent to business creation
4. Separate organisations don't work – or at least not for long
5. Starting a new business is essentially an experiment
6. New businesses proceed through different stages requiring different management approaches
7. New business creation takes time – a lot of time
8. New businesses need help in fitting in with established systems and structures
9. The best predictors of success are market knowledge and demand driven products and services
10. An open mind is hard to find.

(Garvin, 2004, pp 19-21).

Research on Australian companies has confirmed that Garvin's summary is helpful. Case studies in the chemicals, power, motor car industries have revealed these same factors are relevant, and that corporate structures, culture, and an underlying systemic focus on sustaining, incremental innovation act as significant barriers to innovation and corporate ventures, even when carefully developed schemes are introduced to support new business development (see Sheldrake and Fazzino, 2003, for a detailed case study in the chemicals industry).

### **Innovation in the SME sector**

In contrast to the research on innovation and venturing in larger companies, the focus of much of the research on innovation in SMEs has quite a different starting point. The challenges of dealing with routinised processes in large organisation seeking to be innovative are contrasted with the nimble, non-routinised behaviour of potentially disruptive small companies (see, for example, the discussion in Christensen and Raynor, 2004, on disruptive innovation). Given this, it is not surprising to find that many of the themes in the literature concerned with the innovation and entrepreneurial behaviour in SMEs are quite different, focussing on topics which include:

- The capabilities – or traits – of entrepreneurs, or business founders
- The processes and systems that identify and allow choice between opportunities (opportunity development and opportunity analysis)
- Business planning
- Funding.

Research on these themes is well summarised in a number of texts (e.g. Stephenson et al, 2000; Timmons, 1999).

Between 2002 and 2005, three case studies were conducted, looking at innovative SMEs, (more details on the three cases are in Sheldrake, 2004), with a particular interest in looking at the factors that inhibited or discouraged innovation business development. The case studies illuminated a number of issues.

First, despite their small size and relative short periods of business, there was considerable resistance to change, and to stepping out of their (relatively newly created) 'box'. For example, one company, in the food industry, manufacturing sports drinks and bars, identified an opportunity in responding to 'weight conscious' consumers, and decided to develop a new range of products in this area. Having identified market needs, new distribution channels, and product opportunities, within a year the opportunity was slowly dragged back to making an incremental change to the existing business. What had been an innovative business development had changed:

- while market research had identified a new market, the actual products were seen as an extension of the existing range
- branding was a challenge, with uncertainty over the extent to which this should be a new brands (or sub-brand), or should continue to be marketed through the existing and well-established brand
- entry into the new distribution channel was slower and more difficult than expected, and a reversion to the existing distribution channels was taking place..

Having defined a quite new business area, to a large extent, this company's existing operational models and approaches have re-defined the approach to the 'new' business area in a way that mimics its current operations.

Second, the ability to see new product development as 'experimentation' is critical. A second case study, looking at a small company in the entertainment industry, found that for 18 months, every proposed new venture quickly declined and failed, and the response was to cut costs and focus even more on the core business. In late 2003, the approach was changed, and new ventures are seen as 'experiments', as market trials, from which learning could be derived. Funded and supported as experiments, new business possibilities were given greater freedom, and some successful ideas were enabled.

Third, no amount of nimble behaviour can bypass market knowledge and demand driven approaches. In a second organisation, also in the entertainment industry, the core team sought to change audience by offering a quite different mix of products. However, this 'supply driven' approach was only partially successful; while the new approach did increase the number of younger people attending events, the established older audience did not continue to attend as they had in the past, and overall there was a dip in numbers. Poor market research had led to imperfect product selection, and when better demand driven planning was used in the following year, audience began to recover. To borrow from Jim Collins, being a 'fox' was no substitute for being a 'hedgehog' (cf. Collins, 2003).

### **Assessing the challenges**

While three case studies can only be illuminative, it is interesting to consider them through two quite different lenses. The first is that conventionally used in looking at innovative SMEs, and the second is the framework derived from research on larger companies.

From a conventional point of view, these three case studies are unexceptional. Each company was run by an entrepreneur, and in two of the three cases, entrepreneurs with a track record of success and failure. In each case, opportunity evaluation was linear and justificatory: the entrepreneur felt that the business ideas (new products, new approaches) were 'right', and in each case collected data to substantiate the potential market, potential return, and potential competitive opportunity. In none of the three cases did the entrepreneur assess the proposed innovation against others. In each case, interviews with the entrepreneur revealed that they lived with the expectation that 'the market would decide'.

On the other hand, there were a number of issues that did not surface in planning. There was a lack of awareness of the unwillingness of the companies concerned to abandon their relatively new ways of doing things: indeed, in two cases there was a focus on developing SOPs (standard operating procedures) at exactly the same time as the innovations were being brought to market, in the belief that the SOPs would make them work better – rather than allowing new ways of operating to be developed alongside the implementation of an innovative approach. Another issue that was not recognised was that in asking the same staff who were responsible for the on-going

business to also address the new business developments exacerbated unwillingness to allow creative and innovative ideas to flourish.

These three cases exemplify many of the observations made by researchers looking at new venture creation. However, another lens through which to view these case studies is provided by Garvin's summary of the experience of larger companies, and his ten propositions. Here, the comparison proves most interesting.

Overall, eight of the propositions that are put forward for large organisations seem to make equally good sense when applied to these smaller organisations. Of course, in some cases, that is because the propositions are self evident. For example, it is evidently the case that "*Most new businesses fail*" and that "*New business creation takes time – a lot of time*". These do not require further comment.

Some of the other propositions are more interesting, and yet still clearly relevant. First, "*Corporate culture is the biggest deterrent to business creation*": in these three case studies, this proposition is evidently borne out by the innovation histories that were observed. For all three companies, their existing cultures were a barrier to innovation. In the case of the food company, they sought to enter a new market and change their business in this area, but gradually moved back to more of an 'extension of existing business model'. In the case of the two entertainment companies, they were unable to recognise that their culture no longer saw innovation as the centre of the business – once this was recognised, it seems that the chances of successful experiments have gone up. This is closely related to another proposition: "*Starting a new business is essentially an experiment*". Over time, all three companies began to see new business development as experimentation, and as this perspective became more broadly accepted, so they were able to accept failures in start-up ideas, and become more willing to trial several experiments. This was particularly evident in the entertainment company, which now sees its core business as running experiments, and then building on those that work. For the food company, the realisation came late in the process, and it is still grappling with an effective path to develop its new business area.

The next of Garvin's propositions was the observation that "*Separate organisations don't work – or at least not for long*". Small companies do not usually have the luxury of resources that allow them to set up separate units or areas of activity opt promote innovation. However, while a separate group developing the new product line could have helped the food company in the short term, in the long term, reintegration would have been a challenge, as limited resources in areas like marketing, distribution and sales would have required that some people worked across business activities.

The preceding proposition links to another, that "*New businesses proceed through different stages requiring different management approaches*". This might be considered another self-evident proposition, as it is generally agreed that small businesses need quite different management strategies as they move from 'start-up' to 'growth' to maturity', and this developmental process tends to conflict with the challenges of managing innovation as this is taking place. For example, the food company was going through an overall consolidation phase, adopting more routinised

processes and procedures at just the same time as its innovative developments needed a quite different approach.

A particularly interesting proposition is that “*The best predictors of success are market knowledge and demand driven products and services*”. While scarcely surprising, it was striking how hard this was to keep in mind in the case of these three small and growing companies. While this is paradoxical, it is not surprising. In all three companies, there was a clear realisation that the business survived (or not) only to the extent that it met customer needs. On the other hand, management was busily trying to ensure costs were contained, systems put in place and followed, policies and procedures implemented. This is an essential and unavoidable tension: a in larger businesses, the organisation has to ‘work’, and at the same time, success can only come from developing new ways to meet customer needs and aspirations. The only difference between smaller and larger companies is that in the smaller company, getting policies and processes in place is a management challenge; in larger companies, keeping those policies and procedures in their place is the challenge.

Perhaps this is also the point at which research on the attributes of entrepreneurs is also relevant: entrepreneurs often ‘know’ there is a market for their innovative product or service, and are only proved wrong by experience! This slightly cynical observation has to be balanced by consideration of another of Garvin’s propositions, which is that “*An open mind is hard to find.*” In the case of these three companies, all three founder entrepreneurs has a remarkably open-minded approach, and as a result reported on constant battles they had to keep the rest of their staff working effectively, and yet not lose sight of the bigger picture. In larger companies, these two roles can be separated (as with the increasingly common practice of separating the COO role from that of the CEO). In a smaller company, this is very hard to achieve.

There are two areas where the applicability of Garvin’s propositions to SMEs needs to be reconsidered. First, he suggests “*New businesses need help in fitting in with established systems and structures*”. In many cases, smaller companies do not have well-established systems and processes, and are often battling to get these in place as the company moves towards a more stable basis of operation. In the case of the entertainment company, this was particularly important. As noted earlier, alongside a growing realisation that the business is about experimentation, the management has been trying to establish ‘standard operating procedures’. Thus smaller companies are busily trying to put into place the very same set of policies and procedures that the larger ones are trying to overcome. This leads to a dissonance between innovation and the need for a solid and secure basis for organisational effectiveness that makes the CEO’s role in a smaller company particularly challenging.

Second, another proposition is that “*Growth means starting new businesses*”. Clearly, for a small business, this is a contestable statement. Most larger businesses have developed from smaller ones that have grown through increased market share, and through product or service enhancement. Clearly, for the food company this is the case. It is less evident in the case of the other two organisations, where significant growth seems to come from really innovative ideas that ‘change’ the business, rather than simply doing more of the same. Overall, it seems likely that smaller companies will be unwilling to start new ventures while they seek to build up their income and profitability. Limited resources, and the dependence for success on making what is

being done today work well means that the capability to experiment is even more limited.

### ***Summary***

By and large, researchers looking at innovation and entrepreneurship tend to focus separately on new venture creation and start-ups and on larger companies. *A priori*, there are some good reasons for doing this: while new ventures are built around establishing a product or service – which is often (but not always) innovative, the challenge in larger corporations is to shift from focussing on sustaining innovations, and to look for new areas of business. However, while they can only be indicative, these three case studies of small new ventures in Australia suggests that the models being developed to make sense of innovation in larger corporations can be helpful in understanding the issues confronting SMEs. Small, even emerging businesses, face an immediate demand to establish policies and procedures that ensure consistency, quality and predictability, and very rapidly face challenges that, in many areas, are essentially the same as those faced in major corporations. This suggests there may be scope to draw on a lot more of the emerging theory on innovation in large companies in seeking to understand start-ups and new venture creation, and that theories about the different management needs of companies as they move from a start-up to a mature phase of operations may mark some important consistencies at every stage.

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WOMEN ENTREPRENEURS, WORK-FAMILY CONFLICT AND VENTURE  
PERFORMANCE:  
NEW INSIGHTS INTO THE WORK FAMILY INTERFACE

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Existing theory is extended to predict the effectiveness of strategies for structurally reducing work family conflict by manipulating roles, given the salience of work and family roles and the resources available to the female entrepreneur. A conceptual framework is presented to examine the following question: Do female entrepreneurs who achieve high growth in complex service industries choose more appropriate strategies for reducing levels of work-family conflict than those who desire high growth, but are unable to achieve it?

Three basic strategies for manipulating roles are identified: 1) role elimination, 2) role reduction, and 3) role sharing. It is proposed that women who successfully develop high growth businesses will more effectively reduce work-family conflict by choosing strategies that better match their family salience and access to external resources than their less successful counterparts. It is further advanced that work family management strategies are a significant determinant of venture growth, and that role sharing strategies are preferred by most women since they permit women to enjoy the enhancement of both work and family roles while reducing the level of interrole conflict. As a result, it is purported that the high prevalence of team-building and participative management practices observed in women-owned businesses is driven by the need for female entrepreneurs to manage work-family conflicts as well as genetics or socialization.

# **VENTURE CAPITAL INVESTMENTS IN FAMILY BUSINESSES: THE FINANCIER PERSPECTIVE**

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## **ABSTRACT**

This article summarizes findings of the exploratory study investigating the rationale behind the venture capital (VC) investments in family businesses (FBs) from the financier's perspective. The empirical evidence was gathered in the qualitative interviews with seven investment directors of Finnish VC firms. The findings of the study suggest that FBs represent a considerable share of the portfolio of VC firms and that venture capitalists (VCs) perceive this type of organization as an important source of deal flow for their funds. Although sustaining that assessment criteria for FB proposals do not differ from the ones used for the evaluation of other types of business organization, VCs recognize that FBs present particular organizational and cultural features that can increase the level of complexity and risk for their investments. Despite the additional risk involved, most of VCs remain interested in investment proposals from FBs, especially those FBs at the succession or exit phase. While in the case of non-FBs VCFs usually structure deals consisting in a mix of equity and debt instruments and demand exit strategy that includes the possibility for the VCF to force the sell of 100 percent of the business, some VCs revealed openness to structure deals with FBs using instruments that respect the objective of some families to maintain ownership and management control over time.

## **INTRODUCTION**

Why some venture capital firms do finance family businesses while others do not is the question motivating the present study. Despite the fact that family businesses (FBs) are the most prevalent form of business organization in the world, the knowledge on the role that external sources of equity play in this type of organizations is still rather limited. The evidence gathered in previous research analysing venture capital (VC) from the point of view of family business (FB) suggests that this type of firms rely less on VC than non-FBs (Poutziouris, 2001) and that family owner-managers are reluctant to use VC due to their fears of losing ownership and management control (Poutziouris, 2000). The knowledge about the VC investment in FBs from the perspective of venture capital firms (VCFs) is limited to findings of one empirical study (Upton & Petty, 1998, 2000). It was carried out in the US and focused specifically on the decision criteria used by VCs when assessing proposals of FBs in succession phase. The study found that VCs are eager to participate in FB successions and that the attractiveness of the investment opportunity is largely determined by the quality of the successor and the firm's growth potential. One important reason why some VCFs are reluctant to invest in FBs is that they do not consider FBs as sufficiently growth oriented businesses. Incited by these findings, the present study was designed to generate the knowledge about the VCs' perception of FB deals at a more general level and in VC markets other than that of US. Using Finnish VC market as a context, this article explores the rationale

behind the VC<sup>1</sup> investments in FBs from the financier's perspective and shed light on how VCs adjust to the particularities of FBs.

## **LITERATURE ON VENTURE CAPITAL DECISION MAKING CRITERIA**

There exist a number of studies that have sought to understand how VCs assess and select investments proposals and a variety of methods have been used to reveal the criteria involved in this process. In the literature on VC decision making, the criteria discussed are viewed as being associated with the proposals under analysis and the profile and strategic objectives of the VCFs.

Regarding the criteria associated with the investment proposals, one of the first studies (Wells, 1974) detected that management commitment is the criterion having the heaviest weight in VCs' assessment of proposals, other relevant criteria being the product, as well as market and marketing skills. In the study by Poindexter (1976) it was found that the criterion ranking the highest in the opinion of VCs is quality of management, followed by expected rate of return and expected risk. Similar results were obtained in studies by Tyebjee and Bruno (1981) and MacMillan et al. (1985). Applying non-compensatory actuarial models to both VCs' judgement and the actual outcome of ventures, Khan (1987) suggested that the entrepreneurs' desire to succeed and the uniqueness of the product are the variables of essential importance for VCs in arriving at their judgement regarding the financing decision.

Rather than being related exclusively to the perceived quality of the proposals, some further studies suggested that the decision-making criteria of VCs are also strongly influenced by the profile and strategy pursued by the VCF. Using verbal protocols, a method that consists in asking the research participants to verbalize their thoughts as they perform a particular task, Hall and Hofer (1993) discovered that in the initial proposal screening, one of the most important evaluation criteria applied by the VCs was whether or not the proposal fits the venture firm's financing policy in terms of business development stage, size of the investment, geographical location or industry.

## **METHOD**

The findings reported in this article are based essentially on the evidence gathered through interviews carried out with seven VCs from five Finnish VCFs during the summer 2004. The common characteristic of the VCFs included in this study is that at the time of the interview they had invested in at least one FB, here inferred as a business where more than one family member were involved in company's management. In addition to this, the VCFs investigated present variation in terms of the geographical focus of their investment: two of the firms focus on investment at a regional level, two others invest nationally, and the remaining one operates also internationally. Table 1 summarizes the basic information concerning the VCFs.

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Table 1 about here

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The five VCFs included in this study represent 11 percent of the total number of VCFs operating in Finland, employing 26 percent of investment professionals of the area, and managing 27 percent of the VC funds, which represent 48 percent of the capital under management. Their current portfolio comprises more than a quarter of all the Finnish businesses backed by the VCFs operating in the country. At the end of the year 2003, there were 46 VCF operating in Finland with € 3144 million capital under management and 576 Finnish companies in their active portfolio (Finnish Venture Capital Association 2004).

The seven VCs interviewed in this study were investment directors of one or more FB deals, three of them being managing directors of the VCFs. With each respondent a semi-structured one to two hour long interview was carried out using a general interview guide as a basic checklist.

In the following section the main findings of the study are presented. Safeguarding confidentiality, the identity of the participants quoted in this report is not revealed.

## FINDINGS

### Significance of Family Businesses in VCFs' Portfolio

To open up the discussion on VCFs investment in the FBs and to infer the significance of FBs in the overall investment portfolio of the VCFs the participants were provided with the list of investments (found on company's website) and asked to indicate which of their firm's current and past Finnish investments would they consider investments in FBs.

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Table 2 about here

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Taking into account that about 80 percent of the total number of Finnish corporations are FBs (Veaceslav & Lehtinen, 2001) the figures depicted in Table 2 suggest that in the portfolios of the VCFs FBs are comparatively underrepresented<sup>2</sup>. Despite of that, it is important to note that FBs correspond to a significant share of the VCFs' investments. If aggregated, data from the five VCFs investigated show that FBs represent over 20 percent of the total number of investments in their active portfolio.

After having identified the FBs that have received their firm's investment, the participants were asked to rationalize about why from all the businesses on the list they classified those as 'family' businesses. Encouraged to explain their own concept of FB, the participants emphasized such factors as 1) strong influence of the family in the decision making process; 2) having the majority of the shares of the company in hands of the family; 3) more than one family member working at the company; 4) the family envision the transfer of the business ownership to the next generation.

The important aspect discerned in the interviews was that some companies identified as FB at the moment of the interview were not perceived by VCs as such at the moment VC investment

decision took place either because the family dimension was not yet present or it was intentionally or unintentionally concealed from VCs.

*“... at the time when we entered the company we were not so aware of the family interest – we suspected and we even asked about it: do you have such interest? And then it turn out that they really have a very strong family interest! The grandfather (is) very strongly participating in the decision making and (has) a very strong interest in keeping the business in the family ...”*

### **Family Businesses as a Target Group?**

Although FBs statistically represent an important part of the VCFs' investment portfolios, the participants feel that their firms do not target family businesses as such. Nevertheless, they do consider this type of businesses as a potentially important source of deal flow for their funds, especially so, because of the high number of Finnish FBs that are expected to face succession issues in the coming years reported in press and by the Family Business Network. While two of the participants said their VCF only consider investments in FBs in which the family is ready to sell out the business (e.g. due to the lack of successor), the others were convinced that their VCFs could support also other alternatives such as financing the family generation transfer.

In participants' opinion the comparatively low number of VC backed FBs is more due to the attitudes of the FB owners than those of a VCF: the participants believe that many FBs are not keen to consider VC as a financing alternative, because they tend to be reluctant to sell ownership to outsiders. VCs also think that although FBs may have as much growth potential as non-FBs, some families pursue other objectives that limit or hinder the growth potential of the business:

*“They often have the growth potential - they have a lot of that potential in there! It's just that the family orientation impose such restrictions that they cannot use the potential.”*

### **Assessing Family Business Proposals**

The participants' general opinion was that they assess FBs proposal the same way they assess any other investment proposal. From their point of view their decision making criteria continue to focus essentially on the entrepreneur or the management team and on the business potential. In FBs they continue to look for strong and capable management teams and businesses with good growth potential or with a good free cash flow.

Several participants did recognize though that a FB proposal often includes a few features that are unacceptable or that add complexity and risk for the VC investor. Participants from two VCFs, for instance, revealed that a factor that makes them reject FB proposals is the family's intention to regain the business ownership at the VCF's exit phase. One VC considered this desire incompatible with the strategy of his VCF, since their goal is to have a controlling stake in all the business they invest. He considered this as the only way they can effectively influence the decision making process and exit their investment via trade sale or initial public offerings.

Another VC considered that the family must be ready to sell all the company out in order to maximize the return potential of the VCF's investments.

Another issue of concern in financing FBs regards the lack of "normal" corporate governance culture and board procedures in FBs, although some participants recognized that this problem also exists in many non FBs, especially in smaller organizations. Moreover, family ownership is perceived having strong influence on the company culture. The strong company culture, despite its advantages may also present disadvantages that even over a considerable period of time are rather difficult to overcome.

*"The family ownership has very much impact on the way the personnel thinks and the way the operation is organized and that is something that you cannot buy away!"*

The emotional and social connection of the family to the business can also increase the complexity of the investment as the business and the family are usually perceived by the VCs as indivisible.

Often a number of family members are involved in the business, yet the overall opinion of the participants was that this situation represents a problem for the VCF only in the cases when the family members do not have the appropriate skills for the job or occupy the post that can significantly hinder the development of the business. Otherwise, most participants said they would not hesitate to invest in an attractive FB even if unnecessary or less-skilled family members would remain on the payroll. In their view this situation can be accepted as a part of the deal. Yet the consequence of maintaining such members would be a reduction in the business valuation to incorporate the extra burden, or then adaptations in remuneration package of the family members would have to be made to discount the cost of such inefficiencies. As one of the VCs exemplifies:

*"It doesn't really matter if you pay the entrepreneur ten thousands a month or if you pay him seven and (his) less capable son three thousands: it all adds up the same!"*

Despite the fact that the family members involved in the business to finance require an extra assessment to avoid inefficiencies, most participants considered that family members do not normally represent a burden for the business. These members are actually viewed as hard workers being strongly committed to the business and having heightened sense of responsibility.

*"...they take the risk very differently! The risk concept is very different than in some other companies where the managing director just can go to any other company if this doesn't succeed."*

## Structuring Family Business Deals

The participants' accounts revealed that the deal structure for investments in FBs may change, especially in cases when it is clear that the family wishes to continue with the business after the exit of the VCF. Participants from those VCF which regard this sort of FB's aspirations as acceptable revealed that financing package would, in fact, be structured differently:

*“The structure of the investment would be different and also what sort of risk we can assume, what sort of other financing the company should be getting, what sort of participation in the financing the family should have and so on. So... the perspective would be very different and of course the position that the company has in our portfolio would also be very different. We wouldn't be expecting so high return on it but, in return, we would have different type of structures or instruments for our investment and also other sort of financing – probably we would look for more loan type of financing from other investors or other banks.”*

The result tends to be financing packages where the proportion of equity is significantly reduced in favour to debt or quasi-equity. Depending on the leverage capacity of the business and desired risk exposure of the parties involved, the debt can be provided by the VCF (subordinated debt/mezzanine) or by other debt providers. In the cases where it is the VCF who provides the debt the deals normally include some equity kickers (warrants or other payment in kind) or some guaranteed minimum return on capital. From the VCFs' point of view this solution reduces the investment risks and aligns the objectives of the FBs with the ones of the VCF. Some participants also consider that this financing alternative fit well the family needs since it enables them to remain in control of (most) of the ownership.

## CONCLUSIONS

Overall the findings suggest that the decision-making criteria of VCs remain unchanged when considering FBs proposals. However, some VCs do identify organizational and cultural specificities in FBs that need special attention. While some of these specificities can present advantages over non-FBs (e.g. high level of commitment), others (e.g. low level of corporate governance) are clearly perceived by VCs as disadvantages. Although the balance between the advantages and disadvantages depends on each particular FB case, the overall perception of VCs is that these specificities tend to create additional risk for the investment. Despite the additional risk involved, most of VCs remain interested in investment proposals from FBs (especially those FBs at the succession/exit phase) regarding them as an important source of deal flow in the near future.

It is at the deal structuring and the exit strategy where most differences in the approach adopted by VCFs toward FBs as compared to non-FBs can be found. While in the case of non-FBs VCFs usually structure deals consisting in a mix of equity and debt instruments and demand exit strategy that includes the possibility for the VCF to force the sell of 100 percent of the business, some VCs revealed openness to structure deals with FBs using instruments that respect the objective of some families to maintain ownership and management control over time. The solution typically consists in deal structures composed mainly of debt financing instruments

(subordinated debt/mezzanine) with some sort of equity kickers or minimum return on capital. This option of deal structuring seems to have advantages for both parties involved: for the FBs it enables maintenance of the ownership structure desired by the family, and for the VCF it reduces the investment risks and aligns the objectives of the FBs with the ones of the VCF.

The findings of this exploratory study suggest that it is important for the VCFs to understand the specificities of the FBs before investing in such form of business organization. For the FB owners it shows that VC is, indeed, an alternative source of financing worth considering, because even in the cases where the family wishes to maintain ownership and management control over time, it is possible to find VCFs interested in adapting deal structure to finance them. Openness with regard to the family objectives and awareness of variations in attitudes and strategies of VCFs toward investments in FBs are important preconditions for successful collaboration between VCFs and FBs.

## ENDNOTES

<sup>1</sup> For the purpose of this study, the definition of VC adopted is the broader one prevalent in Europe, according to which VC includes not only seed and start-up financing, but also later-stage financing, i.e., expansion projects, buyouts, turnaround and mezzanine financing.

<sup>2</sup> The findings presented in Table 2 include both the FBs that were identified by VCs as such at the time of the investment and those that became FBs or were unveiled during the VCF presence in the business.

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**Table 1 - Basic Information on the VCFs**

|   | VCF 1 | VCF 2 | VCF 3 | VCF 4 | VCF 5 |
|---|-------|-------|-------|-------|-------|
| Year of incorporation                   | 1996  | 1997  | 1993  | 1997  | 1989  |
| Number of funds under management        | 5     | 7     | 2     | 2     | 16    |
| Capital under management (million €)    | 29    | 46    | 60    | 207   | 1159  |
| Investment professionals in Finland     | 6     | 5     | 5     | 6     | 27    |
| Finnish businesses in current portfolio | 34    | 47    | 27    | 4     | 45    |

**Table 2 – Importance of FBs in the Portfolio of VCFs**

|   | VCF 1 | VCF 2 | VCF 3 | VCF 4 | VCF 5 |
|---|-------|-------|-------|-------|-------|
| Total number of investments in Finland    | > 40  | 57    | 39    | 8     | 87    |
| Total number of investments in FBs        | n/a   | 8     | 11    | 1     | 11    |
| Weight of FBs (%) in total investments    | n/a   | 14%   | 28%   | 13%   | 13%   |
| Number of businesses in current portfolio | 34    | 47    | 27    | 4     | 45    |
| Number of FBs in current portfolio        | 9     | 8     | 8     | 0     | 7     |
| Weight of FBs in current portfolio (%)    | 26%   | 17%   | 30%   | 0%    | 16%   |

**THE IMPACT OF THE ENABLING ORGANIZATION ON CUSTOMER  
SATISFACTION: BANKS AND THEIR SMALL BUSINESS CUSTOMERS**

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**ABSTRACT**

The primary goal of this paper is to investigate how banks that are structured as enabling organizations are able to generate higher satisfaction among their SME customers. The enabling organization builds on two principles. Firstly, as banks generally survive through standardization of services the enabling organization needs to maintain a competitive inner standardized core of services to be able to generate income in a competitive market. The second principle is based on the organization's capability to create an atmosphere where the bank officers facing the customers will have a degree of competence high enough to guarantee a professional status. The study is based on a sample of 359 SMEs in Sweden. Lisrel, a structural equation modeling technique, is used to analyze the empirical data. Banks, structured as enabling organizations, generate higher satisfaction among their SME customers primary because they are able to generate an atmosphere where the individual bankers are encouraged to be flexible and take own initiative in the interaction process with the customers. What banks do as enabling organizations is that they actually shield their customers from having to interact with the bureaucratic machinery inside the bank. The bureaucracy is still there; it has to be there in order to comply with regulations. The only, but vital, difference is that the customers rarely see the machinery at work. Instead, they are in the hands of a seemingly individualistic officer of the bank who appears to be as flexible as anyone else in their environment.

## INTRODUCTION

Small and medium sized enterprises (SMEs) are argued to be important customers, offering the greatest profit opportunities for banks (Bannock and Doran, 1991; Zineldin, 1995). A recurring theme in the discussion of SME-bank relationships has therefore been focused on the satisfaction of the SMEs (Ennew and Binks, 1996; Jamal and Naser, 2002; Madill et al., 2002). Among other things it is argued that the more satisfied the customers are the more likely they will have repurchase intentions (Armstrong and Boon Seng, 2000) and the higher probability that they will remain as customers. (Bloemer et al., 2002). This means that the loyalty of the SMEs is increased as they become more satisfied and the bank can in turn gain increased profit through the continual purchase of their SME customers. However, it has been indicated in several studies that the SMEs are somewhat dissatisfied with their banking relationship (Harrison, 2001; Butler & Durkin, 1995; Zineldin, 1995).

The bankers are, among other things, criticized for being too focused on selling the bank's products instead of trying to understand the needs and requirements of their SME customers. It has furthermore been argued that bankers are reluctant in creating close relationships with their SME customers that can require personal involvement. The criticisms are often targeted towards the individual bankers involved in the interaction process. However, as has been indicated by other studies, the organizational structure is also of importance and indeed affects the behavior of the individual bankers and in the end also the satisfaction of the customers (Madill et al., 2002). In this paper we use enabling organization as a concept for an organization that creates an atmosphere where the individual employees are encouraged to have a flexible attitude towards the customers and still being able to maintain a competitive inner standardization of services. The purpose of this paper is to evaluate how banks, structured as enabling organization can generate higher satisfaction among their SME customers.

Many of the basic ideas of the article are based on Henry Mintzbergs (1979) classic definitions of organization structure. The terms adhocracy and machine bureaucracy are also used in this article to stress the impact, the organization structure can have on customer satisfaction. The bankers that possess an ad hoc professionalism spend more time with their customers, rather than spending their time navigating through the often-complicated inner life of the bank. The SME customers are thus met by a highly professional advisor in an ad hoc role whose decisions are based on the customers need. In opposite, bankers employing the machine bureaucracy processes tend to subject their customers to standardized treatment. The aim of this article is thus to investigate how in fact the enabling organization functions through the employees ability to ad hoc relate to the customers and how it by avoiding machine bureaucracy processes is able to generate higher customer satisfaction.

The idea of strategic fit between the capabilities of the organization and the characteristics of its environment is at the core of organization management in general, and thus also for banks as organizations (Hall and Saias, 1980; Miles and Snow, 1984; Markides and Williamson, 1996). In particular, by enabling organization we emphasize the importance of shielding the customers from the inner works of the organization, an integral idea in the decentralized bank organization. Perhaps this is the single most important trait in gaining significantly higher satisfaction levels among SMEs. It should be emphasized, however, that even the enabling bank organization combines elements of simplicity and complexity in handling the environment, implying a step from the bureaucratic traditional form of banking to a differentiated organization, rather than a dynamic, virtual organization which would be all but impossible given the requirements of supervisory authorities in the banking industry (Mintzberg 1978, p. 287).

## THEORETICAL POINTS OF DEPARTURE

The measurement and explanation of organizational structure has been a major concern in organization theory (Wong and Birnbaum-More, 1994). One approach argues that the variables can be found internally in the form of size, technology, or dependence (Pondy, 1969; Pugh, Hickson and Hinings, 1969<sup>1</sup>; Blau, 1970). A second approach that emerged during the late 1960's tried, in addition, to find variables outside the organization in the specific environment (Thompson, 1967; Lawrence and Lorsch, 1967). The determinants of organizational structure have in the latter approach been connected, among other things, with environmental uncertainty as the key predictor (Miller and Dröge, 1986; Greenwood and Hinings, 1988; Wong and Birnbaum-More, 1994). Organizations handle uncertainty through internal strategies of adaptation, adjustment or organizational design, and through external strategies or modes of interaction. The general proposition is that the complexity of the environment is reflected in the complexity of the organizations' structure, or the number and variety of units.

In the case of the banking industry, the banks are embedded in a larger societal context (Emery and Trist, 1965; Pfeffer and Salancik, 1978) that fundamentally shapes their structure. In this, banks are almost at the mercy of environmental determinism (Dastmalchian, 1986; Davis and Powell, 1992), in that banks are shaped by supervisory authorities with few opportunities to themselves shape their regulatory context<sup>2</sup>. The supervising authorities in charge of banks tend to emphasize stability in the banking industry for good reasons. Over time the banks have more and more been shaped in a traditional mode where centralization, formalization and standardization have remained keywords in the industry. The traditional bank has been authority-bound and built on principles of hierarchy and bureaucracy. The

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<sup>1</sup> The Aston school

overwhelming rationality mode in such an organization tends to be cost-efficiency, as banks are bound by economy-of-scale. As a result, the banks as organizations have typically been seen as monolithic rule-bound organizations that in essence functions in the form of the machine bureaucracy. Meyer and Rowan's (1977, p. 341) almost deterministic view on how external obligations come to take on virtually rule-like status within organizations are apt descriptions of the banking industry.

The individual bankers are taught to comply strictly with the rules, as there are virtually no incentives for bankers to behave flexible and show innovativeness in solving problems at work. Instead bankers generally are conservative in their approach to new dilemmas, and rarely deviate from safe procedures. Bankers well exemplify institutions guided by taken-for-granted assumptions on how things are to be done (Scott, 1987). In addition, the way things are to be done in the banking industry is spread throughout different banks creating a highly institutionalized environment<sup>3</sup>. In a study of 165 savings and loans organizations Haveman (1993) used DiMaggio and Powell's (1983) ideas of institutionalism to prove that banks to a high degree mimic each other's organizations and behaviors. The way bankers conduct their business is transferred to the customers. Thus, customers meet bankers who will stick by their regulations no matter what. Some customers are content with what they receive and actually do not have any real incentives themselves to interact closely with their bank. Customers who, however, have pressing matters that need to be resolved promptly in a flexible manner often face difficulties in interacting with their bankers. To them, bankers only care about formality and disregard that the customer is an individual being seeking an individual solution. In effect, the bank transmits their bureaucratic way of doing business to their customers, whether they like it or not.

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<sup>2</sup> This can of course be discussed, as banks tend to work behind the scenes to influence policy-makers.

<sup>3</sup> Akin to institutionalism as described by DiMaggio and Powell 1991

In an attempt to challenge the set up of traditional banks there are a small number of banks abiding to another basic principle. These banks function exactly in the same bureaucratic sense as all the other banks, but they chose to interact with their customers in a different way. The Swedish bank, Handelsbanken is an example that has for a long time worked under a strict regimen of decentralization that has in many ways been the opposite of the way traditional banks function<sup>4</sup>. The decentralized system has, from time to time, clashed with the interests of supervisory authorities, but in particular the system's way of surviving crisis has continued to interest and amaze onlookers. And yet, the system has not been copied very often. The reason, according to an interview made by the authors, is that centralized management in most banks fears the consequences of losing control of operations, both in terms of decreased power and in terms of the consequences of failure.

Handelsbanken, with its decentralized structure can be seen as an enabling organization, as decentralization is more a case of enabling subordinates than anything else. The enabling organization is based on a number of mechanisms. Based on the aforementioned argument of how traditional banks function the enabling organization is inherently based on local initiative and flexibility. Anything goes as long as the banks earn enough money, given compliance with basic banking rules. The range of decision-making is extensive and the purpose of the decision-making system is in promoting own initiative. The bank places less reliance on computerized systems than its counterparts, and the decision-making system is less formal. The integration devices are, in order of importance: (1) policies, (2) procedures and (3) rules. Meaning that the integration devices leaving more room for maneuver are the most important.

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<sup>4</sup> This description is build on personal interviews with Jan Wallander (Silver, 2001), former CEO and chairman of Handelsbanken in Sweden, on books written by him (1991; 1998) and also on an extensive interviews with staff of the same bank and their competitors (Silver 2001).

## **The Enabling Organization**

The enabling organization builds on two principles. Firstly, as banks generally survive through standardization of services (Silver, 2001) the enabling organization needs to maintain a competitive inner standardized core of services able to generate income in a competitive market. The enabling organization strives to push decision-making as closely as possible towards the bankers facing the customer. As a result, the organization manages to achieve cost reduction through minimizing and computerizing administration as well as headquarters and regional management and personnel. Within the organization the amount of interaction is minimized. This will also mean that innovativeness in terms of enhancing processes may be reduced, as the organizations in charge of development are reduced to a skeleton crew size. However, banking is known for blueprint copying, which means that not every innovation needs to be made within the organization.

The second principle of the enabling organization is the capability of the organization to create an atmosphere where the individual bankers facing the customers will have a degree of competence high enough to assure a professional status. Not only will the bankers need to know the inner standardization system intimately, they also need to be able to show some innovativeness and independence in facing the customers (Donnelly, 1994). The enabling organization needs to maintain an organization where a flexible attitude is encouraged. In doing so the enhancing organization maintains an organization based on few, but clear and concise measurements of success. In effect, the organization refrains from signaling preferable ways of action through the use of incentives closely connected to particular conditions, for instance incentives for selling certain products. Instead the enabling organization uses standardized measurement objectives that encourage the local bankers to apply whatever action is deemed applicable to reach those targets. For instance in the use of a

cost/income ratio where it is up to local management to do whatever they feel is most appropriate to reduce costs and increase revenues in their particular environment. The emphasis on easily measured, simple, challenging but obtainable short-term targets is an old idea in banking (Coult 1990, p. 115), but few banks manage to scale them down to one single ratio.

While taking the above-mentioned principles into consideration, two hypotheses are created. Firstly we hypothesize the enabling organization to be positively correlated to the formation of ad hoc professionalism among the bankers actively engaged in the bank-customer interactions. Secondly, we hypothesize the enabling organization to be negatively correlated to the use of machine bureaucracy processes in the bank-customer interactions.

**H 1:** The enabling organization affects the degree of ad hoc professionalism among the individual bankers actively engaged in the bank-customers interactions positively.

**H 2:** The enabling organization affects the use of machine bureaucracy processes in the bank-customers interactions negatively.

### **Ad hoc Professionalism**

The crucial part in determining the success of the interaction between the bank and the customer is in the capability of the individual banker in the actual engagement with the customer. Strategy, organizational structure, structure of internal information systems and activities are all-important determinants for the ability of co-workers to enact in their immediate environment (Grønhaug & Falkenberg 1989; Gioia and Thomas 1996; Weick 1996). The average banker is closely attached to the inner values of the banking system as

most bankers start at a young age at the bank and slowly advance internally before they are provided with a platform for engaging in crucial bank-customer interaction episodes. It is therefore imperative for the enabling organization to educate and internally promote bankers to maintain an individualistic streak within the large bureaucratic machine.

It could be argued that just as the traditional bank instills values in which actors within the bank imitate each other, the enabling organization also instills values where actors imitate each other through taken for granted assumptions (Ritti and Silver 1986; Davis and Powell 1992; Haunschild and Meyer 1997). Even in the training organization the imitation is provided through learning by observation and thus institutionalizing behavior (Whitley 1987). However, the vital difference is that in the enabling organization the individual worker witness the ad hoc role of other co-workers and their initiative and skills. The provision of an incentive system is the most important variable in determining the degree of independence among bankers. Other variables include the interaction between bank officers in charge of bank-customer interactions and their superiors as well as the interaction between bank officers in charge of bank-customer interactions and various specialists in the bank. The individual will if all of these variables are handled be able to possess an ad hoc professionalism where the customer recognizes the bankers as a highly professional advisor in an ad hoc role, both able to and willing to guide the customers through the intricacies of financial decision-making.

The ad hoc professionalism spends more time discussing with their customers and thereby will learn how to interact with them, rather than spending their time navigating through the often complicated inner life of a major bank bureaucracy. Thus, for the individual banker the daily life is more about learning how to interact with the customers, in particular in learning how to listen to the customers. The ad hoc professionalism fostered among bankers result therefore in increasing time spent with the customers and actually listening to whatever

happens in their daily life. This will make it easier for the individual bankers to identify the needs of their customers. With a more accurate picture the bankers can thus deliver services better match to the customers' needs (Ennew and Binks, 1996). As the ad hoc professionalism never pushes individual products, it is more a case of where the banker listens and tries to pinpoint what to sell to this individual customer, than to wait for the opportunity to force sale the product of the day. The bankers will be judged by their ability to provide advice based on what they gather from listening to their customers and in aiding customers as they present particular problems for the banker (Zineldin, 1995). The increased frequency of contacts between the banker and the customer is argued to improve the working relationship between the two, which in turn leads to higher customer satisfaction (Gammie, 1995). We therefore hypothesize that a higher degree of ad hoc professionalism among bankers engaged in the bank-customer interactions will be positively correlated to customer satisfaction.

**H 3:** The customer satisfaction is increased by the higher degree of ad hoc professionalism among bankers engaged in the bank-customer interactions.

### **Machine bureaucracy processes**

A clear indication of the machine bureaucracy processes being forced upon the customers is when the customers are subjected to standardized treatment by the bank. Standardized treatment of customers is partly a result of increased computerization (Chorafas and Steinman 1988, p. 1) and partly due to new entrants in the market relying on standardization (Baumohl 1993). Most SME customers will when they approach the bank for advice in important matters demand that the bank treats their problem as unique in a unique environment. Or at least have the feeling that they are seen as unique. Many will however be dismayed to find out

that they are being subjected to the latest promotion campaign within the bank. It is usually the case of the “new, innovative product” that will be available for the customer, and that this product just happens to be the permanent solution to this particular problem.

Another clear indication of machine bureaucracy processes is when the decisions of the individual bankers mainly are based on the customers’ availability of collateral. The fear of bankers in taking individual initiative is the way that they rather claim that a loan application will be turned down due to a lack of collateral than due to a lack of ability to repay a loan from an operating business. Collateral has been seen as a promising way of computerizing data for credit risk purposes (Clementz 1986, p. 17). As soon as the discussion is based on collateral, however, something is usually amiss in the actual loan application. In theory, the banker should always strive to first and foremost concentrate on the business operation, and not on the collateral available. Especially on cash flow as a decision making criteria (Goldberg 1992). Bankers tend to use the collateral as a way to avoid an argument with the customer about the potential of the business. This is, of course, not a very practical course of action in the enabling organization. Since the use of machine bureaucracy processes leads to a more standardized treatment of the customers, the needs of the customers tend to be put as a second priority. In fact, the major criticism of the banks has been targeted towards their focus on selling standardized products and on their lack of understanding of the customers’ needs and requirements (Harrison, 2001). With this we hypothesize that the use of machine bureaucracy processes in bank-customer interactions is negatively correlated to the level of customers satisfaction.

**H 4:** The customer satisfaction is decreased by the use of machine bureaucracy processes in the bank-customer interactions.

## HYPOTHESIZED CAUSAL MODEL

Hypotheses 1-4 are combined into a structural model (see fig. 1), illustrating the relationship between the different variables. As shown in the figure, the enabling organization is believed to have a positive effect on the used of ad hoc professionalism among the bankers that meet the customers (H 1). Furthermore, banks as enabling organizations are believed to have lesser degree of machine bureaucracy processes within the organization (H 2). The end variable, customer satisfaction, is supposed to be affected by the use of ad hoc professionalism as well as the degree of machine bureaucracy processes among the bankers facing the customers. However, as illustrated in the model, the customer satisfaction is positively affected by the degree of ad hoc professionalism (H 3) while it is negatively affected by the degree of machine bureaucracy processes (H 4). The model can be seen as an additional hypothesis, since it correlates all four hypotheses into one. For example, although we have not stated any correlation between the enabling organization and the level of customer satisfaction, there is a relation, not directly but indirectly. The enabling organization has an effect on the customer satisfaction positively through the ad hoc professionalism. Likewise, the enabling organization is believed to affect the customer satisfaction through the use of machine bureaucracy processes. The relation is however hypothesized to be negative.

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Insert Figure 1 here  
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## DATA AND METHOD

Data used for the empirical analysis were obtained from a survey sent to SMEs in Sweden. A total of 1131 questionnaires were randomly distributed to those SMEs with 200 or fewer employees. The random sampling of the firms was made by the statistic Sweden. Thus, in this paper SMEs is defined as firms that have 200 or fewer employees and also they should not be part of a corporate group. This definition is usually used in earlier research in Sweden regarding SMEs (Davidsson, 1989; Cressy and Olofsson, 1997) and it is also compatible with the one put forward by Bolton (1971).

The survey was formulated and sent out in December of 2003 to CEOs of the firms. After one month a follow-up reminder was sent out to those that had not yet answered. Of the 1131 questionnaires sent out, 359 were returned, giving a response rate of 31,8 percent. The survey conducted was focused on SMEs financial needs and relation to their financiers. Since earlier research has concluded banks as the most important actors SMEs encounter in their search for external capital (Berggren, 2002), a specific part about SMEs banking relationship was therefore included in the survey. In line with earlier research it was also confirmed by the answers that the majority of SMEs in Sweden are finance by banks. Of those firms that answered the questionnaires, banks financed 69.9 percent. A large amount of information could therefore be collected about SMEs and their banks. The bank as organization and the behavior of the individual bankers involved in the interaction process could consequently be portrayed from the eyes of the SMEs by the answers collected. Since the study is to investigate how the satisfaction of SMEs is affected, it seems reasonable to do the study from the perspective of the SMEs.

Due to the relatively large number of non-respondents a dropout analysis was conducted. A comparison between those that have answered the questionnaires with those that

have not answered was conducted to check bias. This was done using key statistic such as size, industry and age. No such bias could however be found.

## **Lisrel**

Lisrel, a structural equation modelling technique (Bollen, 1988; Jöreskog & Sörbom, 1993; Jaccard and Wan, 1996) was used to analyze the empirical data collected. Lisrel structural models are derived into two-step procedures. First, higher-order variables are created, called latent variables or constructs. These variables capture the underlying commonalities of the indicators (Bollen and Long, 1993). The second step constitute of creating a model by linking the constructs in a causal chain (Jöreskog and Sörbom, 1993).

Also the validity of the structural model is assessed in a two-step procedure using three key validity dimensions. These three dimensions are 1) convergent validity, which checks the homogeneity of the indicators and their constructs, 2) discriminant validity, which refers to the extent of separation between the constructs and 3) nomological validity, which checks the validity of the entire model and indicates the fit between the model and the data. The three key dimensions are first used to test the measurement model without causal relationship between the constructs. Thus, the measurement model is tested to see if the chosen indicators for a construct do really measure that construct. When the validity of the measurement model is established the same key dimensions are used in the second step, testing the structural model with causal relation between the constructs.

A number of statistical values can be used in the validity process. In accessing the convergent validity three estimates can be used; coefficient, t-value and  $R^2$ -value (Jöreskog and Sörbom, 1993). Same statistical values can be used when testing the separateness of the constructs. The strength of the relationship between different variables is

presented by the coefficients (Bollen, 1989). There are no definite limits for the coefficient instead the value should be judged in association with the theoretical considerations. The t-value estimates the statistical significance and should be equal or exceed 1.96 to be statistically significant at the 5 percent level. The  $R^2$ -value estimates the linear relationship between two variables. It is preferable to have  $R^2$  above 0.20.

Nomological validity is assessed by using measures as  $\chi^2$  - value, degree of freedom and a probability value.  $\chi^2$  - value and degree of freedom measures the distance between the data and the model while the probability value is a test of a non-significant distance between the data and the model. There are no definite threshold values for the  $\chi^2$  and the degree of freedom measure (Jöreskog and Sörbom, 1993) but some authors have concluded that the fit is good when the two measures are approximately the same. The probability estimate, the p-value of the model must be higher than 0.05 to be valid at the 5 percent level. Comparative Fit Index (CFI), which checks for non-normal distributions, and Goodness of Fit Index (GFI), which checks for sample size effect, are two other frequently used measures of nomological validity. CFI as well GFI should be above 0.90. Another measure worth mentioning is RMSEA, which measures population discrepancy per degree of freedom and should be below 0.08. However, as pointed out by Jöreskog and Sörbom (1993), all the other measures of nomological validity are functions of  $\chi^2$  - value.

### **Construct Validity**

By assessing the measurement model the validity of the constructs is tested. The validity of the measurement model is verified, nomologically, discriminately and convergently. Nomologically the measurement model is verified since the  $\chi^2$  - value is 10.50, with 9 degrees of freedom, at a probability of 0.31. The probability value high over the rule of thumb and the

fit between the data and the model is valid since the  $\chi^2$  - value and the degrees of freedom are approximately the same. Also measures as CFI, GFI and RMSEA support the validity of the entire model (1.00; 0.99; 0.022). The separateness of the different constructs within the model is obvious, securing the discriminant validity. The t-value and  $R^2$  - value are used as measures to test if the chosen indicators really measure the constructs created. Also, the relations between the constructs and the indicators are judged in association with the theory. The indicators and their respective constructs are displayed in *Table 1*. Since there is little difference between the figures in the measurement model and the structural model, we have chosen to present the figures from the structural model, when analyzing the convergent validity. This is mainly done because of pedagogical reasons. As can be seen at *Table 1.*, the dependent variables are standardized; so one of the indicators of each constructs do not have t-value presented.

Enabling Organization is assessed in an organizational level and is measured by using two indicators. The first indicator concerns the first principle of the enabling organization, which is the organization need of maintaining a competitive inner standardized core of services. The question whether the bank provides financing for SMEs at reasonable conditions portrays the respondents' perceptions regarding whether the bank has competitive prices or not. The second principle of the enabling organization is assessed by the question whether the bank is good in solving the SMEs financial problem. With other words, it measures whether the bankers facing the customers have the competence needed to be able to solve their customers' financial problem. The key statistical values in *Table 1.*, shows good convergent validity of the construct. Both indicators have  $R^2$  - values (0.64; 0.75) and t-values (17.06; 19.05) well above the rule of thumb.

The Ad hoc Professionalism construct assesses the individual bank manager's, engaged in the bank-customer interactions, flexibility and adaptability to the need of the

customers. As has been argued by Zineldin (1995), “*bank management’s persuasive action must be geared to the client’s needs*” and not according to the inner life of the bank. Earlier research indicates that SMEs would like their banking relationship to include more than financial transaction. They would like their banking relationship to be based on a more personal level (O’Donnell et al., 2002) including advice and support (Butler and Durkin, 1995) from an individual bank manager. The respondents’ answers to the questions regarding, whether the bank is good in giving (1) advice and (2) support in times of trouble, indicate if they perceive the banker facing them to be flexible and adaptive to their needs. The indicators’  $R^2$  and t-value show that they are well related to the construct, securing the convergent validity. The  $R^2$  values are 0.61 respective 0.83, well above 0.20. Also the t-value of on of the indicators is well above the rule of thumb, 16.40.

Machine Bureaucracy is measured by two indicators, which both secure the convergent validity. The  $R^2$  values above 0.20 (0.25; 0.46) and the t-value well above 1.96 (6.80). The two indicators stress dimensions that have been questioned by SMEs for a long time. The collateral requirements for a bank loan have been argued to be unfair and not particularly situated to the business of the SMEs, instead collateral is required according to the bank’s rule and policy. The collateral requirements have indeed led to a borrowing constraint among the SMEs (Cowling and Westhead, 1996). The second dimension concerns the bank’s focus on selling products. The bankers’ focus in selling the bank’s products has been argued to put the needs of the customers as a second priority (Harrison, 2001). The questions whether the SMEs find their bank to be too focus on the (1) collateral and on (2) selling products, give us answer whether the SME customers are subjected to standardized treatment by the bank.

The Customer Satisfaction is measured explicitly by a question, whereby the SMEs are asked to answer how satisfied they are with their banking relationship. This

construct is based on the customer's perceived satisfaction. The error variance of the indicator is set to zero. The factor loading and the  $R^2$  value are thereby equal to 1.00.

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Insert Table 1 here  
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## RESULTS

As presented in *Fig. 2*, the nomological validity of the structural model is secured. The  $\chi^2$  value is 14.86 with 11 degrees of freedom, at a probability of 0.19. This means that the entire model holds together and the fit between the model and the data is good. This is also confirmed by other measures as CFI, GFI and RMSEA (1.00; 0.99; 0.031). The separateness of the constructs is shown to be acceptable, since the modification indices of the structural model did not suggest any changes. All  $R^2$  values are above 0.20 and all t-values are well above 1.96, securing the discriminant- and the convergent validity.

The results of the statistical analysis indicate that there is a positive relation between the enabling organization and the extent of ad hoc professionalism among the bankers that are actively engaged in the customer interactions. Hypothesis 1 is consequently supported, with a coefficient of 0.84. Hypothesis 2, with a coefficient of  $-0.74$  between the constructs, is also supported, showing that there is a negative relation between the enabling organization and the existence of machine bureaucracy processes in the bank-customer interaction. The result also indicates that the perceived satisfaction of the SME customers is increased by ad hoc professionalism among the bankers facing the customers, supporting the hypothesis 3 (0.38). The last hypothesis is also supported with a coefficient of  $-0.33$ , which

indicate that the use of machine bureaucracy processes in the bank-customer interaction negatively affects the perceive satisfaction of the SME customers. This means that the enabling organization generate higher satisfaction among their SME customers by creating an atmosphere that increase the ad hoc professionalism among the individual bankers and by decreasing the use of machine bureaucracy processes. The individual banker is given incentive to work flexible according to the need of the SMEs. The SME customers are thus not treated by standardized solutions by the enabling organization; instead they interact with an individual banker, who gives them individual solutions to their problems.

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Insert Figure 2 here  
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## **DISCUSSION**

The results of the study indicate why the enabling organization is able to generate higher customer satisfaction. Apparently this type of organization manages to create an atmosphere in the relationship, which cannot be easily matched by their more standardized counterparts. One of the most striking features of the enabling organization is that, inside it is still a highly standardized and computerized bureaucratic machine. Due to reasons of economy-of-scale and due to demands from supervisory authorities, there is still a need for the enabling organization to maintain a highly standardized format. What the organization does not have to do, however, is to show those inner workings to the customers.

In the enabling organization mode the bank chooses what to display to their customers, and knowing that most customers prefer not to interact with machinery in more

delicate and pressing matters, they choose not to display the machinery. The customer may still have to fill in a form or two, but the banker never tells the customer that they will have to await the decision of some unseen decision-makers deeply within the organization. The banker will furthermore never argue that the reason for why a credit cannot be extended is due to regulations, when in fact the reason is that the bankers fail to trust the capability to repay the loan. The banker will never routinely sell standardized solutions to the customers merely because some marketing manager in a head office thousands of miles away has implemented a new sales scheme. Instead, the banker will in every way take personal responsibility for whatever happens to the customer and whatever decisions are being made within the organization.

This means that one of the most significant dimensions of the enabling organization is the ambition to hide some of the inner processes of the bank from the customers. Some may say that in that case the organization cannot really be very enabling after all. In fact, however, based on the 50 or so interviews with bankers and some 60 more interviews with customers, mainly SMEs, the enabling organization really shows its strength as a decentralized organization. Other quantitative material (Silver 2001 for example), show that the decentralized bank significantly differs from its more traditional competitors in the bank industry in terms of control mechanisms.

## **MANAGEMENT IMPLICATIONS**

Banks organized as enabling organizations can create advantages not only for the banks but also for the SMEs. From the perspective of the banks it has been repeatedly confirmed by studies in customer satisfaction<sup>5</sup> that decentralized banks are higher rated than their

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<sup>5</sup> In Sweden called "Svenskt Kvalitetsindex" and is conducted as a national survey by researchers at the Stockholm School of Economics.

counterparts. In addition, the decentralized banks present a higher net return on equity than their counterparts. The only significant drawback appears to be the rigor by which this kind of bank organization is set up. The enabling organization needs to be firmly institutionalized in the very minds of the co-workers. Management needs to avoid interfering with subordinates or alternating the system, in order for subordinates to maintain their attention on the customer. At the same time, the professional banker needs to be better educated, as they cannot rely on set rules. If these criteria are met the bank can become as successful as Handelsbanken.

As has been indicated before, SMEs do not want a relationship with a bank organization, what they want is a relationship with an individual bank managers, who they can trust and turn to in times of problems and who is flexible enough to give them individual adaptive solutions. All SMEs are unique and so are also their financial needs. It is therefore important that the individual banker, interacting with the SMEs, are encouraged to adopt a flexible attitude towards the customers and are competent enough to solve the problems of the SMEs. In this study it has been confirmed that the enabling organization is able to create that kind of atmosphere that allow the individual bankers to be flexible and adaptive to the needs of the SMEs. From the perspective of the SMEs, the enabling organization means that they do not need to interact with the bureaucratic machinery inside the bank, instead they will be at the hands of a seemingly individualistic bank officer who appears to be as flexible as anyone else in their environment. The SMEs will be met by an individual bank officer who will work according to their needs and not according to the bank's need of selling products.

## APPENDIX

Table II.

The coefficients between the constructs, error terms in parentheses and t-values.

| Constructs             | Enabling Organization    | Ad hoc Professionalism | Machine Bureaucracy      | Customer Satisfaction |
|------------------------|--------------------------|------------------------|--------------------------|-----------------------|
| Enabling Organization  | 1.00                     |                        |                          |                       |
| Ad hoc Professionalism | 0.84<br>(0.064)<br>13.25 | 1.00                   |                          |                       |
| Machine Bureaucracy    | -0.74<br>(0.11)<br>-7.08 |                        | 1.00                     |                       |
| Customer Satisfaction  |                          | 0.61<br>(0.13)<br>4.71 | -0.53<br>(0.16)<br>-3.40 | 1.00                  |

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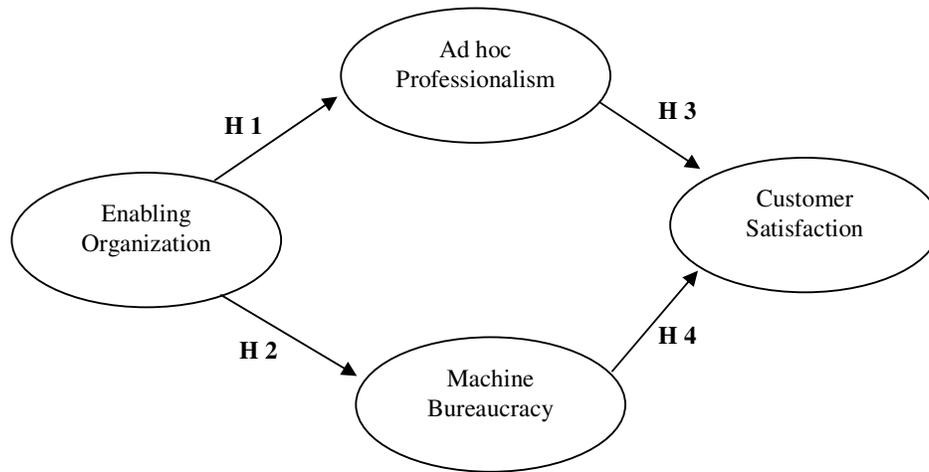
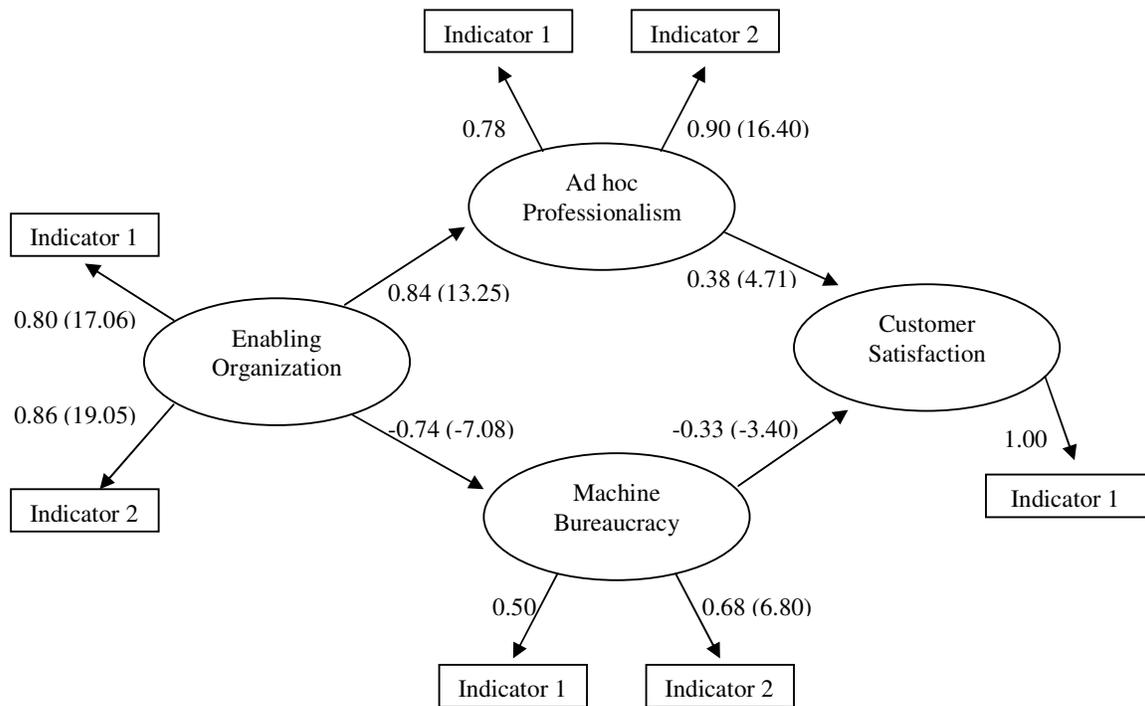


Figure. 1. The hypothesized causal model, illustrating the relationship between the different hypotheses.

Table I. The constructs and their indicators

| Constructs                   | Indicators   | Factor loading | R <sup>2</sup> | T-value |
|------------------------------|--|----------------|----------------|---------|
| <b>Enabling Organization</b> | 1. The bank provides financing at reasonable conditions for SMEs.                                | 0.80           | 0.64           | 17.06   |
|                              | 2. The bank is good in solving the SMEs' financial problems.                                     | 0.86           | 0.75           | 19.05   |
| <b>Ad hoc Professional</b>   | 1. The bank provides good advice to our firm.  | 0.78           | 0.61           |         |
|                              | 2. Our firm can turn to the bank in times of problems.   | 0.90           | 0.82           | 16.40   |
| <b>Machine Bureaucracy</b>   | 1. The collateral requirement of the bank for their loan is too strict.                          | 0.50           | 0.25           |         |
|                              | 2. The bank is too focused on the products to be able to solve our company's economical problem. | 0.68           | 0.46           | 6.80    |
| <b>Customer Satisfaction</b> | 1. How satisfied are you with your banking relationship.   | 1.00           | 1.00           |         |



*Figure 2.* Lisrel model. Model statistics:  $\chi^2 = 14.86$ ;  $df = 11$ ; P-value = 0.18878; RMSEA = 0.031; CFI = 1.00; GFI = 0.99. The figures given in the model are factor loadings of causal relations followed by t-values in parentheses.

# **Social Enterprise Development in the UK: Some Contemporary Policy Issues**

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## **KEYWORDS**

Social enterprise; evidence base; policy

## **ABSTRACT**

The aim of this paper is to contribute to current debates about the role of social enterprise and social entrepreneurship in local development. Whilst currently attracting considerable attention from policy makers in the UK, the evidence base for this is limited. Key issues include a lack of

clarity in policy debates about what constitutes social enterprise and associated concepts of social entrepreneurship; the rationale for public policy in this field; and what can/should be done to foster their development. This paper seeks to address these issues, drawing on a number of recent studies in which the authors have been involved, which includes the co-ordination of a national baseline mapping exercise, on behalf of a UK government department

The paper includes a short empirically-based section, in order to demonstrate the nature and extent of the contribution of social enterprises to local development and how this may be assessed. This part of the paper draws mainly on a study of the contribution and impact of social enterprise to rural economies and communities. Focused on Devon and using a case study-based approach. This study is of wider interest because of the methodology developed to assess a wide range of social and economic impacts that social enterprises are claimed to contribute. As a consequence, the paper seeks to contribute a greater degree of conceptual clarity to current policy debates, as well as some of the practical issues that need to be addressed if the contribution of social enterprise in practice is to be better understood.

## **1. Introduction**

The aim of this paper is to contribute to current debates about the role of social enterprise and social entrepreneurship to local development, focusing particularly on issues related to the development of the evidence base in the UK. More specifically, the paper seeks to make a conceptual contribution, as well as discussing some of the practical issues that need to be addressed if the contribution of social enterprise in practice is to be better understood. Whilst

currently attracting considerable attention from policy makers in the UK, there is a lack of clarity and agreement about firstly, what constitutes social enterprise; secondly, the nature and extent of their contribution to economic and social development; and thirdly, what should be done to foster their development. As a consequence, one of the current policy priorities in the UK is to improve the evidence base of the social enterprise sector.

Current policy interest in social enterprise in the UK was initially associated with the Labour Government's concern to tackle social exclusion through a focus on neighbourhood renewal. This was reflected in the National Strategy for Neighbourhood Renewal (Cabinet Office, 2001) and the reports of the Treasury's 18 Policy Action Teams (PATs). Of these, the recommendations emerging from PAT 3 report on 'Enterprise and Social Exclusion' (HM Treasury, 1999) are of particular interest, since Government adopted them for inclusion in its plan for action.

Recommendations relevant to social enterprises included:

- Recognition of social enterprises as a group of businesses deserving support.
- A commitment to enhancing the potential of social enterprises.
- A commitment to recognising social enterprises in national funding criteria.
- A commitment to shifting the culture of social enterprises and the voluntary sector away from grants and towards loans.

The PAT 3 report was followed by the DTI's 'Strategy for Success' (DTI, 2002), which sets out the current policy approach of government, with a strong emphasis on trading social enterprises. This has been described as close to the 'not-for-profits' approach with which social enterprise is

strongly associated in the US and strongly linked to a market-driven ethos (Peter Lloyd Associates, 2003).

The initial focus on neighbourhood renewal in the UK has resulted in much of the attention being focused on the most deprived local authorities, which are predominantly urban. This is because of the more dispersed nature of deprivation in rural areas and the tendency for pockets of low incomes within rural local authorities to be masked by high income groups because of an 'evening out' effect. Nevertheless, the potential contribution of social enterprise to rural development has been recognised at a policy level as part of the current strategy for economic and social regeneration of rural areas (DEFRA, 2004), although there are few policy measures specifically targeted at social enterprises in a rural context. Whilst there are schemes, such as DEFRA's<sup>1</sup> Rural Enterprise Scheme, which are open to both private sector and social enterprises, the level of take up by the latter group has been modest. The Countryside Agency's grants for schemes such as community transport, community renewables, 'vital villages' has benefited some social enterprises.

The emphasis on social inclusion, in which social enterprise is seen as one of the ways of fostering inclusion through the development of enterprising communities and localities has also been promoted in European policies over the last decade. A 'social economy unit' was set up in the early 1990s by DG XXIII of the European Commission, which, more recently, has officially recognised a consultative committee on co-operatives, mutual societies, associations and foundations (i.e. much of the voluntary sector), which are described as 'social economy enterprises'. In addition, the EC's Green Paper on entrepreneurship includes 'social economy

enterprises', or 'non-profit-driven enterprises' among the applications of entrepreneurship referred to (Commission of the European Communities, 2003, p6). It also refers to the role of entrepreneurship in the "efficient delivery of health, education and welfare services (p8), with social economy enterprises 'encouraging the participation of stakeholders in the delivery of such services. Such an approach can supplement public resources and extend the range of services offered to consumers'.

As Amin et al (2002) point out, there are considerable international differences in the way that social enterprises are considered, reflecting differences welfare systems, as well as different political and institutional contexts. For example, in the US, the absence of a strong welfare state is reflected in a well-established tradition of bottom-up community development. In Western Europe, by contrast, the state has tended to take a more prominent role in encouraging and supporting local development, although the contraction of the welfare state in recent years, in some countries (such as the UK), has given a boost to expanding the role of the social economy.

However, one of the current problems is that there is a lack of data concerning the nature and extent of social enterprise activity and its contribution to social and economic development.

Although central government, most Regional Development Agencies (RDAs) and social enterprise organisations recognise the need to improve the current evidence base, achieving it is not an easy task. A number of RDAs and devolved administrations (i.e. in Scotland and Wales) have undertaken some form of mapping exercise as a starting point for future policy development, but there is a lack of harmonisation between these studies concerning the definitions used and also the methodologies employed.

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<sup>1</sup> Department for Environment, Food and Rural Affairs

The lack of a comprehensive and consistent evidence base led the DTI to initiate a national baseline mapping exercise in 2004 to provide a starting point for building up an evidence base to support the on-going development of the social enterprise sector. This was preceded by the development of guidance on mapping social enterprise in 2003, which is summarised in a booklet of guidance notes, providing some benchmarks for definitions, mapping and evidence collection (DTI, 2004). The authors' experience in applying this guidance in the initial stages of the mapping exercise raised a number of practical issues, drawing attention not just to the heterogeneity of the sector but also to the variety of views among practitioners about what should be included within the social enterprise sector.

## **2. Some Definitional and Conceptual Issues**

There is no universally accepted definition of terms such as social entrepreneurship, social enterprise and the social economy, which means they are sometimes rather loosely used and often defined in different ways by different organisations for different purposes. For example, describing social enterprises, as a new concept, which they suggest, has not yet been widely institutionalised in its member countries, the OECD (1999) has defined social enterprise as:

*“any private activity conducted in the public interest, organised with an entrepreneurial strategy but whose main purpose is not the maximisation of profit but rather the attainment of certain economic and social and which has a capacity to bring innovative solutions to the problems of social exclusion and unemployment” (OECD, 1999, p10).*

The OECD definition is based on a fairly broad view of the social economy, similar to that included in the H.M Treasury's PAT 3 report in the UK, which describes the social economy as composed of:

*“organisations that are independent from the state and provide services, goods, trade for a social purpose and are non-profit distributing” (HM Treasury, 1999).*

In addition, the former Department of Environment, Transport and the Regions (DETR), who sponsored various initiatives concerned with social enterprises since the 1980s stated:

*“sometimes known as social enterprise, a community enterprise is owned and run by local people. It serves the interest of the local community rather than generating private gain, tackling social and environmental issues, providing work, training opportunities and local services. Any financial surplus is used for community benefit, not distributed as private profit” (DETR, 2000<sup>2</sup>).*

This definition uses the term social enterprise as synonymous with community enterprises, which represents just one of a wide variety of types of organisation that may be considered part of the sector, such as worker co-operatives, consumer/retail co-operatives, housing co-operatives and housing associations, agricultural co-operatives, employee owned businesses, development trusts, community foundations, social firms, intermediate labour market projects, credit unions, community loan funds, friendly societies, mutual insurers, building societies and the trading arms

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<sup>2</sup> In the SRB Round 6 bidding glossary:

of charities (Smallbone et al, 2001). Although ‘community’ can also mean an interest-based community, a geographical focus is more usually implicit in the use of the term, at least in terms of the spatial boundedness of the benefits. Another issue raised in the DETR definition concerns ownership, which has been a key element historically in the UK because of the tradition of co-operatives in the social economy. This is explicitly recognised in some definitions, which emphasise co-operative organisational and decision making structures, alongside ‘not-for-profit’ objectives, whilst also including the trading element (e.g. Birkhoelzer et al, 1997).

The definition currently used by the UK Government is taken from the ‘Social Enterprise: Strategy for Success’ document:

*“A social enterprise is a business with primarily social objectives, whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profits for shareholders” (DTI, 2002).*

The lack of a widely accepted definition contributes to the difficulties of obtaining statistical and other data about social enterprises, both nationally and internationally. The issue is complicated by the fact that although the level of policy interest may have increased recently, as a response to dealing with social needs that are not met either by the market or by the welfare state, the concept of social economy has a much longer tradition. The result is that contemporary use of terms such as social enterprise and social economy include different types of organisation, which may share a commitment to social purpose but may differ in their traditions, starting points and emphases. A key feature of the contemporary social economy is the inclusion of some participants in the sector that are driven by an ideological commitment to democratic ownership and control and/or

community empowerment, alongside others who are simply seeking pragmatic solutions to emerging gaps within a market-based welfare state. These may be focused on socially disadvantaged groups, but are not necessarily confined to them. Another potential role is with respect to building social capital through interpersonal networks and collective engagement (Putnam, 1993).

Social entrepreneurship has its origins in the 18<sup>th</sup> and 19<sup>th</sup> centuries, when philanthropic business owners, such as Robert Owen, demonstrated a concern for the welfare of their employees by seeking to improve their lives, both in the workplace and in other respects (Shaw and Carter, 2004). More recently, the term has emerged as a label to describe people who ‘create social value (through entrepreneurship) in the non-profit, private and public sectors, which is part of the definition used by the social enterprise initiative at Harvard Business School ([www.hbs.edu/socialenterprise](http://www.hbs.edu/socialenterprise)).

The Harvard definition explicitly refers to the leadership role of its graduates, whether this is as managers of social enterprises, board members of not-for-profits organisations, or as corporate leaders engaging their businesses in social purpose activities. The approach explicitly encompasses the contribution that an individual or organisation can make towards social improvement, regardless of the legal form of the organisations in which they are operating, claiming to challenge the traditional dichotomy between the not-for-profits and corporate sectors. Whilst such an approach may be an appropriate and innovative one as far as education and training for (potential) entrepreneurs and managers is concerned, it mixes social enterprise activity and corporate social responsibility, which is not helpful in a policy context. Whereas social enterprises are organisations whose primary purpose is social, corporate social

responsibility is practised by privately owned enterprises, whose main raison d'être is the generation of profits for their shareholders.

A number of writers have compared social entrepreneurs with their private sector equivalents. For example, Leadbetter (1997) has suggested that many of the characteristics and behavioural traits of social entrepreneurs mirror those of entrepreneurs working in the 'for profits' sector. These include drive, determination, ambition, charisma, leadership, and an ability to inspire others and to make the best use of scarce resources. In an empirical investigation, based on 80 in-depth interviews with individuals involved in entrepreneurship for social rather than personal financial gain, Shaw et al (2002) found a number of similarities with private entrepreneurs, such as a high level of both serial and portfolio involvement in entrepreneurial activity; an emphasis on vision, passion, and creativity; the ability to engage others in their vision and ability to network.

More detailed analysis of the same dataset drew attention to certain differences between the two groups, of which perhaps the most important concerned the nature and extent of exposure to risk. Since social 'entrepreneurs' rarely invest or risk personal finance in their ventures, the nature of any personal risk for them focuses on their personal credibility and reputation, rather than involving financial risk (Shaw and Carter, 2004). It was also concluded that whilst both social and private entrepreneurship requires creativity and innovation, 'in the social context, this is manifested mainly in managerial actions by applying novel solutions to intractable social problems (Shaw and Carter, op cit).

So can such individuals operating in a social enterprise context be legitimately considered to be entrepreneurs? The reference by Shaw and Carter to the nature of personal risk for individuals

involved in developing social enterprise, together with the reference to managerial actions is relevant in this regard. At the same time, it must be recognised that there is spectrum of views concerning definitions of entrepreneurship expressed in the mainstream entrepreneurship literature, with entrepreneurs ascribed different roles by different theorists. These include the risk-bearing, uncertainty roles emphasised by Knight (1921), which the leaders of social enterprises are unlikely to perform, and the innovator role of Schumpeter (1934), which only a minority may be able to achieve.

In their definition of entrepreneurship, Wennekers and Thurik (1999) emphasised the perception and creation of new economic opportunities, combined with a willingness and ability to introduce ideas into the market, in the face of uncertainty and other obstacles. Hence, entrepreneurship is a type of behaviour that concentrates on opportunities rather than resources and is essentially a behavioural characteristic of individuals, although commonly taking place in an organisational context. By emphasising economic opportunities and their exploitation within markets, the application of Wennekers and Thurik's definition of entrepreneurship, together with that of Knight, casts doubt on the validity of considering all leaders of social enterprises as entrepreneurs. Such people may be able to engage in entrepreneurial behaviour in much the same way as public sector employees can, but not legitimately be considered as entrepreneurs, in relation to such definitions. Entrepreneurs are business owners whose behaviour involves financial risk for them, although the term entrepreneurship may be used to embrace a wider range of entrepreneurial behaviours. Moreover, while social enterprises may be run as efficient businesses, their prime purpose does not lie in profit generation but in building social capacity and responding to under met social needs (Amin et al, 2002).

One of the definitional issues that has been much debated in mainstream literature, and which is potentially relevant to discussions about social entrepreneurship, concerns whether or not self-employed people and small business owners are necessarily entrepreneurs. In practice, business owners perform both entrepreneurial functions (e.g. recognising new market opportunities, creating new ventures) and managerial functions (e.g. organising, co-ordinating), although the balance between these varies between firms and individual owners, as well as within firms over time. For example, an individual may be entrepreneurial in creating a new venture, whilst subsequently managing it conservatively. Additionally, Wennekers and Thurik (op cit) note that few business owners are pure Schumpeterian entrepreneurs or pure shopkeepers. From this it may be concluded that the lack of definitional clarity over social entrepreneurship is not significantly different from that in the mainstream entrepreneurship literature. However, the more fundamental distinction discussed previously remains.

### **3. Mapping The Social Enterprise Sector in the UK**

This section describes the baseline mapping exercise in the UK, commissioned by the Department of Trade and Industry (DTI) in 2004, in order to bring out some of the problems involved in improving the evidence base of the social enterprise sector. Whilst focusing on some of the practical issues arising in assembling the database, many of these issues have wider conceptual dimensions to them.

The starting point for the mapping exercise is the current definition of social enterprise included in the previous section. The DTI definition contains a number of key words and phrases that are important in guiding what should and should not be included. As far as this definition is

concerned a social enterprise is firstly a 'business' that is trading, which by implication means that organisations that are entirely dependent on grant income are excluded. However, unlike a privately owned business, a social enterprise must have social objectives as its primary purpose, rather than simply claiming to be socially responsible. As with any business, a social enterprise aims to generate a surplus, although instead of being distributed to private shareholders, these surpluses are mainly used to achieve the organisation's social aims.

Following the publication of the guidance notes early in 2004, the authors were commissioned by the DTI to co-ordinate the initial stages of the national mapping exercise (specifically stage (ii) below). Previous consultants, who were employed by the DTI to provide guidance for the national mapping exercise, had recommended that the mapping be taken forward in five main stages:

- (i) Compilation of initial databases for each region and devolved administration, containing all organisations listed at Companies House as Companies Limited by Guarantee or Industrial provident Societies.
- (ii) Validation and enhancement of initial databases by regional partners and the national co-ordinator
- (iii) A telephone survey of (a sample) of listed enterprises to establish social aims and trading level.
- (iv) Analysis, including estimation of economic contribution
- (v) Utilisation of data gathered as a resource for the social enterprise sector

Following the initial guidance, the aim of the mapping exercise was to gather baseline data for a 'core group' of social enterprises, recognising that it would be impractical and probably too costly, to collect information on all social enterprises. The core group was defined as organisations that satisfy three tests, with respect to registration, trading status and the pursuit of a social aim. More specifically, the three eligibility criteria were:

- Registered as Companies Limited by Guarantee (CLG) or Industrial Provident Societies (IPS);
- Generating at least 50% of their income from trading;
- Pursuing social objectives and principally reinvesting surpluses in the business or in the community.

In addition, it was also intended to capture information on 'additional groups' of social enterprises that meet the following criteria:

- Businesses which meet trading and social aims criteria but which are registered in some other form than CLGs or IPSs
- Generating between 25-50% of their total income from trading activity

The role of the national co-ordinator (i.e. the authors) was to facilitate the checking and enhancement of the initial databases (see (i) above) by so-called regional expert groups. The idea was that these groups of regional experts, which would be assembled by each RDA and devolved administration, would use their local knowledge to make recommendations for additions and

subtractions to the initial databases provided. Each group was chosen by the staff responsible for social enterprise in each RDA/devolved administration, in consultation with the national co-ordinator and the Social Enterprise Unit (SenU) at DTI<sup>3</sup>. The aim was to reflect the diversity of the social enterprise sector, whilst keeping each group to a manageable number (6-8 persons).

The initial databases were distributed to the convenors of each expert group at the beginning of February 2004. The national co-ordinator arranged meetings with the expert groups in each region/devolved administration, which were held during March 2004. The idea was that each expert group would go through the initial databases (which ranged from approximately 2000 to almost 10,000 organisations prior to the meeting and classify each organisation on the basis of what was known (if anything) about firstly its social aims and secondly its trading income<sup>4</sup>. The idea was to capture whatever knowledge existed at the regional and local levels, in order, on the one hand, to sift out organisations that were known not to meet the DTI's definitional criteria and, on the other, to add any organisations believed to be social enterprises that were missing. Expert groups were not expected to survey or contact listed organisations in order to complete this exercise, but simply to use whatever databases existed at the regional/devolved administration level, supplemented by their own knowledge (including tacit knowledge) and that which could be drawn on through the wider regional social enterprise network. The purpose of the meetings with the national co-ordinator in each region/devolved administration was to finalise the amended/enhanced databases, seeking ways to resolve any problems that may have arisen.

Following the meetings, the enhanced databases were returned to the national co-ordinator for

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<sup>3</sup> SenU is now part of the Small Business Service

<sup>4</sup> The coding scheme adopted for both social aims and trading status allowed for uncertainty, particularly with regards to the proportion of total income from trading activity.

checking and collation, before submission to DTI. The enhanced national database will be used as a basis of the telephone survey (stage (iii)).

A number of definitional issues emerged from the meetings with regional expert groups as a result of their experience in applying the social aims and trading income tests. As far as social aims are concerned, key issues included what might legitimately be considered to be a social benefit and who the beneficiary group are. In this regard, the guidance we provided referred to ‘a reasonable person test’ of what constitutes community or wider public interest, emphasising that access to benefits provided by the organisation should be widely available and not confined to an unduly restricted group (DTI, 2003). Hence social benefits should extend beyond a particular membership group, unless the members are socially disadvantaged/excluded. This is supported by the charitable status test which states: *‘charities must benefit the community at large or a substantial section within it. They must not entirely exclude those of limited means’*.

However, when this interpretation of social aims was applied, concerns were expressed by some members of expert groups about the implications for certain types of organisation. The most consistently expressed concerns referred to worker co-operatives, which some felt justified inclusion because they believe that the empowerment which employee ownership offers employees is inherently social, alongside the working environment and employment created. However, application of the definitional guidance meant that some co-operatives were excluded, because the social benefits they offer do not extend beyond the members/employees of the worker co-operative.

Faith-based organisations were another group that featured in the discussions of several expert groups. One view was that all faith-based organisations have social aims, even if they are exclusive to members, on the basis of their contribution to building social capital and contributing to local communities. However, a more common view was that there needs to be specific social benefits (i.e. other than the spiritual), which are available to a wider group of members, for faith-based organisations to qualify.

Other organisational types discussed in these expert meetings included colleges and higher education institutions, although because of the business element in the definition, most agreed that it was only the trading arms of these organisations that could be eligible; business support organisations; sports clubs, where discussion focused on who the beneficiaries were; and organisations, such as Connexions, which provide information and advice for young people. Housing associations were another controversial type for some expert groups, with concern expressed over cases where the creation of an association simply involved the transfer of housing stock from a local authority to a housing association. An underlying issue concerned the difference between the results of applying the test and what some saw as the spirit of social enterprise.

For some 'experts', a key issue is that the exclusion of many worker co-operatives omits one of the traditional elements in what has been seen as the social economy, whilst many voluntary sector organisations that have not traditionally been considered part of the social economy (and which may not consider themselves to be social enterprises) are included. Another issue raised concerned the treatment of charities, which were included in the mapping if registered as a CLG.

Although other legal forms may qualify for the additional group of social enterprises, these were not included in the mapping exercise because they were being covered by a separate study.

However, the aim throughout was to systematically apply the tests and treat each case on its merits, rather than to make judgements about generic types. Of course, the final decision concerning whether or not particular organisations should be included in the core or additional group, depends on the responses of organisations participating in the telephone survey, which will be undertaken once the database of potentially eligible organisations has been assembled. Application of the trading income test also led to considerable debate in some expert group meetings. A dictionary definition of trading income refers to 'income from sales of goods and services' or 'payments received in direct exchange for a product or service'. DTI guidance is that trading income specifically excludes income from grants, subsidies, supporter's membership fees (unless these are linked to the receipt of specific services), voluntary contributions and fundraising, although it does include service level agreements with public bodies. Service level agreements are contracts between service providers and customers that define the services provided, acceptable and unacceptable service levels, liabilities on the part of the service provider and the customer and actions to be taken in specific circumstances.

One area of concern in most expert groups was the exclusion of organisations in which income from trading represents less than 25% of total income. It was argued that many of these organisations will be fledgling or emerging social enterprises and a potentially important target group for intervention. This would seem to be a potentially strong argument, although to include all organisations meeting the social aims test, whilst undertaking some trading activity (i.e. below the 25% level), would include many organisations with very little trading income.

However, a more fundamental problem concerned the difficulty of distinguishing trading from grant income, especially when some organisations may refer to contracts as grants. Whilst, in principle, grants may involve income that is not necessarily related to specific levels of output, it was reported in a number of expert group meetings that the distinction is becoming an increasingly fuzzy one, because of the inclusion of clawback clauses for many grants. This means that in cases where a service is not delivered, or the outputs are below the level in the grant application, some of the grant must be repaid. However, whilst not a black and white distinction, most recognised that service level agreements include more specific output-related funding than grants; for example, where the income received is on a per capita basis or according to the number of training places actually provided.

The practical difficulties experienced in the regional meetings and the nature of the discussions in the so-called regional expert groups over definitional issues reflect more fundamental differences concerning the nature of social enterprise, reflecting different traditions.

#### **4. Assessing The Impact Of Social Enterprise On Local Economic Development**

Alongside improving operational definitions and completing the baseline mapping exercise, the third element in the development of an evidence base for social enterprise concerns assessing its contribution to local development. In this regard, it is important that the methodology used to assess this contribution takes into account a full range of potential impacts, which include both direct and indirect benefits. Potential direct benefits include the provision of goods and services and employment benefits. Potential indirect benefits include the multiplier effects of any local

spending through purchases and spending by employees, as well as any contribution to building social capital. There also needs to be a combination of 'hard' and soft' indicators used in order to capture the full range of benefits (Figure 1).

Insert Figure 1 about here

An attempt was made to operationalise such an approach in a recent study of social enterprises in rural Devon (Smallbone et al, 2003). The methodology employed involved a series of in-depth case studies of 30 social enterprises located in rural Devon. These included regeneration organisations and development trusts; community shops; community centres/village halls; transport schemes; community finance initiatives; housing associations; and child care organisations. The 30 cases were selected to capture the variety of different types of social enterprise located in the county. For the purpose of the study, social enterprises were defined as organisations that meet social aims by engaging in trading activities, from which any surplus generated is not for personal profit. Since the design of the study predated the publication of the definitional guidelines for the national mapping exercise, the definition used in this study was broader than that described earlier in the paper. These 30 enterprises were fairly evenly divided between organisations that were completely, or almost completely, dependent on contracts or grants from the public sector; those financed through a combination of sources, including trading income and public funding; and those totally dependent on trading income, either from sales or rental income. Evidence from the case studies enables us to draw some conclusions about the nature of the contribution of social enterprise to rural development in the county, although an assessment of the extent of this requires a larger scale survey.

One of the main benefits of social enterprises to rural Devon was the contribution to service provision, particularly those enterprises that are providing basic services to rural communities (e.g. transport, shops). These are services, which in rural areas the private sector is not currently willing to supply and the public sector is unwilling to solely fund, representing both a market and publicly funded gap. This contribution is particularly relevant in a rural context, in view of the continuing decline of a range of services, such as shops, post offices and public transport services in rural areas, which particularly affects low income households and socially disadvantaged groups (including mentally ill, people with disabilities, young, elderly, unemployed, and families on low incomes), with low levels of personal mobility.

Poor access to transport was being tackled by rural community transport initiatives providing both general bus services when public transport is inadequate or non-existent, and specialist services (such as routes to schools, hospitals, delivering meals and laying on transport for the less mobile). The four community shops interviewed were found in villages where all other shops had closed, because it was not financially viable for private enterprise to operate. Where these shops also had a post office, they were able to provide a range of banking and other services that help to reduce financial exclusion in certain social groups. Many rural areas lack childcare provision. In this context, nurseries and crèches provided by social enterprises allow parents to go back to work either full-time or part-time, as well as being an important opportunity to allow children to socialise.

Community centres were providing a local service by letting out rooms to community groups, providing information and, in some cases, running a café. One of the centres was hosting 25 organisations on a regular basis (once a week), renting out rooms to a total of approximately 50

organisations during the year. Through these activities, they were able to build a strong bond within communities and provide social support for groups, such as the elderly. A number of community centres were also involved in training provision. Some were well connected with other organisations and public agencies and had incorporated signposting as one of their activities, which included putting individuals or organisations in touch with other organisations or businesses. Village and community centres are a type of social enterprise with an important potential role as a necessary part of the social infrastructure of rural communities, but with potential contributions to the economic life of the countryside also, such as by hosting training workshops.

On the basis of the case studies investigated, social enterprises are not a major generator of jobs in rural Devon. Moreover, wage levels are typically low and the high turnover of staff, in low skilled occupations particularly, is comparable with private sector businesses. There was also a relatively high degree of job insecurity, particularly in those social enterprises more dependent on public funding. Social enterprises were involved in various networking activities with other organisations and businesses, which involved sharing knowledge, ideas and space or staff with other organisations and businesses, reflecting the contribution of this type of enterprise to social capital.

Although a pilot study, this research provides some evidence of the nature of the contribution of social enterprise to rural development. A more comprehensive assessment will be easier, once the DTI's mapping exercise is completed.

## **5. Conclusions**

There is no doubt that the social enterprise sector in the UK is attracting increasing attention from policy makers, although effective policy development is restricted by the limited nature of the evidence base that currently exists. The baseline mapping exercise that is currently being undertaken by the DTI is an attempt to get a better idea of the scale of the social sector and the characteristics of organisations that are active in it. This is essential if the potential and actual contribution of the social sector is to be estimated, which is necessary if public funds are to be used to support it (or parts of it) in different ways. At the same time, the sector is difficult to define, mainly because it represents such a diverse mix of organisations, which may share a loosely defined social purpose, but in some cases little else. Whilst the current government definition has established a clear set of principles, their application in practice raises some problems. The systematic application of the tests derived from the definition results in the inclusion of some organisations, which few would have previously considered part of the social economy, not even the organisations themselves, whilst excluding other organisations which historically have been one of its foundations.

At the same time, the attempt to establish a clearer set of guidelines to define the sector must be applauded. It may be argued that because of the lack of clear conceptual definitions, the current approach will ultimately lead to greater clarity. Fundamentally, there are two related sets of issues: firstly agreeing on the definitional criteria; and secondly, providing workable guidance for operationalising them. As far as the first is concerned, while most would agree that a social enterprise is an organisation that combines social aims with some attempt to operate as a business, problems arise when attempts are made to define social aims operationally, mainly because of the value judgements implicit in such an exercise. Our attempts to use Community

Interest Company (CIC) and charitable status guidance emphasised wider social benefits, but one is still left to interpret the 'reasonable person test'.

The other key problem involves interpreting precisely what operating as a business means in practice. DTI guidance has set fairly demanding trading income criteria for social enterprises to qualify for the core group in the mapping exercise (i.e. 50% of total income), although it remains to be seen how many organisations will actually qualify when the baseline mapping exercise is complete. At an operational level, the problem focuses on exactly what constitutes trading income. If service level agreements are included, there can be considerable problems involved in distinguishing these from grants, since few grants these days come without some expectations with regards to outputs. Conceptually, we suggest that a service level agreement or contract should only be regarded as trading income if it is won in competition with other organisations, although this raises additional problems at the operational level.

From a policy perspective, once the results from the baseline mapping exercise are publicly available, there is a need to systematically assess the nature and extent of the contribution to local, economic and social development, perhaps in comparison with public and private sector alternatives. However, the evidence base should also include a better understanding of how social enterprises develop, recognising the heterogeneity of types of organisation involved. This includes those emerging from community development or regeneration projects, which may move slowly towards the generation of trading income, as well as more commercially oriented organisations (e.g. community shop, community transport), which may not be completely self financing, but which are inherently trading enterprises. Indeed, in the first case, one might

question whether they can ever become free from a dependence on the public purse, which on the basis of the evidence presented by Amin et al (2002) is doubtful.

Another priority research area, which is closely related to an understanding of the process of social enterprise development, is to better understand the nature of entrepreneurship in the social sector. This has implications for policy as well as being of policy significance because there is a feeling that the entrepreneurship discourse may be overstating the entrepreneurship involved. For example, some critics suggest that part of the current policy push is driven by a desire on the part of government to improve the quality of management in voluntary sector activities, as part of an attempt to encourage organisations dependent on public funding to diversify their income base. We also need to increase our knowledge about so-called social entrepreneurs; in other words, the key individuals behind the social enterprises, using more discriminating typologies rather than including all leaders of social enterprises as social entrepreneurs. This is important conceptually, if we are to better link research in this field to the mainstream entrepreneurship literature (disparate as it is). It may also be important for policy development in helping to define the support needs of such people and their enterprises at different stages of their development.

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## CONCEPTUALISING ENTREPRENEURSHIP IN A TRANSITION CONTEXT

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### **Abstract**

The paper sets out to review entrepreneurship in transition countries, assessing the extent to which theories and concepts of entrepreneurship developed in a market economy context can provide an appropriate interpretative framework. This is done in order to develop propositions for a model of entrepreneurship under transition conditions, which captures (1) the distinctive features of entrepreneurship (2) the context for entrepreneurship in these countries and (3) the

entrepreneurial process. The paper builds on previous papers by the authors, selectively using empirical evidence to support appropriate conceptualisation.

## **1. Introduction**

Alongside the liberalisation of prices and the creation of market institutions, the transformation of centrally planned into market economies involves the development of a privately owned business sector, through a combination of the privatisation of former state-owned companies and the creation of completely new enterprises. In principle, entrepreneurship (particularly in the form of the creation of new ventures) can contribute to the process of transforming former socialist countries into democratic, market based systems in a variety of ways. The potential role of entrepreneurs includes generating employment; using privatised property for production; contributing to the development of a diversified economic structure; contributing to the innovative capability of the economy; and contributing to economic development through the generation of foreign sales and/or import substitution. In addition to these essentially economic roles, entrepreneurship can also contribute to the emergence and development of a middle class that is fundamental to the wider process of transformation to a market based democracy.

However, achieving this potential contribution has presented many challenges in a context where, in most socialist countries, private business ownership was previously considered illegal; the resources for establishing and developing businesses extremely limited and the external environment contains many institutional deficiencies, compared with most mature market economies. Not surprisingly, some 15 years after the start of the reform process, there is considerable variation between countries in the extent to which a facilitating environment for the development of entrepreneurship has been created. As a result, it is inappropriate to refer to transition countries as if they are an undifferentiated, homogeneous group, any more

than so-called market economies may be considered as a uniform group. Instead, it may be more appropriate to think in terms of a continuum from central planned economies at the one extreme to liberal market economies at the other, with individual countries situated at different points along it. In the context of former socialist economies, positioning along this continuum is heavily influenced by the extent of the commitment of government to market reforms, which is demonstrated through their actions with respect to progress with privatisation; the extent to which there is price liberalisation; and the role of government with respect to the creation and effective operation of market institutions as well as their attitude towards entrepreneurship.

In this regard, assessment by the European Bank for Reconstruction and Development (EBRD) shows wide variation between countries with respect to dimensions, such as large and small-scale privatisation; price liberalisation; and banking reform, where the rate of progress has typically been slower. Whilst a detailed classification of all so-called transition economies may be inappropriate here, a broad distinction can be made between Central and Eastern European countries (CEECs) that are either current members of the EU, or in the next group to join; and former Soviet republics (other than the Baltic States). Although considerable variations can still be identified within each of these groups, such a distinction can be justified, not least because of the influence of EU accession in driving the process of institutional reform (Smallbone & Welter, 2003b).

As a consequence, when analysing entrepreneurial behaviour with the aid of concepts and theories developed in a market context, so-called transition economies cannot be treated as a single group. In practice, a growing gap can be identified between CEECs that are essentially emerging market economies and countries where the framework conditions for establishing a

market environment have still to be effectively installed, particularly where there appears to be no current political will to do so (as in Belarus). For the purpose of this paper, we will use the term 'early stage transition' to describe such countries, without meaning to imply any necessary progression to later stages.

In this context, the paper sets out to review the development of entrepreneurship in countries that have emerged from central planning, in order to assess, on the one hand, the extent to which theories and concepts of entrepreneurship developed in a market economy context are appropriate to analysing this phenomenon and, on the other, the implications of the types of entrepreneurial behaviour observed in transition conditions for existing theory. This is done in order to develop propositions to subsequently feed into the development of a conceptual framework of entrepreneurship under transition conditions, which captures (1) the distinctive features of entrepreneurship, (2) the context for entrepreneurship in these countries and (3) the entrepreneurial process.

One of the issues this raises concerns the nature of the evidence base on which to develop or test theories and apply concepts. In this regard, Scase (2003) refers to a lack of reliable data leading, amongst other things, to 'extremely unreliable estimates of the real significance of entrepreneurship and small business ownership in a transition context (Vickerstaff et al, 1998). However, whilst secondary data constraints, and the difficulties of systematically conducting empirical research in some of the former Soviet republics, should not be underestimated, the challenge for researchers is to develop methodological approaches that are appropriate to the context in which they are being used, as well as to the research questions they are addressing. Large scale surveys can be undertaken in transition circumstances, and can produce potentially useful results, provided they are interpreted in the context in which

the data were gathered, with the limits to generalisation clearly defined. At the same time, such methods can benefit from being used in combination with more process-oriented qualitative approaches, which on some issues can produce quite different results than those based on survey responses (Welter and Smallbone, 2003).

The empirical underpinnings of the paper comprises a number of studies since 1993, in which one or both the authors have been involved. These include studies of the survival and growth of manufacturing SMEs in Poland and the Baltic States, based on interviews with 600 businesses (Smallbone et al, 1997); internationalisation and SME development in Central and Eastern Europe in 1997-98, which also involved a large scale survey of SMEs in Poland, Bulgaria and the Baltic States (Smallbone et al, 1999a); a study of the support needs of Small Enterprises in Ukraine, Belarus and Moldova, involving 600 interviews with entrepreneurs, as well as with providers of business support (Smallbone et al, 1999b); the contribution of small businesses to regional economic development in Ukraine, Moldova and Belarus, which involved case studies, as well as a large scale survey (Smallbone et al, 2001); employment, SMEs and Labour Markets in the Russian Federation and Moldova, involving a survey of more than 1000 SMEs and case studies also (Welter et al, 2000); innovation, small and medium enterprises and economic development in Ukraine and Belarus, which also combined case studies with a survey' (Smallbone et al, 2002); female entrepreneurship in Ukraine, Moldova and Uzbekistan (Welter et al, 2003); entrepreneurial strategies and trust in low trust and high trust environments of East and West Europe.

## **2. Concepts of Entrepreneurship under Transition Conditions**

In considering concepts of entrepreneurship in a transition context, it may be helpful to briefly discuss a *number of definitional issues* that are potentially relevant. Entrepreneurship involves both inputs and outputs. Inputs involve entrepreneurial skills and qualities, with participation in the competitive process as the main output. A firm is a vehicle for transforming the personal qualities and ambitions of entrepreneurs into actions and outputs. Context may be viewed as a third dimension of entrepreneurship, since the specific internal organisational and external operating contexts provide the framework within which the input and output dimensions can take place (de Wit and Meyer, 1998).

Entrepreneurship is also a multidimensional concept, which can be analysed at different levels. Firstly, entrepreneurship is concerned with individuals in terms of their roles, traits and actions, integral to which are their learning abilities and behaviours (Pedler, et al. 1998).

Individual entrepreneurs can operate on their own or in teams. The second dimension is at the firm level and the third at the aggregate level of industries, regions and nations. A consideration of the role and characteristics of entrepreneurship in a transition context involves linking the individual level to the aggregate level, as the context for entrepreneurship is a distinctive one, with a much stronger influence on entrepreneurship compared to mature market economies (cf. section 3). Moreover, in any context, entrepreneurial learning activities need to be analysed as a reciprocal process between an individual entrepreneur/firm and the external environment, with the entrepreneur and his/her environment interacting and influencing each other (Berger and Luckmann, 1967).

Richard Scase (1997; 2003) has contributed to the debate about the role of entrepreneurship under transition conditions by distinguishing between entrepreneurship and proprietorship,

based on “contrasting psychologies of business founders; their attitudes towards trading; and their orientation towards capital accumulation” (Scase, 2003, p 67). According to him, entrepreneurship refers to a person’s commitment to capital accumulation and business growth, whereas proprietorship describes the ownership of property and other assets, which may be used for trading purposes to realise profits, but which are not utilised for longer term purposes of capital accumulation. Any surpluses generated by proprietors are likely to be consumed rather than re-invested for business purposes.

In the pursuit of capital accumulation and long term growth, the entrepreneur may forego personal consumption and may actively search out market opportunities, which involves taking risks and coping with uncertainty. In the case of proprietorship, according to Scase, the motives are quite different, since surpluses are not re-invested in the business for future long term capital accumulation but rather consumed and used to sustain a specific standard of living. According to Scase, in the transitional economies of Russia and Central Europe, proprietorship rather than entrepreneurship best describes the majority of small business activity. His assessment is that whilst numerically significant, particularly in sectors such as services and retailing, offering employment and providing earnings, these proprietors are incapable of constituting an indigenous force for economic development at the macro level.

Although Scase focuses on transition economies, his distinction between entrepreneurs and proprietors is not specific to a transition context. The lack of commitment to long term capital accumulation, with an emphasis on consuming any surplus rather than re-investing it in the business (proprietors according to Scase), is a common feature of many small firm owners in mature market economies. It is one of the reasons why few small businesses grow to any great extent. Perhaps the issue needs to be viewed as part of a wider discussion about the role of

entrepreneurship and small business in economic development, rather than being viewed as a specifically transition issue. In this context, the key point to emphasise is the importance of Schumpeterian-type entrepreneurs to economic development in any economy and the creation of 'newness', such as in terms of products and processes, although as Wennekers and Thurik (1999) note, in practice, few business owners are either pure Schumpeterians or pure 'shopkeepers'.

Scase's approach is related to an earlier concept developed by Bögenhold (1987), who distinguished between entrepreneurship motivated by economic needs and entrepreneurship, which is driven by a desire for self-realisation. More recently, the GEM consortium have distinguished between 'opportunity' and 'necessity' entrepreneurship, based on the reasons given by entrepreneurs for starting a new business, with necessity entrepreneurship tending to dominate in transition and developing countries.

However, some empirical results have challenged the appropriateness of such a simple dichotomy. For example, it has been suggested that concepts of 'necessity' and 'opportunity' entrepreneurship are overly simplistic classifications, especially in the context of the conditions pertaining during early stages of transition, where it may lead to overly negative conclusions about the contribution of entrepreneurs (Smallbone and Welter 2003a). This is partly explained by the specificities of external conditions that can lead even well-educated people being presented with limited opportunities for satisfying and sufficiently rewarding employment, which contributes to entrepreneurship attracting individuals with high levels of human capital. As a result, many entrepreneurs in transition environments are well equipped to identify and exploit opportunities as they emerge over time, even if the initial reasons for becoming an entrepreneur in the first place can reasonably be described as 'necessity'. It is

also influenced by the learning experience of individuals, which can contribute to changes in their motivation and behaviour with respect to entrepreneurship over time. Even in those post socialist countries where institutional and other external conditions for private entrepreneurship are deficient, entrepreneurs set up businesses for a variety of reasons, including 'pull' as well as 'push' factors. Moreover, the aims and orientation of entrepreneurs can change over time, as new opportunities are presented, the business environment improves and/or because of the development of their own entrepreneurial capacity.

Concepts such as proprietorship/entrepreneurship and the distinction between opportunity- and necessity-driven entrepreneurship implicitly focuses on the attributes of individuals, which can be measured through, for example, the motives and objectives of entrepreneurs, or, as Scase emphasises, through "psychological profiles". This draws on the psychological traits approach, which has been widely criticised for its restrictive focus on entrepreneurship as a personal phenomenon, divorced from its social and institutional context.

New venture creation must be viewed as a process, which means that the aims and motivations of (potential) entrepreneurs can operate at different levels, including deep-seated antecedent influences, as well as immediate triggers. The entrepreneurship literature contains numerous models and frameworks developed to analyse the process of starting a business, most of which have been based on research undertaken in market economies. In the context of a transition environment, such frameworks are potentially useful for analysing the barriers faced by entrepreneurs and potential entrepreneurs, since it is likely that these barriers will vary at different stages of market development. At the same time, the distinctiveness of transition conditions raises the question of whether these models can fully capture the entrepreneurial process in post socialist countries.

One issue that arises in countries that until ten years ago were operating under a centrally planned system, concerns the potential of entrepreneurial activities during the socialist period to 'breed capitalism' (Kornai 1992), thus acting as the 'antecedent influences', identified by authors such as Cooper (1981), which have potential implications for the balance between productive and unproductive entrepreneurship (Baumol 1990). Although in Central and Eastern European countries private entrepreneurship lost its major role with the introduction of a centrally planned economic system, different forms of private entrepreneurship co-existed beside state ownership and entrepreneurship within state enterprises during the socialist period. In this regard, we can distinguish between the formal and the grey economy (consisting of the second and the illegal economy), where 'boundaries' frequently changed following political trends of liberalising and restricting private ownership and entrepreneurship.

In addition, Rehn and Taalas (2004) have emphasised how entrepreneurship flourished during the Soviet period in the daily lives of individuals, as they struggled to cope with the material shortages that were a common occurrence in the Soviet system. In pointing out the importance of interpreting entrepreneurship in its specific social context, Rehn and Taalas raise definitional issues concerning the nature of entrepreneurship, which they interpret as a 'search for opportunities and beneficial outcomes in economic interactions' (Rehn and Taalas, op cit, p246) which, through necessity, made most citizens of the USSR entrepreneurs, in the Rehn and Tallas sense.

All this contributes to a different background of entrepreneurs in transition conditions, which interacts with characteristics of the institutional environment to influence the specific patterns

of their entrepreneurial behaviour. For example, in early stage transition countries, where progress with market reforms has been slow or stalled, we can frequently observe a persistent type of behaviour that may be characterised as ‘muddling through’ and ‘rule avoiding’, but which nevertheless represents a learned response to a particular set of external environmental conditions (Welter and Smallbone 2003). Examples include economic activity that is at least partly in the shadow economy, tax evasion, and a heavy reliance on personal network contacts in daily business life.

Principally, entrepreneurs fall back on behaviour they have previously applied successfully, as long as they are facing familiar situations, for which ‘closed loop’ learning can provide the basis for making an adequate response. However, faced with unpredictable or even unknowable change situations, tried and tested routines may be inadequate. An example relates to the rapid series of changes and instability of macro and institutional conditions at the beginning of the transition process. Although this situation would require a change in entrepreneurial behaviour, cognitive biases inherent in decision making processes could reinforce a muddling-through approach and unstructured behaviour of entrepreneurs. The conflict theory of decision making explains this in terms of ‘avoidance’ (Lyles and Thomas 1988). Once an entrepreneur has settled on a particular course of action, (s)he will only change her behaviour in cases where current actions lead to negative results, which are higher than the risk coupled with taking an unknown course of action.

### **3. The Institutional Embeddedness of Entrepreneurship in a Transition Context**

In a transition context, the environment is characterised by a high level of uncertainty, rapidly changing external conditions and institutional deficiencies, which result in significant

additional operating costs for businesses without contributing any additional value (Smallbone and Welter 2001b). The key question is whether or not this results in fundamental differences in the way that entrepreneurs identify and exploit opportunities, compared with their counterparts in mature market economies and/or whether the outcomes, for example, in terms of the types of organisation established are distinctive. Although much of the research on entrepreneurship in transition economies has focused on entrepreneurs and their behaviours at an individual level, the specific characteristics of the external environment under transition make the latter a potentially more dominant influence on entrepreneurship than in a mature market context, where external conditions are typically more stable.

So far, with the exception of the eclectic approach to entrepreneurship (cf. Verheul et al. 2002) most entrepreneurship theories focus on micro-level influences in order to explain new venture creation and the development of entrepreneurship, taking the institutional environment as given. However, there is considerable empirical evidence from transition economies, which shows the external environment to be one of the dominant feature influencing the nature and pace of entrepreneurship (e.g., Peng and Heath 1996, Peng 2000, Polishchuk 2001, Smallbone and Welter 2001a, 2001b). It can be argued that in any context enterprise behaviour results from a dynamic inter-relationship between internal (i.e. both organisational and personal characteristics) and external conditions, but in situations where market conditions are only partially installed, the institutional context becomes a critical factor. Referring back to the introduction, where a continuum of market development was described, if entrepreneurship is viewed as an individual act, undertaken in specific social/institutional/environmental conditions, then the balance between individual and environmental factors in explaining entrepreneurial behaviour is likely to vary at different points along that continuum.

In this context, an institutional perspective can be used to explore differences in the embeddedness of entrepreneurship in post socialist and market-economy environments and the influence on entrepreneurial processes. Institutions represent the ‘formal’ and ‘informal’ constraining and enabling forces with respect to entrepreneurship, creating opportunity fields (e.g., through laws) and influencing the collective and individual perception of entrepreneurial opportunities. Nooteboom (2002: 34) defines institutions as “things that constrain, enable and guide behaviour”, consequently discussing a separation between so-called surface institutions, which would enable and constrain, and deep structures, which would guide individual behaviour. However, Nooteboom himself concludes that a clear separation is not viable due to recursive and feedback links between both concepts, illustrating the difficulties in achieving a clear-cut distinction between formal and informal institutions.

One prominent example of formal or regulatory institutions is laws, which might create new opportunity fields for entrepreneurs, as happened in transition economies with the introduction of property rights allowing for private ownership. On the other hand, a deficient legal infrastructure (e.g., implementation gaps, a lack of judges, economic courts) could restrict entrepreneurship, especially where an ‘institutional void’ (Polishchuk 1997) allows for discretionary actions of administration, thus fostering rent-seeking, corruption and non-compliant or defiant behaviour of entrepreneurs. Normative and cultural-cognitive elements contain the collective sense making and individual understanding of societal values and rules respectively, which depends on previous experiences and knowledge.

The nature and extent of entrepreneurship across different environments reflect particular settings of institutions and enforcement mechanisms (Scott 2001, Honig and Karlsson 2004).

Formal institutions are enforced by coercive mechanisms as mainly set down in government rules, whilst informal institutions are enforced by normative and mimetic mechanisms.

Normative mechanisms push entrepreneurs to follow codes of behaviour as set out by a specific community such as industries, business associations, families or ethnic groups. They assist in creating legitimacy, which is of particular importance for nascent entrepreneurs and entrepreneurs in environments such as the transition context, where they face an additional degree of liability of newness. Formal mechanisms to ensure normative behaviour include regulations such as licensing, registration or accreditation (Scott 2001), while informal institutions are also enforced by trust (Welter 2003b, Welter et al. 2004).

Normative pressures, as codified in informal institutions, regulate entrepreneurs' behaviour and restrict their options, thus often forcing entrepreneurs to comply, even when they have to employ illegal actions. One such example is the Russian tax system. When paying taxes, entrepreneurs face a bundle of unwritten rules such as bargaining over the law, making friends within the tax authority, observing the formalities (i.e., filling in fictitious statements) and knowing their limits, which applies to both taxpayers and inspectors (Busse 2002). Again, these institutions are partly founded on Soviet predispositions, where the individual bureaucrat was the ultimate decision-making authority, rather than a law or written regulation itself (Busse 2002: 215), although they also result from regulatory shortcomings and gaps in implementing the new institutional frame.

In a transition context, several studies have confirmed the occurrence and persistence of avoidance behaviour (e.g., Frye and Shleifer, 1997; Hendley et al., 2000; Gustafson, 1999), which can be explained by a highly volatile institutional environment, encouraging entrepreneurs to fall back on learned behaviour. Feige (1997: 28) characterises such actions as

the 'legacy of non-compliance', which dominated most of the tolerated and non-legal entrepreneurial activities in Soviet times. Other examples of entrepreneurial behaviour reflecting a response to specific institutional conditions include a high degree of networking, based on personal connections; particular financial bootstrapping tactics; and diversification or portfolio entrepreneurship (Welter and Smallbone 2003). With regard to networking, entrepreneurs draw on behaviour, which was widely used during Soviet times, namely reciprocal favours ('blat'). During the Soviet period, 'blat' was an integral part of the everyday lives of Soviet citizens, providing a mechanism for 'realising the hidden potentials of the system' (Ledeneva 1998). Such behaviour represents an integral part of the inheritance of citizens in transition countries, originating from the Soviet period and one of the mechanisms for dealing with resource constraints facing entrepreneurs during the transition period.

Another enterprise reaction to the external environment in transition economies concerns the so-called financial strategies of SMEs, in a situation where access to finance from formal sources is extremely scarce. Here, financial bootstrapping is used including, for example, serial entrepreneurship as one way for SMEs to accumulate the financial resources necessary to start a business in a context where the financial system is inadequate (Smallbone and Welter, 2001a). This often is extended to portfolio entrepreneurship and diversification particularly in sectors such as manufacturing where access to external capital is scarce and demand may be fluctuating and uncertain. The establishment of a retail shop or market stall by a clothing manufacturer is one example. In a transition context, such behaviour does not only reflect 'normal' risk behaviour of entrepreneurs, but it can also be encouraged by certain institutional deficiencies. For example, diversification commonly represents a deliberate strategy of making business success less visible to officials and those who may seek to make

money from offering 'protection'. Although our evidence from several projects also implies that motives for diversification strategies include the realisation of market opportunities, as well as ongoing access to markets, the role of both portfolio entrepreneurship and product diversification as a means of overcoming (short-term) financial constraints is even more important, especially with respect to enterprises with high investment and working capital needs.

In addition, case studies show that diversification in most cases results in a broad and apparently unrelated portfolio of activities. Thus diversification strategies of enterprises in a transition context, particularly in early stage countries do not mainly reflect long-term strategic considerations. They chiefly express short-term behaviour to overcome financial and environmental constraints and institutional deficiencies. This emphasis on behaviour driven by short term expediency, necessary for a business to continue to operate, is also reflected in the reported pattern of use of advice and assistance from external sources, which in early stage transition environments, is typically focused on the use of legal and tax consultants, rather than on help (e.g. with marketing) associated with improving the basis for longer term business development (Smallbone et al., 2001c).

Although such behaviour may fall short of the optimal, standard set of economic man assumptions, it may be viewed as a rational entrepreneurial reaction to the given institutional framework. In adverse, unfamiliar and fragile environments, entrepreneurs keep a low profile, mainly avoiding official regulations whenever possible, or attempting to conform, which is made difficult in environments with rapid institutional changes. Thus, environments with institutional gaps generally favour a muddling-through type of behaviour (Barrett 1998). New and unfamiliar environments lack the basic strategic options, which have to be tested and

learned in a trial and error manner, going from simple to more complex patterns over time (Welter 2003a). In fragile and turbulent environments, entrepreneurs have to decide and (re-) act rapidly, whilst the deficient institutional settings re-enforce institutional mistrust.

In this regard, the concept of path dependency helps to explain rule-avoiding and seemingly sub-optimal behaviour. Conflicting formal and informal institutions encourage individuals to recur to familiar courses of action. If successful, this tends to reinforce trusted and known codes of conduct, resulting at the individual level in an 'escalating commitment' of entrepreneurs to viable, but not necessarily the best courses of actions (Whyte 1986). This in turn further constrains the required adaptation of informal institutions, often resulting in vicious circles and low-level efficiency traps for entrepreneurial behaviour, which are a widespread phenomenon in transition economies, especially in the early phases of transition (Kuznetsov 1997).

From an economic point of view, these 'lock-in effects' foster sub-optimal resource allocation, resulting in unproductive entrepreneurship as described by Baumol (1990). In such situations entrepreneurship remains restricted, the number of firms small and their contribution to economic development in terms of jobs, innovation and external income generation rather limited. As a result, institutional change becomes an important resource needed to initiate entrepreneurship, particularly in uncertain and unstable contexts.

Institutional change positively influences entrepreneurship when it removes or lowers barriers to market entry and market exit, thus creating opportunity fields for entrepreneurs, and vice versa. Examples of positive institutional changes include the introduction of private property rights at the beginning of the transformation process in some former socialist countries, or efforts to reduce regulatory burdens on enterprise in mature market economies.

#### **4. The Entrepreneurial Process under Transition Conditions**

One of the contemporary themes in the mainstream entrepreneurship literature is concerned with the creation and identification of entrepreneurial opportunities, which raises the question of whether the entrepreneurial process differs in a transition environment, and if so, in what aspects. In this context, some of the most recent models of the entrepreneurial process concentrate on opportunity recognition as an important element. For example, Beattie (1999) identifies two major models of the business creation process, differentiated by factors, which influence the opportunity recognition process. The first incorporates individual characteristics and environmental influences, understanding venture creation as an interactive process in which a person, his/her personality and interpretation of events influence any decision to start a business. Theoretically, this process is reflected, for example, in Shapero's concept of the entrepreneurial event, or Ajzen's theory of planned behaviour, which interprets entrepreneurial intentions as a function of feasibility and desirability.

The second model, of which Gibb and Ritchie's approach (1982) is an example, accepts venture creation as an outcome of the situations encountered and the social embeddedness of the entrepreneurs, thus implicitly picking up the theme of opportunity enactment outlined below. In this context, Kirzner's understanding of opportunities as a result of entrepreneurial alertness, entrepreneurial beliefs and information asymmetries (Kirzner 1997a, 1997b, 1999) emphasises the cognitive properties of (potential) entrepreneurs, which have an impact on entry patterns into entrepreneurship as well as subsequent development paths, thus indirectly influencing the extent and nature of entrepreneurship.

Shane (2003) distinguishes between two types of opportunities, i.e., Schumpeterian and Kirznerian ones. Schumpeterian opportunities result from disequilibrating situations, which makes them rare and innovative, involving the creation of new combinations. Sources of Schumpeterian opportunities include technological changes, political and regulatory changes and social and demographic change. Compared to this, Kirznerian opportunities are understood as being equilibrating, not requiring new information, less innovative, common and having a limited potential for discovery and innovation (Shane and Venkataraman 2000, Shane 2003).

Schumpeter's understanding of opportunities draws attention to environmental influences. This allows us to construct a link between the embeddedness perspective of entrepreneurship and an individual perspective, as the institutional framework influences the existence of opportunities as well as their recognition and possibilities for exploitation, which is explicitly recognised by Kirzner (1980) also. In this context, Shane (2003: 22-33) and Eckhardt and Shane (2003: 341-343) review empirical evidence for opportunity creation resulting from what they label 'exogenous shifts in information'. Several studies confirm that changes in technology, political forces, regulation and macro-economic influences, as well as social trends, are decisive influences on the existence and occurrence of new opportunities. All this applies to transition economies, which underwent fundamental changes when starting the transition from central planning economy towards a market-based system.

In a transition context, the Kirzner type of opportunities would be more apparent in later stages of transition, where markets have been developed and flows of information, ideas and knowledge from mature market economies represent an important source of innovation for enterprises (Smallbone et al. 2002). It is reflected in empirical surveys in more advanced

transition countries, where entrepreneurs complain about growing competition as one of their pressing business problems (e.g., Smallbone et al. 1999, Smallbone and Welter 2003b), whilst in early stage transition countries it is a lack of resources needed to realise an entrepreneur's business idea, together with a lack of institutional stability and unpredictability of institutional behaviour that is emphasised (e.g., Smallbone et al. 2002, Welter et al. 2003) At the beginning of the transition period, limited competition existed in many markets and market opportunities resulted from the shortages of certain goods, for which a latent demand existed. Such an environment was potentially a 'seedbed' for the Schumpeterian type of opportunities for entrepreneurs, although a variety of institutional constraints limited their ability to exploit these.

The embeddedness of opportunities in the formal institutional environment may be illustrated with reference to the initial changes in the institutional framework, which fostered entrepreneurship, when legal and administrative reforms made it legally possible for privately owned businesses to compete with state owned enterprises. Consequently, the number of private firms increased sharply in what has been described in Poland, for example, as "an explosion of entrepreneurship", facilitated by a removal of legal barriers to market entry, combined with the low intensity of competition and the existence of opportunities to earn monopoly profits and/or speculative incomes for a period (Piasecki and Rogut 1993). In explaining this, McMillan and Woodruff (2002) emphasise the results of distortions created by the planned economy, which created new market opportunities for potential entrepreneurs (e.g. in consumer services), once the establishment of privately owned enterprises became legal. However, in situations where a new formal framework is not (yet) properly implemented, 'loopholes' for 'creative' entrepreneurial activities may be created, although

some of these may fall into the category of more unproductive or even destructive entrepreneurship, as described by Baumol (1990).

Whilst focusing on the effects of the institutional environment on the exploitation of opportunities, Shane (2003, p160) recognises, in principle at least, that the former may also influence the discovery of opportunities. An example of institutional deficiencies creating opportunities for entrepreneurship is the development of business service consultancies in Ukraine, which is a new and emerging sector in such a context (Smallbone et al., 2002). The customers of these small consultancy firms are mainly private businesses, but also include some state and municipally-owned enterprises, which are increasingly looking for firms to supply a full range of services to avoid the necessity of employing several specialist companies. This 'full service' portfolio would include not just business advice, but also the acquisition of the necessary licences and permits needed to start and run an enterprise or, in some cases, to develop a new project. The consultancy firms that had developed to fill this niche were not 'grey sector' enterprises, but some of the most innovative and successful services firms in the study, which had responded positively to a market opportunity created by the specific institutional conditions pertaining in Ukraine at the time. Whilst the specific nature of the opportunities may be transient as the institutional environment for productive entrepreneurship improves, the behaviour demonstrated by these enterprises shows a high level of sensitivity and responsiveness to the needs of customers, which are themselves heavily influenced by institutional conditions.

Whilst Schumpeter puts more emphasis on the 'objective' side of opportunities and the related process of discovering and exploiting them, which he describes as a process of creative destruction, Kirzner (1997a: 51) implicitly understands this as an enacted phenomenon:

“Entrepreneurial discovery represents the alert becoming aware of what has been overlooked. (...) When the (...) human agent acts, he is determining what indeed he ‘sees’ in the murky future.” In this context, Kirzner (1979, 1997b) also refers to spontaneous learning and ‘surprise’ as a fundamental basis for entrepreneurial discoveries, allowing to include ‘serendipity’ and ‘luck’ as possible sources for entrepreneurial actions. A Kirznerian perspective draws attention to the interplay of ideas, beliefs and actions in defining and creating opportunities defying a simplistic view (Sarasvathy et al. 2003). Opportunities do not only “exist out there”, they are also created (Davidsson 2003). Opportunities emerge as individuals make sense of information and their actions, thus retrospectively ‘discovering’ and ‘recognising’ opportunities (Gartner et al. 2003).

As Gartner et al. (2003) argue, this opportunity enactment perspective draws attention to the fact that environments are also influenced by the scope of individual actions, which draws attention to the recursive links, existing between individual perceptions and environments, both simultaneously creating opportunities. This brings us back to the institutional embeddedness perspective on entrepreneurship outlined in section 3 above, which can be integrated into our discussion around opportunities in a transition context. Whilst formal institutions create opportunity fields for entrepreneurship, informal institutions influence the collective and individual perception of entrepreneurial opportunities, thus resulting in differences in the opportunity recognition process across contexts, cultures and countries. In a transition environment, this conception takes on particular importance, because the environment, in which opportunities are created, is qualitatively different compared to market economies and conditions can also change very quickly.

## **5. Conclusions and Implications**

Davidsson (2003) has emphasised the need for entrepreneurship research to acknowledge the heterogeneity of environmental conditions, outcomes and behaviours. The key question, as far as this paper is concerned, is the extent to which existing concepts and theories are appropriate bases for analysing entrepreneurship in transition conditions. The discussion shows that entrepreneurship in a transition context is not unique, as the essential principles of individual behaviour are the same regardless of the environment. However, where the process of entrepreneurship is distinctive is with respect to the specific interplay between individual entrepreneur/firm behaviour and the external environment, which changes as the process of transition unfolds. This emphasises the need to carefully review theories and concepts based on market economy principles for their usefulness and applicability in a context where market conditions are only partially established.

In this context, our selective review of literature and the empirical evidence base leads us to suggest a number of key propositions:

(i) In assessing the relevance of concepts and theories of entrepreneurship developed in market economies to transition environments, it is important to recognise the distinction between countries where the process of market reform is advanced, such that they may be better described as emerging market economies, on the one hand, and countries where the framework conditions for a market economy are still to be installed, on the other. In the latter case, external conditions may encourage unproductive, and even destructive, forms of entrepreneurship, with implications for its contribution to economic development.

(ii) As in mature market economies, the nature and extent of entrepreneurship in a transition context depends on individual goals and self-perceptions of the entrepreneur with regards to opportunities for venture creation and development, as these influence the steps entrepreneurs take to set up and/or expand their venture. All are influenced by the values and conventions within a society, as well as by the background of entrepreneurs, who for the most part have no prior experience of entrepreneurial activity in a market context, but are often educationally well qualified, with some experience of management.

(iii) The institutional environment influences the extent to which entrepreneurship develops, but also the forms that entrepreneurship takes and the behaviour patterns exhibited by entrepreneurs. In environments, where institutional settings are not clearly defined, as in 'early stage' transition countries, (nascent) entrepreneurs face a high level of uncertainty and ambiguity. This results in entrepreneurs falling back on learned behaviour, such as networking and avoidance strategies, which are to some extent path dependent. Although such behaviour might support firm performance and/or survival in the short run, it might be detrimental to firm development and growth in the long run.

(iv) Typologies which crudely classify individual as entrepreneurs or proprietors; or necessity- or opportunity-driven, fail to recognise the learning capability of individuals, interacting with a rapidly changing external environment. Whilst the point applies to entrepreneurship in all types of external conditions, it is a particular issue in transition economies, because of the reported dearth of opportunity driven entrepreneurs.

(v) Institutional change can create opportunities for entrepreneurship, as it opens up new fields which entrepreneurs can pursue. However, institutional change may also trigger and/or reinforce norm-deviant behaviour at the individual level. Conflicts within the institutional settings may encourage entrepreneurs to revert to familiar and known courses of actions (learned behaviour), based on the requirements of a previous institutional environment, thus fostering 'lock-in' situations where path-dependency prevents entrepreneurs from adapting to new context conditions.

(vi) Fostering entrepreneurship in 'locked-in' situations, where institutional change is needed, requires entrepreneurial (re-) learning. Institutional change itself may trigger entrepreneurial learning, but the learning capability of entrepreneurs and businesses influences the nature of the response.

(vii) Entrepreneurial opportunities in a transition context differ across the various stages of transition, being linked to the institutional environment. In early stages where a new institutional framework is in the process of being created, Schumpeterian opportunities result from disequilibrating situations. Kirzner type opportunities (equilibrating, less innovative) would be more apparent in later stages of transition, where markets and business environments have been developed and are more stable, thus forcing nascent entrepreneurs more and more into imitative new ventures.

The implications for further research on entrepreneurship (in a transition context) emphasises the importance of viewing entrepreneurship as a learning process, where entrepreneurs change their behaviour in reaction to changes in their external environment, or in anticipation of this.

In this perspective, entrepreneurship is understood as a non linear process with feedback loops between individuals and their environment. This draws attention not only to the individual component of entrepreneurship, but also to its institutional embeddedness. This emphasises the need for caution when applying entrepreneurship theories and concepts, which have been elaborated in the context of a mature market economy to explain the entrepreneurship phenomenon in situations where the framework conditions for a market economies are still to be established..

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**MANAGING THE LABOR SHORTAGE: AN IMPENDING SME CRISIS?**

by

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## **ABSTRACT**

While the adequate supply of skilled employees for Small and Medium Sized Enterprises (SME) should be a priority, little is known about their awareness of or management of the human resource component of their capacity. There has been significant research and popular press coverage of impending labor shortages affecting large business firms, but not its possible impact on SMEs. Reporting on interview results from 76 small business firms across a variety of industries, this research explores SME perceptions and reactions to the labor shortage issue. Small business firms readily admit to already experiencing such shortages. Their responses are different than what one might anticipate. There is a notable paradox indicating the absence of proactive planning. While the majority of SME firms interviewed have experienced frequent or constant problems finding people with important or firm-survival critical skills, only thirty percent indicate human resource needs and availability processes. We report on the nature of skills sought, and current and anticipated responses to the anticipated shortages. Perceptions of and remedies to the shortage are different than might be expected. This study suggests skill weaknesses, shortsightedness, and naïveté on the part of the small business owners and managers. Considering this as a skill shortage confronting SMEs causes the authors to consider this potentially being more significant than shortages within the external labor market. Although the findings are tentative due to the relatively small sampling of SMEs, they provide encouragement and direction for future research.

## **INTRODUCTION**

Since small businesses represent 99.7 percent of all employer firms in the United States, the impact of small business on the economy and society cannot be overstated. Further, small businesses serve as predictors for the general economic activity of the nation (Dunkelberg, Scott,

Dennis, 2004). The need for those companies to develop and maintain appropriate capacity with which to meet the needs of their customers – customers who range from large original equipment manufacturers (OEMs), to other small and medium businesses (SMEs), and to end consumers – is critical to the success of the general economy. Clearly, a vital component of small business capacity is the collective set of skills, knowledge, and abilities (KSAs) possessed by the firm’s human resources. This paper focuses on that issue.

Given the importance of small business in the U.S. economy, one would suspect that the adequate supply of skilled employees for those firms would be near the top of any list of commercial priorities. Unfortunately, little is known about how well off small businesses really are when it comes to the human resource component of their capacity.

Some of the more obvious specific questions include: Are there significant KSA shortages among small business? What skills are most critical to small business survival and / or mission accomplishment? How aware are small and medium enterprise (SME) managers of KSA shortages that may exist? How do they monitor current and future needs and availabilities? What actions are SME managers willing to take should future shortages emerge? Are KSA acquisition programs formalized? Are they budget lines in company plans? This study aims to address these and related concerns.

## **BACKGROUND**

Although the broad topic of “labor shortage” has long been a mainstay of interest to practitioners and scholars within the human resources management (HRM) field, background themes for the present study serve to emphasize the fact that the impact of any human resource deficit is obviously much broader. At the microeconomic level, adequate labor of the right mix is a cornerstone of company competitiveness. At the macroeconomic level, economic growth of

community (or nation) depends on having access to adequate levels of competent labor.

Fundamental changes in the nature of work itself, however, are serving to amend both local and global notions about what constitutes needed labor and thus what defines “labor shortages.”

SMEs, not unlike larger companies, must develop and implement effective procedures for acquisition and retention of appropriately skilled personnel. The cost to remain competitive can, however, be substantial, particularly for SMEs (*Training and Development*, 2003).

### **Microeconomic Issues**

In a bygone era, tangible items largely defined a firm’s assets, but today’s interest has shifted to intangibles. Human resources create the intellectual capital of an organization, and increasingly, that capital determines the market value of the organization and ultimately its competitive success. As crucial elements of what an organization or firm is capable of providing, employee capabilities as well as shortcomings emerge throughout any company’s managerial dialog. Competitiveness depends on productivity, and productivity depends on how well humans can use the tools of work. As those tools continue to get more complex, higher-level skills must be developed. Increasingly, the objective in HR planning is not labor, rather it is labor with certain critical skills, knowledge, and abilities (KSAs).

When a company faces a shortage of requisite KSAs, something must be done. The company must increase or enhance its recruiting, increase or enhance training of the existing workforce, outsource for needed skills, alter demand patterns for its goods and services (demand management), forego all or some of the operations that depend on the needed KSAs (and thus the ensuing output goods and services that emanate from those operations), or continue to serve customers without having the KSAs that are required. The last option raises serious questions about quality, safety, responsiveness, costs, and workforce fatigue (and other issues). Cessation

of operations can produce direct and immediate revenue decline; demand management can be unpopular because of the short-term disruptions in workflow and potential loss of profitable customer base, and outsourcing has negative short- and long-term effects on local economies and potential long-term effects on company supply lines. That leaves training and / or recruiting – options not totally dissimilar to those in a manufacturer’s make-or-buy decision.

When skills are the sought-after resource, the issues raised in the make-or-buy discussion remain; just the terms and bodies of literature change. Moreover, when the buyer is a smaller firm, the economic consequences of mistakes are exacerbated... company demise can easily be the consequence of inattentive management, whether in manufacturing or in services. Another problem exists in the skills acquisition situation: Need is not always readily apparent. Finally, even if the “right” decision is known, the smaller business owner or manager must typically provide for enhanced training and / or recruiting with minimal staff assistance.

### **Macroeconomic Issues**

The existence of critical KSAs is rapidly becoming a major concern as global competition forces leaders to redefine a country’s wealth. At one time, the key to any nation’s future was its natural resources, but perhaps that time has passed. Today, human resources dominate the assets column in competitive nations. As is the case with global businesses, the quality and number of a nation’s skilled people now determines that country’s likely prosperity or decline (Adler, 1992).

Global and national-level research has historically focused on “labor shortages” rather than on shortages in critical KSAs, but that might be changing. In the United States, concerns about impending labor shortages have been voiced for over a decade (e.g. Johnston, 1992). And not surprisingly, studies generally suggest that labor shortages constrain economic growth (Buss,

1996). A study from the U. S. Chamber of Commerce suggested that the shortage of *skilled* labor is most pronounced in the Midwest (Buss, 1996).

Approximately 70 million U.S. workers from the so-called baby boom will retire, or at least reach retirement age, before 2018 (Sterling and Waite, 1998). This group constitutes about 60 percent of what both employers and economists call the prime-age workforce—that is, people between the ages of 25 and 54. (Kaihla, 2003) Only 40 million new people are expected to enter the workforce during the same period, clearly too few to replace vacated slots, much less fill newly created positions. (Fisher, 2003)

Evidence of worldwide shortages of skilled human resources in certain industries continues to build. In the United States, there is a general consensus among private and public sector analysts that the demand for skilled workers in today's global economy has been outpacing the supply, and that this situation will continue to grow as the millennium continues to evolve. The U.S. Department of Labor has projected that by 2010; U.S. companies will face a shortage of more than 10 million employees (Fisher, 2003). Others have projected that a shortage in the 10-million range will occur several years sooner, perhaps as early as this year (Herriott and Torrey, 2003). Regardless of which prediction is closer, the fundamental message is that the shortage exists and is growing. Shortages of skills could threaten competitiveness, a point that has already been argued in the realm of information technology skills. (Hoffman, 1998)

### **Impact on SMEs**

While the issue of the impending labor shortage has received global press coverage, existing research on the matter is dated (most of it was performed in the early 1990s), and predominately oriented towards larger employers, and focused on the anticipated workforce rather than on the employer. Relatively recent publications still rely on data from over 10 years

ago. While interest in this issue is emerging (e.g., Shane and Knod, 2004; Diebolt and El Murr, 2003,) there has been very little attention focused on Small & Medium Sized Enterprise firms' (SME) skills shortages *per se*. We've been told that there was a surplus from the 1990s through the early half of 2000 (Dundelberg, Scott and Dennis (2004), and that small firms in general will *not* face a shortage (Phillips, 2004), but even that prediction was framed with the recognition that the information is "less than perfect." (ibid.)

Research into the human resource practices of SMEs is limited. There has been some inquiry into the formality of Human Resource processes, and changes to those processes through firm growth. While the processes may become formalized for employees with firm growth, the managers tend to remain informal (Kotey & Slade, 2005; Nguyen & Bryant, 2004). This pattern parallels the research evidence pertaining to SME planning in general. Entrepreneurs and SME managers tend to avoid formal planning (Kern, 2002), preferring informal plans and processes (Penn et al., 1998). Research shows that networking is one method by which SMEs respond to shortages (Sherer, 2003); however, this does not address the shortage, it addresses the migration of workers from one firm to another. Rather than resource development, this reflects a resource hoarding behavior.

Larger organizations are beginning to recognize long-term impacts of KSA shortages, and many have boosted investment in corporate training and management development. Larger companies are more likely to employ a wider variety of external organizations for training than small businesses. Clearly, this trend can have a disproportionate negative impact on small businesses, and therefore, economic development. Though Phillips (2004) argues that overall, small businesses will not experience great labor shortages, he does concede that economic and

demographic changes will create labor shortages in certain industries and in certain parts of the country.

Small firms' source of training is generally an in-house program at the unit or department level. The limited research on small business firms' participation in training initiatives indicates that they do not get involved in external training programs in spite of governmental policy initiatives designed to assist those endeavors. (Devins and Johnson, 2003) According to a recent study conducted by the Research Institute for Small and Emerging Business (RISEbusiness), SMEs utilize handbooks or manuals, and are disappointed with limited access to and affordability of training options (*Training and Development*, 2003).

Small companies have more difficulty filling certain positions than larger firms, and a lack of skilled employees has negatively impacted their businesses in many ways. According to a report from Maryland Business Roundtable for Education (2001), the majority of SMEs so affected have lowered their level of operation and productivity. In short, many of the remedies available to large business firms as they seek to maintain KSAs are not feasible for the small business due to resource constraints. The scope of the present inquiry was intentionally left general, is an attempt to better ascertain the unique SME perspective.

## **METHODOLOGY**

Semi structured interviews were conducted with key senior management and / or ownership personnel from 76 small businesses and entrepreneurships. Fifty-one of the companies operate in the Midwest, specifically in the Mississippi River corridors of Illinois and Iowa. The remaining 25 respondents are located along the Atlantic seaboard in the Eastern Virginia area. Respondents represent 10 diverse industries, with relatively more respondent

concentration in professional services, manufacturing, retail, and construction. Exhibit 1 illustrates participation by industry.

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Insert Exhibit 1 about here

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Respondents were asked to identify themselves, state their company positions, indicate the primary industrial classification for their firms, and supply the number of employees in the company. An open-ended item explored how the small business firm was monitoring the labor market. Interviewers were prepared to assist less forthcoming or hesitant respondents to this item with prompts about professional or organizational networks such as trade associations or chambers of commerce, informal networks, information from colleagues, intuition, and so forth. Another open-ended item served to close each interview; respondents were asked if there were any other comments regarding the topic of skills shortages. A Yes / No item indicated whether or not the company had and maintained policies and procedure for preparing *formal* needs and availability budgets for human resources.

The other questions focused more narrowly on respondents' experiences with hiring difficulties, the relative importance of different skill sets for their small business firms, their perception as to whether or not there was a shortage of employees with requisite knowledge, skills, and abilities (KSAs), and on their current and intended future responses to those perceptions. Those items asked respondents to indicate:

- The extent to which the company is currently experiencing shortages of people with specific (named) knowledge, skills, and abilities.

- The extent to which the company relies on each of a (specified list) set of remedies to alleviate any KSA shortage.
- The current importance of each type of skill (from a specific list) to the company.
- The projected or anticipated availability and cost of each type of skill (again, from a list of specific skill types) needed to maintain or increase company capacity for meeting demands.
- The likelihood that, should the company face critical skills shortages, certain remedy options (from a specified list) would be undertaken.

The interviews were conducted by graduate students under the supervision of the principle author (for the Mississippi River corridor), and under the supervision of one of the co-authors (for the Atlantic Coast area). Interviews were scheduled in advance and conducted at a location and time convenient to the interviewee, generally at their places of business and lasting approximately one-half hour.

## **RESULTS**

Results from this exploratory inquiry shed light on several of the research questions noted in the earlier sections of this paper. Additional data are being collected by the authors as part of a long-term study and might certainly cast a different light on these tentative findings. At this juncture, given the limited data set, all analysis has been conducted on the data set as a whole; there has been no attempt, for example, to compare midwestern respondents with east coast respondents. That issue, and related others, will be the subject of another study. Finally, due to the exploratory nature of this research, both qualitative and quantitative interpretations of the interviews provide insight.

### **KSA Shortages in General**

Respondents indicated the degree to which their companies were currently experiencing shortages of people with appropriate knowledge, skills, and abilities with a Likert-type (ordinal) response: Never, rarely, frequently, or constantly. Exhibit 2 shows the frequency of each response and serves as a general overall indicator of the current KSA shortage problem within small businesses.

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Insert Exhibit 2 about here

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The fact that 57.9 percent of respondents experience KSA shortages either frequently or constantly suggests that skill shortages are already a real problem for small businesses. Although several respondents identified specific skill shortages (e.g., machining, accounting, marketing), the overall results suggest that shortages are probably more generalized. The authors performed a cross tabulation analysis of the reported degree of shortages (Exhibit 2) with the industry types (Exhibit 1). A chi-square test of independence revealed no support for any relationship between type of industry and KSA shortages ( $X^2$ ,  $df\ 27 = 26.56$ ,  $p = 0.49$ ). Thus, we tentatively conclude that the KSA shortage problem might be expected to affect small businesses across a wide cross variety of industries.

Respondent commentary on the open-ended items provides a rich collection of qualitative data. While personnel from some responding small business firms indicated that they have “no difficulty in finding the people we need” (a comment from a manager at a non-profit agency), or voice a lack of concern because “the union supplies our needs,” there does appear to exist overall anxiety about skills shortages. The concerns are expressed using a variety of words, such as

“critical shortages,” (from a long-term care facility manager), “scarce,” (from an owner of a veterinary / animal hospital), “severe shortage” (from a manager at a trucking company). [The lead author is reminded of a small robotics-welding firm with 50 employees that revised its employee selection process a few years ago. The company abandoned education and experience requirements, and according of the human resources manager, if an applicant was “breathing,” he or she was offered a job.] While it might be easy to consider such a reaction as extreme, the present study suggests that small business firms across a variety of industries are experiencing similar circumstances.

Responses to open-ended questions are replete with comments pertaining to shortages of people with hands-on-skills, deficiencies in critical thinking abilities, and needed interpersonal skills. Somewhat reminiscent of the robotic firm, several of the responding small business firms indicated that they hire people that do not meet qualifications and instead rely on training to instill necessary skills. As one manufacturing firm manager indicated, “We have yet to find anyone in the area with the skill set we need to start off as a contributor.”

Another of the research questions pertains to the nature of skills (or knowledge and abilities) that are deemed “critical for company survival” or at least “important” for the firm’s ability to carry out its mission. Exhibit 3 illustrates the relative degree of importance that respondents attached to a specified list of KSA areas.

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Insert Exhibit 3 about here

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Four of the skill areas have been highlighted in Exhibit 3. Over 80 percent of respondents stated that basic communications skills, basic mathematics and quantitative skills, interpersonal leadership skills, and critical thinking skills were either *critical* or *important*. Comparable ratings for strategic skills (58%), information technology skills (42%), and basic science skills (34%) relegated these three categories to a level of somewhat lesser importance in the minds of the respondents.

The skill area labeled “functional” represents a skill that is more or less company or industry specific (e.g., machine tooling, laboratory skills, or patient care), or a more universally needed skill area that was not listed specifically on the survey list but was deemed important or critical by respondents (e.g., marketing, purchasing, or accounting). Most respondents (67 out of 76) did volunteer one or more of these additional functional skills and that information could assist in refinement of future research. Finally, we note that 70 percent of respondents considered one or more of the functional skills to be either *critical for survival* or *important*.

### **Responses to Perceptions of KSA Shortages**

With nearly 60 percent of respondents reporting a frequent or constant KSA shortage, the inquiry shifts to what those companies are currently doing about the shortage, and also what they plan to do about it in the future. The relationships between perceived skills shortages and (1) current responses to those shortages as well as (2) potential future responses to those shortages are somewhat mixed as to the likelihood that a given response activity is being or will be followed.

Respondents were presented with an array of options for dealing with or responding to skills shortages and asked to indicate whether their companies currently used each option *constantly, frequently, rarely, or never*. Ordinal data correlations (Spearman’s  $r_s$ ) between the

degree of shortage experienced (See Exhibit 2) and strength, or intensity, of action on various types of response are summarized in Exhibit 4.

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Insert Exhibit 4 about here

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Contents of Exhibit 4 suggest that there is a positive relationship between skills shortages perceptions and efforts to increase training for employees, to recruit both full-time (permanent) employees and part-time (or, temporary) employees, and to engage in overtime and / or extra work shifts. However, there is no significant relationship between the degree of skills shortages perceived and tendency to engage in outsourcing. A tentative explanation might include a general negative opinion of outsourcing *per se* in light of its association with loss of jobs. The very low (4, or 5.3 %) response rate to the “other options” item is evidence that company principals either felt that the listed response options sufficiently covered the scope of their efforts or were unwilling to reveal other steps that they are taking to alleviate shortages.

Respondents were also asked to indicate how their companies might face a future critical skills shortage. Specifically, they were to indicate the likelihood that their firm would engage in any of several possible activities by responding with one of the following choices:

- This is likely to be the preferred option
- We would do this, but we have not yet done so.
- This option would be unlikely.
- My company would not do this.

Ordinal data correlations (Spearman’s  $r_s$ ) between the degree of shortage experienced (See Exhibit 2) and likelihood of action on various types of possible future response are summarized in Exhibit 5.

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Insert Exhibit 5 about here

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Exhibit 5 data suggest a very strong positive relationship between the intensity of perceived skills shortages and the likelihood that the firm will work to secure contracts with employees that make extended overtime more feasible. This finding is not surprising given that overtime is among the least risky avenues for short-term capacity enhancement; the existing workforce is knowledgeable, in place, and at least somewhat loyal to the firm. At the same time, this exhausts resource capacity in the long run, and does not enhance sustained human resource capacity. For small business owners, long hours are the norm rather than the exception, so paying employees to work longer hours has a sense of normalcy about it.

Strength of perception of skills shortage is also positively related to the likelihood that the firm will recruit skilled personnel from suppliers and will increase general recruiting that is not targeted to customer or supplier workforce personnel. The option to phase out operations that require needed skills produced interesting results: Fifty-four respondents (71%) said their companies *would not* phase out operations if faced with skills shortages and another 15 (20%) said their firms would be unlikely to do so. Thus, over 90 percent of respondents say they would stay the course and intend to continue providing goods and services even if facing a shortage of the skills necessary to do so.

### **Perceptions Regarding Future KSA Shortages**

Respondents' unwillingness to phase out operations when confronted with critical skills shortages raises several questions, some of which are at least partially addressed by respondents'

open-ended responses. An immediate “reality-check” arises: How do these small business firms envision continued operations without skilled personnel? Several of the companies rely on labor unions to supply workers and don’t appear to have considered the decrease of new entrants into the trades. Other managers or owners admitted to accepting less-than-qualified employees. One must wonder about the resultant impact on the quality, efficiency, and competitiveness of those firms. Several respondents indicated an awareness of impending difficulty, but imply that it is not important to them *now* although company growth may bring KSA shortage into sharper focus.

Throughout the respondent SMEs, there seems to be no great sense of either urgency or acknowledgement of the potential for enduring skills shortages. Some of the respondents do not anticipate growth, and have experienced stability in their current workforces. For those respondents, there is no shortage, and they believe that any cries of impending labor shortages do not apply to them. This might explain why responding SME managers do not anticipate the necessity for drastic steps (such as ceasing certain operations) in current business. Perceptions about the likelihood of being able to acquire each of the types of skills listed in Exhibit 3 were gathered, and summary findings are shown in Exhibits 6 and 7.

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Insert Exhibit 6 about here

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Exhibit 6 shows that very few respondents consider any of the types of skills listed in Exhibit 3 as likely to be *impossible* to acquire. Given the exploratory nature of the present study, perhaps any consistency of beliefs concerning ease of future acquisition across skill types may be

assessed appropriately in graphical form. Exhibit 7 contains a bar chart presentation of the data in Exhibit 6.

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Insert Exhibit 7 about here

---

Exhibit 7 illustrates the rather consistent *collective* agreement among respondents across the eight types of skills for the categories of *readily available with surplus* and *impossible to acquire*. The relative “flatness” of the bar heights for all skill types in these two categories suggest little variation in the number of respondents who believed a particular skill to be either *readily available* (range 10 to 17 respondents; average 12.9), or *impossible to acquire* (range 0 to 4, average 1.4).

There is less consistency among respondents as a group regarding skills that are thought to be in the two intermediate skills acquisition categories, *available at reasonable cost* and *difficult or costly to get*. The first of these categories exhibited the greatest variation (range 27 to 49; average 36.4) in the number of respondents who categorized the difficulty of obtaining a needed skill as available at a reasonable cost. Skills viewed as *difficult or costly to get* exhibited slightly less variation in the number of respondents (range 12 to 37, average 23.3). Critical thinking skills, and to a lesser extent interpersonal leadership skills, were top contenders in the *difficult or costly to get* category, while basic mathematics and quantitative skills followed closely by basic communications skills were the KSA types most often rated as *available at a reasonable cost*.

### **Effects of Formal Budget Processes**

In an effort to gain some (arguably) more tangible insight into just how serious the companies represented by respondents are about acquisition of critical KSAs, a “yes / no” item inquired as to the existence of a *formal* (formality of process was emphasized during interviews) needs and availability budget for human resource needs. The authors hypothesized that having a formalized procedure to analyze small business firm needs and a plan *and budget* for acquisition of critical KSAs would signal a more definitive commitment than merely having a plan to do so. Fifty-two of seventy-four (70%) respondents to this item indicated that their firms did *not* have a formal planning and budgeting process for this purpose in place.

Moreover, the expressed (perceptual) existence of a formal planning and budgeting program does *not* appear to be related to either (1) the degree of company engagement in any of the current efforts (options) to acquire needed skills (Refer to list in Exhibit 4), or to (2) the likelihood of engaging in any of the possible future responses should critical KSA needs arise (See list in Exhibit 5). In other words, when it comes to various techniques for acquiring critical KSAs, respondent small business firms are either “doing” or “not doing” regardless of whether or not the actions can be tied to strategic intent or to specific budget lines.

The finding regarding the (relative lack of) existence of formal budgeting opens the door to a broader issue: When it comes to managing the critical skills component of company capacity, just how sophisticated are small business managers? How well are they performing when it comes to awareness of critical skills needs and in their responses to those needs?

### **Managerial Awareness and Performance**

The principle mechanisms used by respondents to monitor the labor market are their personal and professional networks, including relying on associations, temporary agencies and even competitors for signals of impending shortages. In one sense, relying on networks is

typical behavior for entrepreneurs; on the other hand, depending on others to provide reliable information about a critical resource is contrary to the resource-based view of the firm. Under this framework, any critical resource will be guarded (hoarded) rather than openly shared. Therefore, small business firms that rely on networks to provide signals of impending shortages may get the information late. The timeliness (or lack of it) of the monitoring process is further demonstrated by the number of firms in the present study that indicated their primary labor market indication was response rates to their ads. One could argue that such behavior suggests reactive rather than proactive management.

Another somewhat unexpected hint of managerial weakness (or at least, underperformance) among small business firm owners / operators emerged from the interviews. Several respondents seem to be overly shortsighted, focusing on short-term, operational issues to the exclusion of long-range planning. Moreover, some respondents openly admitted weaknesses in the management of skills acquisition. As one respondent stated, “Only we don’t know what the next step will be.” (From a retail manager) A general review of the interview commentary suggests that small business owner / managers might be insufficiently aware of the managerial KSAs required to perform strategic planning and respond to changing labor market conditions. In short, the small business firms are not aware of what they don’t know. They are focusing predominately on their current situation and not looking into the future.

The short-term or near-term focus can be understood when one considers the operational reality of entrepreneurship and managing an SME. The small business manager is both a productive worker and manager. The nature of entrepreneurship calls for the manager to spend the majority of time with operational issues at the sacrifice of strategic planning. Growth brings new challenges, however, and the skills needed to successfully manage a growing, functionally

structured business are significantly different (Solymossy and Penna, 2001). While previous studies have identified migration of managerial personnel from large business firms to small business firms (Gendron, 1999), the present data provide some indication that the migration might also be between similarly sized and positioned firms. One respondent unabashedly admits to actively recruiting managerial personnel from competitors.

## DISCUSSION

This research, though exploratory in nature, does lend support for the contention that small businesses are indeed facing critical KSA shortages. Moreover, the study data show no evidence that KSA shortage is confined to a particular industry. Our tentative suggestion is that the shortage is widespread among small businesses, perhaps affecting all industry segments. Verification of this dispersion of shortages and investigation of the degree of impact across segments appear to be viable research agendas.

While the original intention was to discover the perceptions of *impending* skill shortages and intended strategies, it is meaningful that the study results suggest (1) that small business firms *are already* experiencing such shortages and readily admit so, and (2) that the responses to current and anticipated (impending) shortages are different than what one might anticipate.

For example, when we consider the issue of a formal planning and budgeting program for acquiring critical KSAs, what appears to be a notable paradox emerges: First, approximately 60 percent of the firms investigated have experienced frequent or constant problems finding people with appropriate skills. Second, depending on the skill area, from 16 to 52 percent of the respondents indicate the likelihood of a skill being either impossible or difficult and costly to acquire. Third, from 34 percent (for basic science) to more than 80 percent (for four of the examined skill areas) of respondents considered the KSA as either critical for company survival

or at least important to the attainment of the company mission. Any one of those three conditions should motivate firms to engage in proactive KSA acquisition planning and budgeting; yet only 30 percent of the responding small business firms do so.

Although 23 responding SME managers do indicate a formal process, the level of sophistication could be questioned. One respondent's notes might be another respondent's formalized plan, since the strategic and managerial processes of entrepreneurs tend to be unique to each entrepreneur's personality (McCarthy, 2003). While McGee and Sawyer (2003) found that the "Perceived Strategic Uncertainty" (PSU) of younger business owners suggest they use more external information than their older counterparts for business planning, evidence continues to indicate that entrepreneurs avoid formal planning (Kern, 2002), preferring informal plans and processes (Penn et al., 1998). Some have even been characterized as "flying by the seat of (their) pants." (Salter, 2004)

The apparent lack of managerial awareness among the current sample of small business firm respondents as to *what one might do in order to alleviate KSA shortages* is of great interest. It suggests that the skill shortage might well rest within the domain of the small business owners and managers; perhaps more significantly than within the labor market itself. Although a shortage of managerial skills in SMEs has been suggested (Higson and Wilson, 1995), it does not appear to have been explored through research.

Responses to the present survey also suggest shortsightedness. While a strong majority of the firms have already experienced critical shortages, they apparently don't equate the skill shortage as having an economic cost to the firm. There seems to be an expression of need for the skills, absent of a willingness to pay for them. Believing that there will be difficulty in

obtaining people with the necessary skills, but believing that they can be acquired at a reasonable cost indicates naiveté.

Another somewhat troubling indication concerns the nature of possible future efforts to acquire the skills necessary for capacity building. The small business firms indicate increasing intensity of current efforts – or what could be expressed as a “try-harder-attitude,” as opposed to a “try-something-new” attitude. In one sense, this demonstrates entrepreneurial tenacity. On the other hand, it is troubling because it appears to contradict the entrepreneurial characteristics of innovative behavior. At what point of time does determination to “stay-the-course” become harmful to the future of the firm?

Regarding the relative importance attached to various skills, some comments are in order. First, an overwhelming proportion of respondents consider basic communications skills, basic mathematics and quantitative skills, interpersonal leadership skills, and critical thinking skills as either critical for survival or important to the company mission. This suggests that these KSA areas are foremost in the minds of small business managers. While there is evidence of a general concern in our society about deficiency in these skills, it is interesting that the small business respondents express far greater concern over these skills than has been demonstrated by previous research with large business firm research. One explanation for this could be that employees of small business firms are expected to perform multiple tasks and multiple functions. Therefore, any weaknesses will have a higher proportionate impact on the firm than might be experienced by a large firm. Even though current respondents placed less importance on basic science, information technology, and strategic skills, relegation of these latter three skill categories to less-than-equal emphasis at this point seems premature.

We note that previous studies (e.g., Haskel & Martin, 2001; Hawley & Raath, 2002) place information technology skills and strategic skills in somewhat higher importance than did the respondents in this study. There are several possible explanations for this difference. The number of employees with the more advanced technological and strategic skills in a small business firm is low; frequently these are the skill sets of the manager or owner of the firm. The small business perspective *might* be acting to downplay these skills in the eyes of respondents. SME firms are niche focused, and *may* not require their employees to demonstrate the depth and breadth of information technology skills sought by large employer respondents of previous research. The matter of whether or not this difference can be generalized to the entire SME community, and if so, investigation of the reasons for any variance from conditions found in larger-companies provide fertile opportunities for further inquiry.

While anticipated shortages of qualified personnel do appear to be real, the effects upon the firm need not be negative. The first step requires recognition of the needs of a growing enterprise. Many of the prescriptive remedies offered by the literature (e.g., increasing pay levels, increasing recruitment efforts and retention rates [Johnston, 1992]) are not as available to SMEs because of their resource constraints. The most significant shortage facing SMEs could well be the lack of a managerial awareness of the knowledge, skills and abilities necessary to grow the firm. The personal attributes and skills used to initiate a venture are different from those that are required to move the organization to a growing, functionally structured enterprise (Solymossy and Penna, 2001).

Entrepreneurs initiate their ventures by creative innovation under conditions of risk. Entrepreneurs must continually manage the growth of their firm with innovative management. Vorhees and Meulenber (2004) conclude that the business owner's level of innovativeness has a

direct impact on firm performance. As demonstrated by some organizations, this can take the form of employee empowerment (e.g. Leonhard Plating Co.), strategic alliances to share resources (Kenton County Airport Board and Cincinnati / Northern Kentucky International Airport), utilization of automation software (e.g. Kendle), tapping alternative labor markets such as stay-at-home mothers (The Payne Firm), or using college students in an internship program (Schafer, 1997).

Drawing on the themes and relationships suggested from this exploration, the authors are developing a general model to guide our subsequent research efforts. Presentation, testing, and discussion of that model, however, are beyond the present scope. Clearly, a major impediment to more thorough analysis in the present study is the limited data set. More powerful parametric and nonparametric statistical analyses must await the growth of the database. Comparisons of critical skills perceptions and responses across industry types, geographical regions, and degree of aggressiveness in seeking needed talent are among the more general types of analyses planned for the future. Future surveys also add the potential for longitudinal studies as well. The present study does highlight, however, the existence of skills shortages and suggest marked differences in perceptions and responses between small business firms and those of previously researched large business firms.

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| <b>Exhibit 1: Respondents by Industry</b> |           |            |
|---|-----------|------------|
| Industry                                  | Frequency | Percentage |
| Professional services                     | 18        | 23.7       |
| Retail                                    | 11        | 14.5       |
| Consumer services                         | 5         | 6.6        |
| Guest services                            | 3         | 3.9        |
| Agriculture                               | 1         | 1.3        |
| Manufacturing                             | 18        | 23.7       |
| Construction                              | 10        | 13.2       |
| Transportation                            | 3         | 3.9        |
| Healthcare                                | 5         | 6.6        |
| Not-for-profit (e.g., government)         | 2         | 2.6        |
|   | 76        | 100.0      |

| <b>Exhibit 2: KSA Shortage Problems (Experienced)</b> |       |            |
|---|-------|------------|
| Degree to which KSA shortages are experienced         | Count | Percentage |
| Never   | 7     | 9.2        |
| Rarely  | 25    | 32.9       |
| Frequently  | 28    | 36.8       |
| Constantly  | 16    | 21.1       |
| Totals  | 76    | 100.0      |

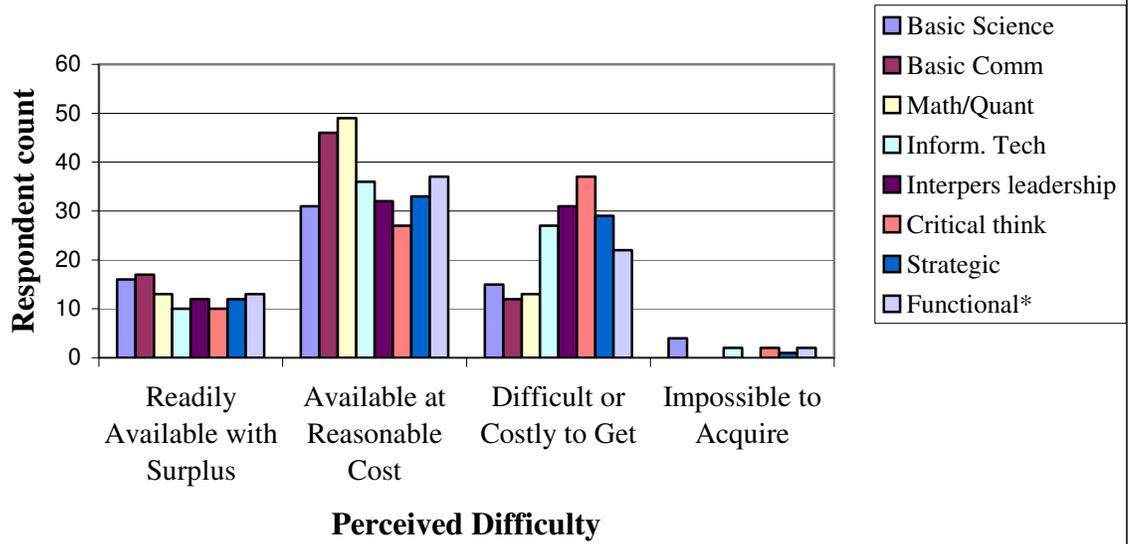
| <b>Exhibit 3: Relative Importance Attached to Various Skill Areas</b> |                                       |             |              |                |                 |                |           |              |
|---|---------------------------------------|-------------|--------------|----------------|-----------------|----------------|-----------|--------------|
| Importance to Firm  | Skill, Knowledge, or Ability Category |             |              |                |                 |                |           |              |
|   | Basic Science                         | Basic Comm. | Math - Quant | Inform. Techn. | Interp. Idrship | Critical Think | Strategic | Functional * |
| Not necessary   | 25                                    | 1           | 2            | 20             | 3               | 9              | 17        | 5            |
| Of limited value  | 25                                    | 10          | 11           | 24             | 11              | 4              | 15        | 9            |
| Important   | 22                                    | 25          | 40           | 18             | 39              | 33             | 28        | 34           |
| Critical for Survival   | 4                                     | 40          | 23           | 14             | 23              | 30             | 16        | 19           |

| <b>Exhibit 4: Relationships of Shortages Perceptions to Current Responses</b>                           |       |  |
|---|-------|--|
| Current Response  | $r_s$ | Significance of relationship (with shortages perception) |
| Outsourcing   | 0.024 | 0.841  |
| Additional training for current workforce   | 0.304 | ** 0.008   |
| Recruiting new permanent or full-time employees   | 0.336 | ** 0.003   |
| Recruiting new temporary or part-time employees   | 0.266 | * 0.021  |
| Overtime or utilization of extra shifts   | 0.261 | * 0.025  |
| Other option(s). +  |       |  |
| + Only four respondents indicated that other options are being used, too few for meaningful comparison. |       |  |

| <b>Exhibit 5: Relationships of Shortages Perceptions to Possible Future Responses</b>                   |       |                      |
|---|-------|----------------------|
| Possible Future Response  | $r_s$ | Sig. of relationship |
| Recruit personnel with skills we need from a client or customer   | 0.079 | 0.500                |
| Recruit personnel with skills we need from our suppliers  | 0.352 | ** 0.002             |
| Increase general recruiting, but not target customers or suppliers                                      | 0.290 | * 0.012              |
| Increase budget and efforts to develop in-house training programs                                       | 0.071 | 0.542                |
| Secure formal contracts with schools to provide needed skills   | 0.179 | 0.124                |
| Secure agreements with employees for extended overtime  | 0.369 | *** 0.001            |
| Phase out operations that require the skills in which we are short                                      | 0.064 | 0.591                |
| Other option(s). +  |       |                      |
| + Only seven respondents indicated that other options might be used, too few for meaningful comparison. |       |                      |

| <b>Exhibit 6: Perceived Difficulty in Acquiring Skills in Future</b>  |               |             |              |              |                 |                |           |              |
|---|---------------|-------------|--------------|--------------|-----------------|----------------|-----------|--------------|
| <b><i>Skill will be ...</i></b>   | Basic Science | Basic Comm. | Math - Quant | Inform. Tech | Interp. ldrship | Critical think | Strategic | Functional * |
| Readily Available with Surplus  | 16            | 17          | 13           | 10           | 12              | 10             | 12        | 13           |
| Available at Reasonable Cost  | 31            | 46          | 49           | 36           | 32              | 27             | 33        | 37           |
| Difficult and / or Costly to Get  | 15            | 12          | 13           | 27           | 31              | 37             | 29        | 22           |
| Impossible to Acquire   | 4             | 0           | 0            | 2            | 0               | 2              | 1         | 2            |
| Note: Columns do not all sum to 76 due to omitted responses; a response of “not applicable” meant the skill was not sought. |               |             |              |              |                 |                |           |              |

**Exhibit 7: Perceptions of Difficulty in Acquiring Future Skills**



# ENTREPRENEURSHIP, INNOVATION, AND WEALTH DISTRIBUTION: THE IMPACT OF CREATIVE DESTRUCTION ON INCOME INEQUALITY[ASS1]

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## ABSTRACT

*Recent attempts to guide research on entrepreneurship leave out an important aspect of entrepreneurship, namely its relationship to wealth distribution. Drawing from Schumpeter's work we combine recent research on technical innovation with entrepreneurship research. In doing so, we demonstrate that entrepreneurship, narrowly defined, is a contributing factor towards a more equitable distribution of wealth.*

## INTRODUCTION

*"It is important to note that ... it is not sufficient to know merely the quantities of goods existing in our theoretical country taken as a whole. Not only must the sum of individual wealth be given, but also its distribution among individuals.... The distribution of wealth is important for determining values and shaping production, and it can even be maintained that a country with one and the same amount of general wealth may be rich or poor according to the manner in which that wealth is distributed." - J. A. Schumpeter*

"Entrepreneur" and "entrepreneurship" have become buzzwords both in academia and in the popular press, and have been used in a wide variety of contexts (Shane & Venkataraman, 2000; Schoonhoven & Romanelli, 2001). Interest in entrepreneurship today arises from the recognition that it is an activity that is important for economic growth (Baumol, 1968; Stevenson & Jarillo, 1990). Entrepreneurs and entrepreneurial activity improve competitiveness, create jobs, stimulate the larger economy, and so forth. However, often overlooked in the discussion of entrepreneurship is its role in helping create an equitable distribution of wealth.

In this paper we will investigate the role of the entrepreneur in wealth distribution. First, we will describe the concept of wealth distribution in relation to economic development, in particular how wealth distribution distinguishes economic development from economic growth. We will review the current literature on entrepreneurship, emphasizing the difference between Schumpeter's and Kirzner's theories of entrepreneurship as evident in contemporary views, and in the process develop a definition of entrepreneurship that is suitable for investigating and understanding entrepreneurship as a mechanism for creating and maintaining an equitable distribution of wealth. Third, we will link this definition to, and review the literature on, innovation and technological change, emphasizing on how it relates to wealth distribution. We will use the theories of technological innovation to demonstrate wealth distribution in action and to guide researchers to make a distinction between the entrepreneur's roles in wealth creation and distribution. In doing so, we support a narrower definition of entrepreneurship that excludes some of what is currently labeled as entrepreneurship.

## WEALTH DISTRIBUTION AND ECONOMIC DEVELOPMENT

The gain in social well being within nations is often referred to in a dual statement: "economic growth and development." By this economists mean to draw attention to their two main measures of economic well being - growth in wealth and distribution of wealth. One of Alfred Marshall's motives for developing the neo-classical model was his concern for the inadequacy of wealth distribution evident in the slum sections of England's cities and the misery of the people who lived there (Marshall, 1890: 41). This inequitable distribution of wealth was within the nation with the greatest per capital wealth and the fastest growing wealth in the world at the time. Marshall argued that markets should and could function so as to distribute wealth. Marshall's perfectly competitive markets would adjust prices to equate supply and demand, not just in commodities but also in labor. In his model, markets will adjust prices such that consumers pay fair prices for goods and services; all workers will receive fair wages for their labor; managers will receive fair compensation for their risk taking and organizing of effort; and investors will receive a fair return to their invested funds.

Today, Marshall's tenets form the foundation of the whole field of "general equilibrium theory." But general equilibrium theory has significant weaknesses that are important in this context. First, the model provides no explanation for the process of growth but only for the process of equilibrating markets if and when they grow. Second, the model assumes that generation of new technology is external to the economic system, i.e. not affected by economic factors. Third, it assumes that knowledge is a public good. Finally, there is no room for the innovative entrepreneur since all suppliers offer undifferentiated products and have equal information.

Recent developments in general equilibrium theory, most notably within a field termed "new growth theory" (Solow, 1956, 1957; see Scherer, 1999: for a review) have tried to amend these weaknesses but still there is no role for the entrepreneur in the theory. As Kirzner (1997) persuasively notes, although most economists today agree that markets work, the neo-classical model does not explain how they work (9). He suggests an explanation in which the entrepreneur is a central actor.

Inequitable wealth distribution is the essence of most criticisms of capitalism. Social critics have long considered capitalism to be "unjust" because of the widely differing shares of wealth held by different segments of society. Perhaps the best known critic, Karl Marx (1845), was concerned about the concentration of wealth in the hands of a few under capitalism due to economies of scale. He believed that the largest firms would come to dominate all markets. Perhaps Marx's most important point was that if the distribution of wealth does not meet widespread societal acceptance as a fair, equitable or just phenomena, there will be social unrest and eventually an upheaval (revolution) in the society.

Schumpeter (1942) had similar concerns as Marx, but for different reasons. He argued that economies of scale would not threaten the legitimacy of the capitalist system as long as innovations by new firms (entrepreneurship) bring with them the gale of creative destruction, leading to wealth redistribution. But, he then concluded that large organizations would become more efficient innovators through organized research and development and they would "buy out" potential entrepreneurs. Thus, new independent firms and entrepreneurs (innovators with new independent firms) would cease to exist. Large firm innovation would continue to increase the total output of the economy (growth) but the increasing wealth would be unevenly distributed, eventually undermining the legitimacy of the capitalist system. This in turn leads to the emergence of socialism. Even if this has not happened yet, the greatest challenge today is

demonstrating that the capitalist system is just, fair, and equitable (see, for example, Kirzner, 1997: 71-75) and provides the right institutions for it to remain so.

To date Schumpeter's pessimistic prophecy on the future of capitalism has not come true. The prophecy was based on the assumption that large firms would become much more efficient innovators than entrepreneurs and wealth would become more concentrated thereby requiring emergence of a socialistic system to redistribute wealth. His assumption about the decline of entrepreneurship has been rejected by empirical evidence that has shown small firms are major innovators (Gellman, 1976; Futures Group, 1984). Furthermore, entrepreneurs are important for job creation and economic growth (Birch, 1979, 1987; Kirchoff, 1994). Even if Schumpeter's prognosis on the future of capitalism has turned out to be wrong, his logic on the importance of wealth redistribution for the legitimacy of the capitalist system is still valid. Innovation by new, independent, firms is a mechanism for wealth redistribution. Although the distribution of wealth may change as established firms 'destroy' competitors by means of innovation, this leads to increased concentration of wealth since one large firm gains wealth at the expense of another. Only when innovation is accomplished by newly formed independent firms does wealth become redistributed.

### **WHAT IS AN ENTREPRENEUR?**

As formulated by Richard Cantillon in 1755, entrepreneurs "commit themselves to certain payments in expectation of uncertain receipts, and are therefore essentially risk-bearing directors of production and trade, competition tending to reduce their remuneration to the normal value of their services" (Schumpeter, 1939). Jean-Baptiste Say added the combination of the factors of production (Say, 1836) and Schumpeter qualified this as a 'new combination' (1934: 66, 74). It is currently used to identify individuals who innovate, create new businesses, make decisions, initiate and implement changes or take risk (Schumpeter, 1934: 66).

Shane and Venkataraman (2000), on the one hand and Wennekers and Thurik (1999) on the other attempt to use both the theory and empirical literature to develop a comprehensive definition of entrepreneurship with somewhat different perspectives. Shane and Venkataraman are concerned about establishing entrepreneurship as a research field providing distinctive contributions to the field of business studies. They argue that entrepreneurship involves the discovery, evaluation and exploitation of opportunities by enterprising individuals, unrelated to the setting of that interaction. Wennekers and Thurik, on the other hand, are concerned about the link between entrepreneurship and economic growth. They view entrepreneurship as activities related to perceiving and creating new economic opportunities and exploiting them in the market. These activities are linked to economic growth through the processes of new business creation, innovation and competition. Nevertheless, these theorists do not attend to the link between entrepreneurship and wealth distribution which, according to Schumpeter (1934; 1942) was fundamental to the capitalist system and a condition for its existence.

### **THE CONCEPT OF ENTREPRENEURSHIP**

In their careful review of the economics literature HZbert and Link (1989) identified 12 distinct themes of entrepreneurship. In his survey on how researchers in entrepreneurship, business leaders and politicians define the field of entrepreneurship, (Gartner, 1990) identified 90 different attributes that were mentioned in their definitions. From these exercises it is clear that no universally accepted definition of the phenomenon exists.

The concept nevertheless has a common history within the field of economics traced back to the work of Cantillon (1755). As mentioned before entrepreneurs lost their role in the economic analysis done in neo-classical tradition that became dominant in the early 20th century. In this

tradition resource allocation became the focus and under perfect competition it became merely a routine task by managers who exhibited predictable profit maximization behavior. To many economists this result contradicted the experience of the realities of the economic system that was more lively and less deterministic than pictured by equilibrium theory. Three different schools of the concept of entrepreneurship were constructed as a response to this problem in neo-classical theory (Hřbert & Link, 1989) their most prominent members being Frank Knight, Joseph Schumpeter and Israel Kirzner. Contemporary views are usually related to these three schools, but in different ways.

### ***Knight-Coping with Uncertainty***

Knight's concept of entrepreneurship is based on his distinction between risk defined as measurable uncertainty and uncertainty defined as un-measurable uncertainty. The main difference in the economic sense is that risk is the condition of perfect competition and uncertainty is the source of imperfect competition. Imperfect competition takes many forms and it the primary source of in the capitalist economic system (Knight, 1921: 19-20). In a system of risk that is without uncertainty, which is the perfect competition situation described by neo-classical theory, management of productive resources is merely a routine task. With uncertainty present the primary problem of management is deciding what to do and how to do it. (Knight, 1921: 268). Solving that problem, by selecting and implementing a direction is the core of entrepreneurship according to Knight (1921: 276).

In real life, Knight argues, entrepreneurship is seldom carried out in its pure form, i.e. the entrepreneur is neither owner nor manager of the business. Actual entrepreneurs will in most cases either own part of the business or be the routine manager as well as the entrepreneur. But owners of the productive resources could employ the entrepreneur, and in that case the owners will share the profit and the responsibility (Knight, 1921: 288-290, 299-300). Knight makes no reference to the creation of new business organizations.

### ***Schumpeter - Opportunity Creation***

Although Knight focused on the entrepreneur as an economic agent that directed action in the face of uncertainty, Schumpeter saw the entrepreneur as the agent that changed the economic system from within. According to Schumpeter, neo-classical theory was unable to describe the whole economic process, especially historic change brought about by changes in methods of supplying commodities (Schumpeter, 1939: 46-47, 72). The carrying out of these changes, or innovations, Schumpeter called enterprise. And those who carried them out he called entrepreneurs (Schumpeter, 1934: 77). These innovations competed on the bases of their performance rather than price giving rise to a process of "creative destruction" of existing markets bringing with it an increase in and an equitable distribution of wealth. Entrepreneurs, therefore, create new economic opportunities through innovation.

Schumpeter argued that entrepreneurship necessarily was confined to actions of new firms. He stated that "new combinations are, as a rule, embodied, as it were, in new firms which generally do not arise out of the old ones but start producing beside them" (Schumpeter, 1934: 66). Additionally, "new enterprises are mostly founded by new men and the old businesses sink into insignificance" (136). He nevertheless did see it as possible that innovations could be done within existing firms. He was therefore not consistent on using the entrepreneur and innovator as synonyms; actually, some evolution can be seen in his work on the sources of innovations. In his first book, Schumpeter did not see the entrepreneur's function to "find" or "create" new possibilities upon which to base innovations. These are always present, abundantly accumulated by all sorts of people and generally known (Schumpeter, 1934: 88). Later on he became

concerned that innovation would become a routine activity mastered by existing large firms who created their own sources of innovation through organized R&D and marketing departments. Although innovations by large firms would result in similar effects on the growth of the economy as those by entrepreneurs in new firms, large firms' growing dominance would lead to unacceptable wealth concentration, leading to the emergence of socialism (Schumpeter, 1942: 132-134):.

### ***Kirzner - Opportunity Recognition***

Kirzner criticizes mainstream general equilibrium theory for focusing too much on the equilibrium itself rather than the processes by which equilibrium is attained. According to him markets are constantly in states of disequilibrium and the role of the entrepreneur is to bring economic markets into equilibrium by exploiting the opportunities that arise because of the disequilibrium (Kirzner, 1997: 27-30). Because of uncertainty the entrepreneur does not seize just any 'given' opportunity, but he is discovering and acting on it simultaneously. In fact, to Kirzner, "entrepreneurship becomes reduced to the quality of alertness" (Rothbard, 1985: 281). Part of the discovery is realizing undervalued resources and in the process of doing so the entrepreneur brings markets towards equilibrium. For Kirzner, the innovation process is exogenous to the economic system: "For me the function of the entrepreneur consists not of shifting the curves of cost or of revenues which face him, but of noticing that they have in fact shifted." (Kirzner, 1973: 81). In other words, disequilibrium opportunities are there for the alert entrepreneur to discover and act upon. New technical innovations are exogenous to the economic system in keeping with the general equilibrium model.

Kirzner argues that the entrepreneur has a key role in achieving the efficient allocation of resources in the economy. The entrepreneur makes it possible for equilibrium to be achieved even without perfect information, with product differentiation, and without many competitors. Therefore entrepreneurs have an important function for providing equitable wealth distribution as promised by equilibrating markets. And, they do this while stimulating economic growth (Kirzner, 1997: 7-75). While Schumpeter discards the neoclassical equilibrium model as useless, Kirzner attempts reconciliation with the model. Schumpeter's entrepreneurs create opportunities for innovations by creating new markets, while Kirzner's alert entrepreneurs discover opportunities in existing markets.

### ***Contemporary Views***

Although the concept of entrepreneurship originates from economics, the field of entrepreneurship is currently a multidisciplinary field involving researchers with backgrounds in psychology, sociology, economics and management. The interdisciplinary nature of the field has made it open to different interpretations of the concept of entrepreneurship.

Much of the early work within the entrepreneurship field focused upon the formation and development of independent new ventures (Cooper, Hornaday, & Vesper, 1997). In this tradition Gartner (1988) has defined entrepreneurship as the creation of organizations. Bygrave and Hofer extended that definition to include the identification of opportunities, i.e. the entrepreneur is someone who "perceives an opportunity and creates an organization to pursue it" (1991: 14). Kirchoff has similar focus on the creation of new ventures when he defines entrepreneurship as "the process of (1) identifying an invention worthy of commercialization; (2) converting the invention into a salable product/service; (3) creating or finding a small independent firm to sell the product/service; (4) obtaining the resources to operate the firm and sell the product/service; and (5) successfully operating the firm and generating product/service sales so as to achieve firm survival and growth." (1994: 62).

A number of researchers within the field have emphasized entrepreneurial and innovative behavior of managers, whether in start-ups or established firms. Stevenson (1997) defines entrepreneurship as the "pursuit of opportunity without regard to resources currently controlled" and Shane and Venkataraman define entrepreneurship research as "the scholarly examination of how, by whom, and with what effects opportunities to create future goods and services are discovered, evaluated, and exploited" (2000: 218).

The definitions above relate to Knight, Schumpeter and Kirzner in different ways. The small firm perspective is obviously inspired by Schumpeter but adds the specific aspects of the new organization in a way that Schumpeter did not do. The link is strongest in Kirchoff's definition that is explicitly inspired by Schumpeter. The focus on opportunity recognition is based on Kirzner's view of entrepreneurship and his contribution is clearest in the definition provided by Shane and Venkataraman. Wennekers and Thurik's definition is inspired by Schumpeter's original contribution, but missing his emphasis on the wealth distribution function performed by independent entrepreneurs. Instead their focus is on increase in output. In that context it is natural to include innovation involved in the innovation process, new as well as old. Baumol's definition combines the three of the basic economic perspectives and suggests that they are not incommensurable. He states that the entrepreneur is "incapable to leaving matters where they are" (Baumol, 1993: 11) but faces uncertainty, thereby combining Schumpeter's view on the creative entrepreneur, Kirzner's view of the alert entrepreneur, and Knight's view on the entrepreneur as dealing with uncertainty. This synthesis of the three different schools of entrepreneurship is appealing as it includes both innovation based on disruptive technology and innovation based on evolutionary technology as well as the uncertainty inherent in the innovation process.

Entrepreneurs can create change through innovation and they can respond to change through innovation. However, no attention is given to the effects of the innovation on wealth distribution. We cannot specifically investigate, understand or promote entrepreneurship as a mechanism of wealth redistribution using this definition. We cannot distinguish between the innovations that can redistribute wealth and those that may concentrate wealth. Successful innovation by large, existing, firms may change the wealth distribution but tend to concentrate wealth rather than redistribute it. Wealth redistribution is only possible through new, small independent firms. To identify the link between technical innovation, entrepreneurship and economic development, we have to look at the literature on the economics and management of technical innovation. Much of this literature is built on the foundations laid out by Schumpeter (Becker & Knudsen, 2004).

### **TECHNICAL INNOVATION AND ECONOMIC DEVELOPMENT**

Schumpeter (1939: 46-47) defined technical innovation as the introduction of new combinations of methods for supplying commodities in the economy. According to Schumpeter, entrepreneurs introduce new combinations, i.e. innovations, to the market and enter into competition with existing firms. Unlike Marshall's model, competition is not from equilibrating markets at lower prices, but rather from "...the new commodity, the new technology, the new source of supply, the new type of organization (the largest-scale unit of control for instance) - competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the output of the existing firms but at their foundations and their very lives" (Schumpeter, 1942: 84). In the process the entrepreneur gains a temporary monopoly situation, which transfers market share (and wealth) from existing firms to the entrepreneur.

Schumpeter's description of innovation process is not without critics. Rosenberg (1982) has criticized the distinction that Schumpeter makes between invention and innovation, and between

innovation and imitation or diffusion. Rosenberg sees the innovation process as a continuous process that proceeds in small steps where there are feedbacks and interactions between the steps (Kline & Rosenberg, 1986). Baumol (2002b) focuses on the routinization of this type of innovation in large firms, though he recognizes the importance of innovations by small firms as well (Baumol, 2002a).

Along with the literature on the economics of innovation there has emerged a discipline interested in the management of technology and innovation. The differences between those innovations that have and those that do not have a large impact on society are a major focus of literature in this discipline. Morone (1993), Bower and Christensen (1995) and many others identify two classes of technology: (1) disruptive, radical, emergent or step-function technologies; or alternatively (2) evolutionary, sustaining, incremental or "nuts and bolts" technologies. We will use the terms disruptive and evolutionary.

The definition of disruptive technologies can be found in the strategy categorization scheme developed by Bower and Christensen (1995). They view technologies as two categories and define one as disrupting the current capability set required by a given market. Disruptive technologies are those that do not support current firm based manufacturing or marketing practice. Bower and Christensen note that disruptive technologies may not be "... radically new from a technological point of view" but have superior "performance trajectories" along different critical dimensions that a new set of customers value, but not existing customers (Bower & Christensen, 1995; Christensen, 1997). Abernathy and Clark (1985) focus on capability disruption rather than market disruption. They argue that, due to disruptive technologies' radical newness, robust manufacturing infrastructure does not exist or is very limited. These two viewpoints are not incompatible; in fact the authors recognized that both forms of disruptive technologies exist.

Abernathy and Utterback (1988) confirm this as they describe disruptive technologies as those that create entirely new technology-product-market paradigms that create new to the world markets that may be opaque to customers. There is a clear understanding among these writers that a category of technology exists that serves as the basis for development of innovations that are radically different, are resisted by the existing markets and create entirely new market structures. The activity Schumpeter describes as creative destruction is clearly driven by what these technology theorists call disruptive technologies and discontinuous innovations - radically different, resisted by existing market structures and creating entirely new market structures. Further, the mechanism for overcoming buyer/user resistance to adopting disruptive technologies is the commercialization process that Schumpeter describes as the work of entrepreneurs. Typically, there are no existing markets and new markets for the innovation have not been developed (Abernathy & Utterback, 1988). The entrepreneur must create a commercialization opportunity by pushing the technology upon customers, overcoming their resistance to behavioral change (Moore, 1991). The entrepreneur must demonstrate that the technologies embodied in a new product provide significant cost reductions and/or performance improvements to overcome buyer resistance. In this way, customers are found who are willing to take the risks of newness (Mansfield, 1968).

Evolutionary technologies improve incrementally from a body of existing knowledge (Foster, 1986). Bower and Christensen (1995) describe such technologies as "sustaining technologies," that is technologies that sustain the current manufacturing practices and technological capabilities required in an industrial setting. Evolutionary technologies create innovations that are modifications of, improvements to, or replacements for existing products. These are called

continuous innovations (Morone, 1993). Evolutionary technologies do not alter markets the way that disruptive technologies do as they do not require users to significantly change their behavior. Instead, evolutionary technologies often are driven by customer demand for improvements of existing products; improvements make better products that fit current customer behaviors. Market opportunities for shifting market shares to alternative suppliers arise when customer needs are unmet by existing suppliers in a well defined market structure.

Disruptive technologies create discontinuous innovations that destroy markets. Such discontinuous innovations change the very nature of competition and the overall structure of markets. An example will help illustrate this phenomena. The personal computer changed the entire nature of the computer market. The firms in the market changed; much of their value as operating businesses has been acquired by the start ups who now dominate the market. This truly is an example of Schumpeterian creative destruction. On the other hand, although evolutionary technologies that underlie continuous innovations may shift market shares among competitors, they do not overturn or destroy the markets. They provide improvements of or replacements for existing products. But such continuous innovations have had little impact on determining which firms are in the market, or the way people use a technology. Disruptive technologies and discontinuous innovations logically embody Schumpeter's concept of creative destruction. A disproportionate number of these disruptive technologies emerge from newly formed firms, as Schumpeter believed. New firms are not trapped in an existing stream of evolutionary technology and are free to invent and commercialize for a whole new set of customers. These initiators of discontinuous innovations play a vital role in creating new economic opportunities, and are Schumpeter's entrepreneurs.

### CONCLUSION

We have shown above that the entrepreneur, as a new, independent firm, has a significant role to play in maintaining an equitable distribution of wealth. It is for this reason that we maintain a distinction between the entrepreneurial innovation of a small or startup firm, and the innovative activities of existing, especially dominant, players in the market. It may seem odd that the vitality of the economy is maintained through the decline of large firms, but the continual births of new firms usually more than make up for the lost jobs (Birch, 1987) as well as providing the new blood that keeps the economy going.

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# ENTREPRENEURSHIP: RE-MAPPING THE WINDS OF CREATIVE DESTRUCTION

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## ABSTRACT

*The purpose of this paper is to examine the important role of small start-up firms in creative destruction. We begin with the exploration of innovation in Abernathy and Clark's "Innovation: Mapping the Winds of Creative Destruction". We find that innovation, while admittedly an important driver of economic growth, is not a sufficient condition to bring about creative destruction. The type of innovation most closely associated with creative destruction, namely disruptive, discontinuous or radical innovation, is significantly more likely to occur in small or newly formed companies than in large incumbent firms. Hence, we argue first, that entrepreneurial innovation, that is, innovation by independent new companies, is the actual driver of creative destruction, and second, for a narrow definition of entrepreneurship that is limited to new independent firms.*

## INTRODUCTION

In 1985, William Abernathy and Kim Clark published "Innovation: Mapping the Winds of Creative Destruction" (1985). Their purpose was "to develop a descriptive framework that may be useful in categorizing innovations and analyzing the varied role they play in competition." The authors also wanted to "develop concepts that may prove useful in the effort to incorporate technological consideration into business strategy, and perhaps in developing appropriate public policies" through "intensive analysis of the technical and competitive history of the US automobile industry"(Abernathy & Clark, 1985: 4). In the process, though only briefly, they began to shed some light on the mechanics of "creative destruction" (Schumpeter, 1934). Two decades later we revisit the topic to shed some light on the distinctions between innovation and entrepreneurship, through exploring the role of each in creative destruction.

There has been a growing tendency in the entrepreneurship literature to conflate the concepts of innovation and entrepreneurship, rolling corporate innovation and new business creation together under the heading of entrepreneurship. Shane and Venkataraman, for instance, "argue that entrepreneurship does not require ... the creation of new organizations" (Shane & Venkataraman, 2000). This dilution of the concept of entrepreneurship also obscures the differences between ordinary competition and Schumpeterian "creative destruction". Abernathy

and Clark, arguing that innovation is the engine that drives creative destruction, give support to this conflation of concepts. We argue that innovation alone is not sufficient to bring about the process of creative destruction, but that the innovation needs to be both a specific type, disruptive, and occur in a new, independent firm. Further, we conclude that this distinction is important enough to narrow the definition of entrepreneurship to innovation which is associated with the creation of new firms.

### ***Schumpeter's Innovation***

According to Schumpeter, the innovative process creates market disruption which leads to the rise of new firms and the simultaneous decline of the large incumbent firms which they replace. This occurs through the introduction of "...the new commodity, the new technology, the new source of supply, the new type of organization (the largest-scale unit of control for instance) - competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the output of the existing firms but at their foundations and their very lives" (Schumpeter, 1942: 84). This is fundamentally different from general equilibrium theory, where competition is primarily price-based. In this model, competition ceases to be based solely on price, and instead is based heavily on non-price aspects of a product such as features and performance — shifting the basis of competition from cost minimization to innovation.

Mainstream economics, grounded in general equilibrium theory, began to recognize the importance of innovation for economic growth with the introduction of "new growth theory" (Solow, 1956, 1957; Romer, 1990, 1994). However, this model viewed innovation as occurring in a smooth, continuous manner, ignoring the variable nature of it. Further, it makes no allowances for the nature of innovation, nor the way in which innovation impacts competition. Abernathy and Clark recognize this and attempted to establish a framework for understanding innovation. However, despite the title of their paper, they did not describe the role of that innovation in creative destruction; in fact, "creative destruction" is only mentioned once outside the title in the whole paper. Rather, they explore the role of innovation generally as a basis for competition and economic growth.

Baumol (2002b) refines the role of innovation in economic growth, arguing that the routinization of innovation is the primary driving force behind growth in the capitalist system, and calling for "economists to devote more effort to discuss the process of innovation and growth" (Guarino & Iacopetta, 2003: 3). Schumpeter believed that the routinization of innovation would lead to the concentration of wealth in the hands of a few large corporations, leading to the decline of capitalism and the rise of socialism (Schumpeter, 1942: 132-134). However, Baumol apparently does not see routinization as posing a problem (Guarino & Iacopetta, 2003: 7).

So far, Baumol has been right: Schumpeter's prediction has not come to pass. At the same time, however, Baumol presents a persuasive argument that the routinization of innovation Schumpeter feared, is, in fact, occurring. Large companies have become very efficient innovators, yet their skill at innovation appears to be unequally distributed across the spectrum of types of innovation. We need to understand different types of innovation in order to understand why this is so.

### ***Types of Innovation***

In their attempt to develop a framework for categorizing innovation, Abernathy and Clark group innovations according to their effects on competencies on one axis and linkages to customers on the other. In their own words:

The differences in organizational environments in each mode of innovation implies that a transition from one phase to another may pose a significant challenge to established firms. This suggests the need to examine the impact of innovation on market structure during periods of transition, as well as implications for management. Historical evidence suggests that the creation and development of technology-based industries leads the industry from quadrant to quadrant. (Abernathy & Clark, 1985: 21)

They call their framework the “transilience map”. This framework is reflected in later work on innovation and technological change. For instance, Abernathy and Utterback (1988) deal primarily with the competency related issues of innovation, while Bower and Christensen (1995) focus more on the customer linkage aspects of “disruptive innovations”, yet each recognizes that both aspects of the theory are important.

In the transilience map, the four quadrants of innovation are “regular” on the lower left (conserves both competencies and linkages), “niche” (conserves competencies but disrupts linkages), “revolutionary” (disrupts competencies but preserves linkages) and “architectural” on the upper right (disrupts both competencies and linkages). In later work with Henderson, Clark presents a variation of the framework, with similar quadrants, although “architectural” and “radical” (“revolutionary”) seem to have switched places (Henderson & Clark, 1990). For many purposes, however, it is sufficient to use a single scale, which cuts diagonally through the transilience map from minimal to maximum disruption. Later authors use this type of categorization, with minimally disruptive innovations being called evolutionary, sustaining, or incremental, while at the opposite end are disruptive, discontinuous, revolutionary, or radical innovations.

Other innovation typologies are compatible with this basic model. For instance, in the “product” and “process” categorization (Utterback & Abernathy, 1975; Utterback, 1978; Abernathy & Utterback, 1988; Utterback, 1994), high levels of “product” innovation tend to be correlated with disruptive innovation, while high levels of process innovation tend to go along with sustaining innovation. The routinized innovation conducted in large firms tends to be predominantly sustaining and process innovation, whereas the innovation introduced by small firms is more likely to be disruptive and product innovation (Tilton, 1971). Here we begin to see evidence of creative destruction happening through technological change.

### ***Creative Destruction***

There is an increasing recognition of the importance of innovation in the economy (Foster, 1986; Scherer, 1999; Baumol, 2002b), but relatively little discussion of how that innovation, or more specifically, what types of innovation, contribute to creative disruption. Abernathy and Clark deal only briefly with this issue: “It is at these points of transition [between quadrants on the transilience map] that originating firms exit and are replaced by new firms better able to manage in the new mode” (1985: 21). However, they do recognize that radical change “is at the heart of Schumpeter’s theory of innovation and economic development in which ‘creative destruction’ is the vehicle of growth” (1985: 6)

Schumpeter believed that neo-classical theory did not properly explain the economic process, particularly in regard to innovation and technological change (Schumpeter, 1939). He described a process in which “new combinations [innovations] mean the competitive elimination of the old” (Schumpeter, 1934: 67) and referred to this process as a “perennial gale of creative destruction” (Schumpeter, 1942: 84). More specifically, for Schumpeter, innovators reform or revolutionize the pattern of production by exploiting an invention, or, more generally, an untried technological possibility for producing a new commodity or producing

an old one in a new way, by opening up a new source of supply of materials or a new outlet for products, by reorganizing and industry and so on (1942: 132).

Schumpeter emphasized how important this process is: (1942: 83)

The opening up of new markets, foreign or domestic, and the organizational development from the craft shop and factory to such concerns as U.S. Steel illustrate the same process of industrial mutation—if I may use that biological term—that incessantly revolutionizes the economic structure *from within*, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism. It is what capitalism consists of and what every capitalist concern has got to live in.

Christensen (Bower & Christensen, 1995; Christensen, 1997, 1998) Utterback (1994) and others have talked about the role of technological change in bringing about the fall of leading firms. While they generally do not mention Schumpeter and creative destruction, it is clear that what they are describing is the creative destruction process as viewed at the firm and industry level. Over and over again, they describe instances in which large, leading incumbent firms are brought down by their inability to change and adapt to radical new technology. A glance at economic history (i.e., Schumpeter, 1939) shows that this is not a new phenomenon, but has been going on at least as long as the Industrial Revolution, perhaps longer.

### ***Sources of Disruptive Innovation***

If disruptive innovation, as recognized by Abernathy and Clark, and demonstrated by repeatedly by others (see above) is the driver of creative destruction, it follows that we must identify the sources of disruptive innovation. Going back to the transilience map, we notice an interesting fact: in Abernathy and Clark's study of the automobile industry, the most disruptive innovations (which they call "Architectural") occurred early in the industry's evolution. In fact, these innovations all occurred before any of the other types of innovation, early in the lives of the firms studied. This is, in fact, the key point. Research has shown that new entrants are not only major innovators (Gellman, 1976; Futures Group, 1984), but also more likely than incumbents to introduce radical innovations (Tilton, 1971; Abernathy & Utterback, 1988; Scherer & Ross, 1990). According to Schumpeter, "new combinations [major innovations] are, as a rule, embodied, as it were, in new firms which generally do not arise out of the old ones but start producing beside them" (Schumpeter, 1939: 66). These new entrants are, of course, entrepreneurs.

It is not impossible for large firms to introduce disruptive innovations, but there are significant internal pressures, from risk aversion to organizational inertia (Burgelman & Grove, 1996) and external pressures, like the demands of existing customers (Christensen & Bower, 1996), that combine to make it much more likely for large firms to engage in incremental and process innovation. Routinized innovation, by its very nature, excels at these types of innovation. But it is in new, independent firms, missing the organizational constraints against radical innovation, where the disruptive technologies are most likely to be developed. **Furthermore, new independent firms do not have an existing group of customers demanding improvements to existing technologies.** Many of the most important innovations of the century, from the airplane to the zipper, occurred in small firms (SBA, 1995).

When an entrepreneur introduces a new (radical) innovation, the market for that innovation does not yet exist. The entrepreneur must go through the process of creating a market for the innovation, persuading new customers that the new technology provides a combination of price, performance, and features that fits their needs, which are different from the needs of the

customers in the established market (Moore, 1991; Christensen, 1997). Schumpeter recognized this as well: “It is, however, the producer who as a rule initiates economic change, and consumers are educated by him if necessary; the are as it were, taught to want new things, or things which differ in some respect or other from those which they have been in the habit of using” (Schumpeter, 1934: 65). As the entrepreneurs find customers who are willing to accept the risks associated with new products (Mansfield, 1968), the market for the innovation grows, and the technology matures to the point where it can compete with the previous technology on the same criteria that the established market values. When this happens, the new technology usually displaces the old technology rather quickly and the firms which produce the old technology disappear along with it.

### ***Impact of Entrepreneurs***

Evidence for the importance of innovation by entrepreneurs continues to mount. A 2002 study for the U.S. Small Business Administration found that “small patenting firms produce 13-14 times more patents per employee as large patenting firms” and that “small firm patents are twice as likely as large firm patents to be among the 1% most cited patents” (CHI Research Inc., 2002) Further, “in the modern economy, innovation remains largely the work of smaller firms. Though in the aggregate, NTBFs [new technology-based firms] spend only a fraction of what large firms spend on total R&D, they produce more than half of the innovations”(SBA, 1996). Small firms also contribute disproportionately to net new jobs (Birch, 1979, 1987; Kirchoff, 1994; Storey, 1994).

Given, as suggested above, that entrepreneurs tend to be more innovative than large firms, and that those innovations are more likely to be disruptive innovations, we can see why the entrepreneur, the “independent innovator” (Baumol, 2002b), rather than all innovators, is the driver of creative destruction.

It may be helpful to illustrate how this process might work. The following hypothetical example serves to illustrate the contributions of many of the above-cited authors. An employee at a large firm has an idea for a new product which differs substantially from the product line currently produced by the firm. His proposal is rejected as too risky, and is not funded for development. Our nascent entrepreneur decides that the product has enough potential that he quits his job to develop the product on his own. Soon, he makes enough progress that he is able to convince private investors (angel investors or venture capital) to fund the product and create a new firm to complete the development and commercialize the product. The product at first finds a small niche market, but is able to mature in this market and improve its performance. Eventually, the product catches on and moves into the mass market, where it now competes against products from the entrepreneur’s old firm, but offers superior performance at a lower price. The old firm finds itself rapidly losing sales to the entrepreneur’s new firm, and in spite of pouring resources into the old technology, is unable to match the performance of the new technology. As the new firm gains market share, it overtakes the old firm, and becomes the new market leader, while the old one declines.

### ***Entrepreneurship and Intrapreneurship***

Much of the literature on innovation and technological change recognizes that entrepreneurship is a danger to large firms, and seeks to offer advice on how to change the culture of those firms to make them more like entrepreneurs (Foster, 1986; Foster & Kaplan, 2001; Christensen & Raynor, 2003). This reorientation, which is sometimes known as “intrapreneurship” (Pinchot, 1985), can help revitalize large corporations and help them to take risks more like entrepreneurs. However, even if these incumbent firms are able to produce

disruptive innovations, they can still not produce creative destruction; as the incumbent firms, in order to do so, they would have to destroy themselves!

It is for this reason that we argue for the definitional distinction between innovation by new independent firms (entrepreneurship) and innovation by large incumbent firms (intrapreneurship). There are many who use a broader definition of entrepreneurship in their research (Stevenson, 1997; Wennekers & Thurik, 1999; Shane & Venkataraman, 2000), considering activities in large and small firms alike, but much early research on entrepreneurship studied the formation and growth of new ventures (Cooper, Hornaday, & Vesper, 1997). Some current researchers (Gartner, 1988; Bygrave & Hofer, 1991) also use a definition of entrepreneurship that includes the creation of a new organization. We hold that, due to the linkage to creative destruction discussed above, entrepreneurship inherently involves the creation of a new independent entity for the exploitation of an innovation. While innovation in large corporations is interesting, and deserving of study, the impacts on the economy are different from innovation by new firms, and the definition of entrepreneurship needs to reflect that fact.

### ***Conclusion***

We have argued that while innovation is a necessary condition for creative destruction, it is not a sufficient condition. Rather, the innovation must be both a particular type of innovation, namely radical, disruptive, discontinuous or revolutionary innovation, and the innovation must occur outside of the ranks of the incumbent leading firms in the industry at the hands of an independent new firm, an entrepreneur. While innovation generally, including routinized innovation, offers significant contributions to economic growth, it is disruptive innovation by entrepreneurs which brings about the process of creative destruction.

On this basis, we have further argued for a narrow definition of entrepreneurship as the creation of a new, independent firm to exploit an innovation. Although innovation is not the exclusive domain of new and small firms, the economic impacts, as discussed above, of impact in small and large firms are different enough to warrant specific attention by researchers. Hence, we reserve the term “entrepreneurship” for the creation of new independent ventures to commercialize an innovation.

Schumpeter feared that the entrepreneur was (Schumpeter, 1942: 132):

already losing importance and is bound to lose it at an accelerating rate in the future even if the economic process of which entrepreneurship itself was the prime mover went on unabated. For on the one hand, it is much easier now than it has been in the past to do things that lie outside familiar routine—innovation itself is being reduced to routine. Technological progress is increasingly becoming the business of teams of trained specialists who turn out what is required and make it work in predictable ways. The romance of earlier commercial venture is rapidly wearing away, because so many more things can be strictly calculated that had of old to be visualized in a flash of genius

He feared that this concentration of the innovative capacity in the hands of large corporations would eventually lead to a corresponding concentration of wealth, necessitating a transition to socialism.

Fortunately for capitalism, the innovative genius of the entrepreneur seems to be undimmed. Although the routinization of innovation has indeed proceeded (Baumol, 2002c),

one can offer the plausible conjecture that most of the revolutionary new ideas of the past two centuries have been, and are likely to continue to be, provided more heavily by independent innovators [entrepreneurs] who, essentially, operate small business

enterprises. In turn, these innovators, once successful, often establish firms of their own, joining [or displacing] the large enterprises that engage preponderantly in routine innovation (Baumol, 2002a).

As long as these “revolutionary new ideas” continue to come from entrepreneurs, the process of creative destruction will continue, and capitalism will remain healthy. Hence, to truly map the winds of creative destruction, one must study the entrepreneur.

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# **THE CHILLING EFFECTS OF SARBANES-OXLEY: MYTH OR REALITY**

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## **ABSTRACT**

The passage of the Sarbanes-Oxley Act in 2002, an act of the US Congress in response to Enron and other corporate misdeeds, apparently had little thought behind it as to its impact on start-ups and early stage firms and their IPOs. From 2000-2003, particularly in the technology sector, IPOs, one of the effective ways chosen by many entrepreneurs world-wide to raise capital, were on the decline due to the world-wide recession. While technology based IPO numbers had begun to increase in 2004, many posit that going public has now become a greater challenge due to the Sarbanes-Oxley legislation. The now required complex record keeping and concomitant internal organization with associated high costs (\$1,000,000 or more for initial compliance and a like amount or more yearly) may have impacted the number of IPOs. The act, anecdotally, appears to have also served to increase the number of mergers, joint ventures, and acquisitions. This paper covers an initial survey of 79 entrepreneurial technology incubating firms and their views of the impact of Sarbanes Oxley on their future development.

## INTRODUCTION

United States Federal legislation known as the Sarbanes-Oxley Act (SOX) was passed in the wake of corporate scandals involving spectacular bankruptcies; inappropriate accounting practices; and audit firms that apparently closed their eyes to those practices. The provisions of the legislation were designed to “protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes...” Although the legislation was designed to ensure a high quality of financial reporting by publicly traded companies, proposals to extend the legislation to privately held companies are now (March 2005) being considered at both the U.S. federal level and in some states. Also being considered is extending the legislation to “special interest” (not-for-profit) corporations. Even if the legislation is not extended, bankers and other stakeholders may begin to view SOX mandated practices as “best practices” and give preferential treatment to entities that are voluntarily SOX compliant.

Four of the areas addressed by the SOX legislation are: (1) defining appropriate relationships between independent auditors and the companies being audited; (2) specifying appropriate corporate governance practices and inappropriate corporate activities; (3) stipulating provisions with respect to corporate fraud and accountability; and (4) establishing requirements that companies implement and document internal control systems to help insure the integrity of financial information being reported to the public.

The fourth area of the provisions has received the most attention in the press because compliance related to internal control can be quite costly. This cost may inhibit firms from entering into the public markets to raise capital, or may cause firms that have been publicly traded to go private.

In turn, it has been speculated by the popular press that this may result in stunting creation of new jobs and products because firms do not have access to the large amounts of capital that they could have accessed in the public markets. Most of these claims are supported by anecdotal evidence citing only a few specific cases of companies that have decided not to go public due to SOX or have delisted.

## **BACKGROUND**

Today mergers and acquisitions appear to have taken the place of the traditional IPO for substantive capital creation. Mergers or acquisitions may relieve some of the capital needs of start-ups and early stage firms. However, independent entrepreneurs, though helped by having the senior level management in their new partner firms, may not be so easily managed or incorporated into the firm. The parent firm may also find itself diverted from its business activities due to the challenges presented by a merged or acquired younger firm. Creativity and innovation may likely suffer as well.

### **Review of the Provisions of SOX**

**Independent auditors** The first two sections of the SOX Act relate to auditors of publicly traded companies and relationships between the company and its auditors. Of particular concern to companies preparing for an IPO are the provisions related to limitations on the amount of consulting services that auditors may perform for clients; requirements that non-audit services must be approved by the company's audit committee; and requirements that the CEO, Controller, CFO, Chief Accounting Officer or any person in an equivalent position cannot have also been employed by the auditing firm during the 12 months preceding the audit. *Companies*

*considering an IPO will need to be in compliance with these provisions at least 36 months prior to the IPO.*

**Corporate governance** The SOX provisions related to corporate governance include requirements designed to improve corporate governance by (1) requiring specific actions that need to be taken by the company and/or its management; and (2) designating activities that the company and/or its management are prohibited from pursuing.

Specifically, Section 301 establishes a requirement that the company have an audit committee and states that each member of the audit committee will be an independent member of the board of directors. Although the Act did not require a member of the audit committee to be a “financial expert,” companies must disclose whether at least one member of the audit committee is a financial expert. A study by the Institute of Internal Auditors (2004) on the SOX affects on audit committees of non-publicly traded entities concluded that non-public companies could find it more difficult to recruit and retain qualified members to serve on audit committees.

Other corporate governance features of SOX require that the CEO and CFO must certify the financial statements; require that a corporate code of ethics be in place for top management; expands required disclosures about transactions involving the company and principal stockholders or directors or officers; and prohibits the purchase or sale of stock by officers and directors and other insiders during black-out periods. Companies considering an IPO need to have appropriate policies in place prior to the IPO. The SEC also is given the power to ban any person from serving as an officer or director of a publicly traded company.

## **Corporate Fraud and Accountability**

Titles VIII through XI of SOX relate to Corporate Fraud and Accountability and White Collar Crime Penalty Enhancements. Title VIII of the Act imposes criminal penalties for destroying, altering, concealing, or falsifying records where the intent is to obstruct a federal investigation or a bankruptcy proceeding; made debts incurred in violation of securities fraud law nondischargeable through bankruptcy; and extended the statute of limitations for private actions for securities fraud violation to not later than two years after discovery of the fraud or five years after the violation occurred. One implication of these provisions is that companies need to develop, implement, and periodically review document retention and destruction policies.

The Act also extends whistleblower protection for employees who provide evidence of fraud. Implications of these provisions are that companies need to implement or review whistleblower policies to ensure compliance with the requirement that employees have an avenue for “confidential, anonymous submissions” and to ensure non-discrimination against whistleblowers.

## **Reliable Financial Reports**

Section 404, related to management assessment of internal controls, and has probably received the most negative attention, due to the cost of completing the assessment and having auditors report on the company’s assessment. In July 2004 Financial Executives International (2004) surveyed 224 public companies with average revenues of \$2.5 billion to determine estimates of the cost to comply with Section 404. Results showed the average total cost of compliance was estimated at \$3.14 million or 62% more than the \$1.93 million estimate identified in FEI’s January 2004 survey. First-year compliance cost for companies with revenues of less than \$1 billion was estimated at \$1,000,000 or less. First year compliance costs for companies with over

\$5 billion in revenue had increased from an estimated \$4.6 million in the January survey to \$8 million in the July survey. These costs may be viewed as a significant deterrent for a company considering an IPO.

### **Venture Capital and Technology IPOs**

The number of venture backed technology IPOs declined from 245 in 1999 to a low of 28 in 2002. In 2003 the number of deals was up one to 29, but is up to 93 in 2004.

(<http://www.nvca.org/ffax.html>, March 8, 2005; and Gorton et al., 2003). Overall, technology firm IPOs did not fare better during the same time period. In 1999 there were 900 such IPOs. In 2000, 2001, and 2002 respectively there were 713, 77 and 71. In 2003 times were not better and there were only 20, but in 2004 there was a four fold plus increase to 88. As of March 8 there were 12 from the first of the year. (<http://www.hoovers.com/global/ipoc/index.xhtml>, March 8, 2005; Gorton et al., 2003).

### **Costs and Consequences of SOX**

The law firm of Foley & Lardner (Hartman, 2004a) conducted studies in 2003 and 2004 on the impact of SOX on firms. The survey found that the average price of being public had nearly doubled following enactment of SOX, from \$1.3 million to almost \$2.9 million for firms with revenues under \$1 billion. A significant portion of the increase was related to insurance for directors and officers (D&O). The study indicated that D&O insurance increased from an average of \$329,000 a year pre-SOX to an average of \$639,000 a year for FY2002, and \$850,000 annually for FY2003 post SOX.

As a consequence, there have been reports of companies that have delisted their securities and reports of companies electing to delay or cancel initial public offerings (IPOs). Of the 115

public company respondents to the 2004 Foley and Lardner survey, 21% indicated that they were considering going private, 6% indicated they were considering selling the company, and 7% indicated they were considering merging with another company as a result of Sarbanes Oxley requirements (Hartman, 2004a).

Companies currently listed with the SEC can avoid SOX by either going private or going dark. When a company goes private, its shares are no longer publicly traded in any venue. On the other hand, a company that elects to “go dark” will deregister its securities, which means it no longer has to file with the SEC, but shares will continue to trade in the over-the-counter (OTC) market. The decision by many companies to either go private or go dark has been attributed to costs to comply with SOX, as discussed below.

Linster W. Fox, Chief Financial Officer of Anacomp, a data management company that decided to go dark, was quoted as saying “complying with [SOX] would have added \$1 million to its annual costs” (Deutsch, 2005). Fidelity Federal Bancorp is another company that went dark. Donald R. Neel, Fidelity’s CEO, was quoted as saying “going dark will save \$300,000 a year, a substantial sum for a bank with just \$200 million in assets” (Deutsch, 2005). Max & Erma’s, an Ohio restaurant chain, is also going dark. Delisting is expected to save the company \$450,000 in the first year, and \$350,000 each year thereafter (Wolf, 2005). Other companies that have cited the cost of compliance with SOX as a reason for going private include Emergisoft, which estimated the cost of compliance with SOX as \$400,000 (Ligos, 2004) and Calloway’s Nursery, which estimated that the company would save more than \$500,000 a year in audit fees (Calloway’s Nursery, 2004).

Leuz et al. (2004) studied the reasons that firm “went dark” between 1998 and 2003. They reported that 67 companies went dark in 2002 (prior to SOX). That number jumped to 198 companies in 2003, and the numbers were expected to stay at about that level in 2004. Based on their study, the authors concluded compliance with SOX provisions was a reason firms “went dark.” These firms could still have their shares traded on the OTC markets without meeting SOX requirements. However, the costs of SOX compliance were not sufficient cause for firms to go private. Rather, additional motivations needed to be present to cause a firm to go private such that its shares were no longer traded on any market.

Articles published soon after the passage of SOX cited costs of complying with SOX as a reason companies delayed IPOs or elected to be acquired by other companies. Examples of specific firms cited to support these claims included Telica, an Internet phone provider, which had been set to file for an IPO but instead decided to be acquired by Lucent Technologies (Malhotra, 2004). PayMaxx, “the country’s sixth largest payroll service provider, shelved plans for a public offering, issued some convertible debt structures, and began stashing cash generated from its operations as a result of Sarbanes Oxley (Sarles, 2004). Rackspace, profitable web-hosting company delayed its IPO for at least two years, until “they hope to be so big that absorbing the extra costs [of complying with SOX] won’t be too painful” (Murphy, 2004).

An editorial in *The Washington Post* (2005) stated “Many new firms cannot go public to raise the capital to start on the road to possibly being the next Microsoft because of the compliance costs” SOX. (Deutsch (2005, p. 1). More recent claims include “The passage of SOX ... has served as a catalyst to make smaller companies rethink the idea of going public.” Charles

Schwab also expressed concerns, stating that “SOX may be keeping companies from going public” (Countryman, 2004).

Although the headlines are chilling, and cases where firms citing SOX as the reason for shelving IPOs have been reported, the evidence to date has been largely anecdotal or limited in scale. *The purpose of this study is to determine whether there is specific evidence related to early stage technology based firms to support the claim that SOX has had a significant negative impact on firms’ decisions to go public.*

### **Benefits of SOX compliance for smaller firms**

Finally, there is no doubt that the cost of compliance with SOX has made it more expensive to be a public company, which may deter smaller firms from becoming public companies and may also result in some firms electing to withdraw from the public markets. However, entrepreneurs need to be aware of SOX provisions to which private firms are subject and the benefits of voluntary compliance with SOX.

SOX impacts all companies, public or private, in the areas that relate to enforcement of federal laws and regulations. Specifically, the provisions related to criminal liability for document destruction, retaliation against whistleblowers, increased penalties for white collar crime, securities fraud, and blackout notice requirements relate to both public and private companies (Perkins Cole, 2004). While company executives and management may have no intentions of violating laws and regulations and therefore feel no need to worry about these provisions, having policies and procedures in place to establish compliance with these provisions could be “preventive medicine.”

Entrepreneurs that anticipate being acquired by a public company will also need to be compliant with SOX, if the operations of the acquired firm will have a material effect on the financial statements of the public company.

Other stakeholders may view SOX compliance as “best practices.” Companies that are not SOX compliant may discover that the cost of raising funds, either through venture capital or borrowing from financial institutions is more expensive than it would have been if the company is SOX compliant. David Katz (2003) reported that “some Chicago banks are requiring CFOs and CEOs to certify financial statements in their loan covenants with private companies.”

Robert Braun (2004) has suggested that insurance companies may also ask for SOX compliance “as a means for reducing the frequency and amount of claims, particularly with regard to errors-and-omissions insurance coverage.”

At the moment, private companies can selectively apply some of the SOX provisions related to relationships with auditors, corporate governance, and financial reporting. Foley & Lardner (Hartman, 2004b) surveyed private organizations about corporate governance. The results (based on surveys returned by 8 non-profit organizations and 22 for-profit private companies) indicated that 77% of the entities had been impacted by SOX. Most of the impacts (60%) were from self-imposed reforms. Many of them met the requirements for audited financial statements (87%), independent directors (63%), and disclosure of off-balance sheet financing and contingent liabilities (63%) prior to the issuance of SOX. Most of the actions that private companies had taken or planned to take involved CEO/CFO certification of the financial statements (44%), outside audit of internal financial controls (44%), board approval of non-audit

services performed by auditors (43%), establishment of whistleblower procedures (40%), and adoption of corporate governance policy guidelines (40%).

As long as compliance is voluntary, companies can weigh the cost versus the benefit of SOX compliance and pick and choose which SOX provisions to implement. However, federal legislation extending SOX provisions to private companies has been considered. Some state legislators are also considering SOX-type legislation that would apply to private companies. Therefore, entrepreneurs who currently believe that SOX does not apply to them may want to develop at least some familiarity with SOX and SOX-type legislation, even if they do not intend to take their companies public in the near future.

### **THIS PAPER**

As a result of the major decline in IPOs, including venture capital backed deals, and the authors' interest in the impact of SOX on entrepreneurial technology based firms, this study focused on US technology based business incubators and their firms. If these firms are to grow rapidly and create large numbers of jobs and wealth for a region, the import of SOX on the capital infusions historically needed and derived from public sale of stock is important for all of the US determining whether SOX compliance is inhibiting their pursuit of capital in the public markets, thus hampering the creative development of such firms and their new innovative products and services was another reason for this study. While largely anecdotal evidence of a negative impact abounds in the public periodicals and in private reports, surveying likely technology based IPOs was indicated. This paper reports on such a study and the implications relative to SOX.

## METHODOLOGY

### Sample

A random telephone survey of 79 technology based firms was conducted. All firms were US-based and housed in US technology-based incubators. By definition, then, these firms were entrepreneurial.

### Instrument

The survey was conducted in three parts: general firm information, an ethics survey, and a Sarbanes-Oxley survey. All respondents were asked to complete all three parts of the overall survey during the telephone interview. Survey questions included demographic information; a series of yes/no questions; and a series of Likert scale questions. Questions relating to knowledge about SOX; the impact of SOX on going public; and other issues related to SOX were asked.

The hypotheses and the related questions (See Table 1) are shown below.

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**Insert Table 1 Here**

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### Hypotheses

- *Hypothesis 1 Firms will not go public because of SOX.*
- *Hypothesis 2 Firms were not delayed from going public because of SOX requirements.*

### Comments on Methodology

The original data set had 79 firms, with the size of respondent firms as measured by employee numbers ranging from 1 to 285 employees. The average firm size was 8.75 (sd 9.22) after the

outlier with 285 employees was removed from the data set. The original data set had firms ranging in age from 1 to 38 years old, with an outlier of 38 years, which was also removed. Average firm age was 4.76 years (sd 9.12). Female respondents and their responses were tested between male respondents and no significant differences at the  $<.100$  level were found. Thus the data set was not split on the basis of gender and all respondents, except for the two noted, were included in the analysis.

Thirty-five percent (25/71) of the firms that responded to the question about their plans to go public indicated that they were likely to do so in the near future.

The data set is not overly large, which may lead to a lack of universal results for technology based entrepreneurs and their firms.

Finally, these results relate only to technology based incubating firms.

## **RESULTS**

The average education of the respondents included some graduate school, a result that is similar to that of other researchers in technology based firms (Teach et al., 1985). The entrepreneurs were predominately male (69 males and 10 females). The respondents were either CEO's, VP/COOs or others, including directors, scientists, engineers, etc.

The firm positions of the female respondents were not at the same level as the males; more males were CEOs or VPs/COOs than were females. More males had more advanced education than females.

The initial data set was reduced to 77 firms with the two outliers removed (one age (35 years old) and one size (235 employees). Two additional firms were removed because they did not indicate whether they had plans to go public in the near future. Four respondents did not answer the question asking whether they were familiar with SOX legislation, so these cases were also removed. The final data set consisted of 71 firms.

Not all respondents answered all questions, making multivariate analyses such as clustering, factoring or discriminant analyses not possible. Thus only means testing was used. While strategies are multivariate in nature, the results nevertheless provided some insight into how these firms thought about their future.

## **Hypotheses**

The results of the analyses are shown in Table 2.

---

**Insert Table 2 Here**

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- *Hypothesis 1 Firms will not go public because of SOX.*

In order for SOX to be a deterrent to firms' decisions to go public, decision makers must be familiar with SOX legislation and the steps necessary to be in compliance with its provisions. Respondent firms were not very familiar with SOX, as shown in Table 2. The level of familiarity was not significantly different between firms that indicated they were likely to go public (1.68, sd 0.69) and those firms not likely to go public (1.76, sd 0.77).

Responses to the question about whether SOX had an impact on their decision not to go public were obtained from 34 of the 46 firms that did not have plans to go public. The responding firms

disagreed (1.71, sd 0.94) with the statement that SOX had negatively impacted their decision. The number of incomplete responses did reflect firms being unfamiliar with SOX and thus declining to respond to this question.

*It would appear that SOX had only a very minor role in firms' decisions to not go public, because the majority of firms either were not familiar with SOX or had no plans to go public.*

With only a few thousand technology firms publicly traded in the US, and with over a 1,000,000 technology firms cited in the 2002 County Business Patterns, US summary, ([www.census.gov](http://www.census.gov), March 12, 2005), perhaps there would be only one in a thousand firms that are considering going public. However, about 35% of the respondents indicated they would consider doing so and perhaps this is indicative of changes occurring in market dynamics, following the four years of challenges faced by technology based firms and their IPO needs (Gorton et al., 2003).

While the results are inconsistent with the prior literature cited, perhaps there are two reasons for the differences. The first may be that the firms discussed in the literature are not a cohort to the firms surveyed in this work. The second would relate to the paucity of actual anecdotal evidence cited in those reports and research papers.

- *Hypothesis 2 Firms were not delayed from going public because of SOX requirements.*

While SOX may delay firms from going public either because the firms do not have the necessary organizational or reporting structures in place, or because the firms do not believe that advantages of being public justify the additional cost to comply with SOX provisions, when firms were questioned about whether their decision to go public was delayed by SOX, firms disagreed with the statement that SOX was a reason for the delay, (1.76, sd 0.73). (Table 2)

Five of the firms that indicated they were likely to go public did not respond to the question of whether SOX had delayed their decision to go public. Again, these firms did not respond because they were unfamiliar with SOX. The 20 other respondents did indicate that SOX did not delay them.

Thus the hypothesis is supported, which goes against the conventional wisdom about SOX.

Anecdotal evidence (reviewed earlier) indicates that firms have delayed going public because they need greater size to absorb the costs of SOX and thereby reap the benefits of being public.

*Interestingly enough, the outlier that was eliminated due to size is the only respondent who responded “highly familiar” with respect to SOX.*

### **Challenges Posed by SOX**

Respondents were asked to identify challenges from a list associated with SOX requirements.

The responses (included in Table 2) demonstrate the view of SOX that respondent firms have.

Responses were received from firms not considering going public as well as firms going public.

Again, the limited number of responses is due to the overall lack of familiarity that firms have regarding SOX. None of the respondents mentioned “relationship with auditors” or

whistleblower protection provisions. Interestingly, the same number of respondents indicated

“prohibitions on loans to directors or company executives” and “assessment and reporting on effectiveness of internal control structures” as challenges. Also, more respondents cited

“financial statement certification” and “corporate governance” than “assessment and reporting on effectiveness of internal control structures.” Most of the publicity about the cost of SOX

compliance has related to cost of assessment and reporting on effectiveness of internal control.

Respondent firms did not seem to place the same relative emphasis on these costs.

## SUMMARY/CONCLUSIONS

The results of this study do not indicate that these entrepreneurs are factoring SOX compliance into their current thinking even though there are benefits associated with SOX compliance for non-public firms, and there are situations where SOX compliance may be required of non-public firms. *These firms did not indicate that SOX was preventing them from going public, and neither were they delayed from going public because of SOX requirements.*

About 35% of the respondents indicated they would consider going public. This may be indicative of changes occurring in market dynamics. After the four years of challenges faced by technology based firms and their IPO needs (Gorton et al., 2003), perhaps firms are once again starting to consider the public market for capital.

The challenges firms face to meet SOX requirements are diverse. While these challenges may not chill entrepreneurship to the level the authors initially thought, SOX thus remains more a myth than a reality for entrepreneurs until they and their incubator management “go to school” on SOX. As these entrepreneurs become more familiar with SOX, their level of concern about the impact it will have on their decision to go public may rise. Academics; periodical authors in the financial and popular press; and executives of companies currently subject to SOX may understand the implications of SOX.

And while the results of the analyses are relatively inconsistent with most of the prior literature cited, perhaps there are two reasons for the differences. The first has to do with the firms that the literature is discussing not being a cohort to the firms surveyed in this work. The second would relate to the paucity of actual anecdotal evidence cited in those reports and research papers.

Finally, the authors do not know whether the level of the “unfamiliarity effect” can be separated from the “no deterrence effect” for this sample.

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**Table 1 Questionnaire for this Study**

|   |
|---|
|   |
| Age   |
| Employee Numbers  |
|   |
|   |
| How familiar are you with SOX legislation?<br>1 Not 4 Highly familiar   |
|   |
| <b>Likert like 1-6 (highly agree)</b>   |
| Our decision to go public was delayed by SOX.   |
| Our decision not to go public was influenced by SOX.  |
|   |
| Challenges related to Sarbanes Oxley are: <ol style="list-style-type: none"><li>1. Corporate Governance</li><li>2. Relationship with Auditors</li><li>3. Financial statement certification</li><li>4. Prohibitions on loans to directors or company executives</li><li>5. Assessment and reporting on effectiveness of internal control structures</li><li>6. Whistleblower protection provisions</li><li>7. Document destruction provisions</li><li>8. Other</li></ol> |

**Table 2 Results of Analysis**

|  |                     |
|--|---------------------|
|  |                     |
| Age  | 4.76 (74) (sd 3.44) |
| Employee Numbers   | 8.75 (77) (sd 9.12) |
|  |                     |
| How familiar are with SOX legislation?<br>1 Not 4 Highly familiar                |                     |
| All firms  | 1.73 (71) (sd 0.74) |
| Likely to go public  | 1.68 (25) (sd 0.69) |
| Unlikely to go public  | 1.76 (46) (sd 0.77) |
| <b>Likert like 1-6 (highly agree)</b>  |                     |
| Our decision to go public was delayed by SOX.                                    | 1.88 (24) (sd 1.88) |
| Our decision not to go public was influenced by SOX.                             | 1.71 (34) (sd 0.94) |
|  |                     |
| Challenges related to Sarbanes Oxley are (some respondents chose more than one): |                     |
| 1. Corporate Governance  | 6                   |
| 2. Relationship with Auditors  | -                   |
| 3. Financial statement certification   | 5                   |
| 4. Prohibitions on loans to directors or company executives                      | 3                   |
| 5. Assessment and reporting on effectiveness of internal control structures      | 3                   |
| 6. Whistleblower protection provisions   | -                   |
| 7. Document destruction provisions   | 1                   |
| 8. Other:  |                     |
| 9. Paperwork   | 2                   |
| 10. Overall reporting requirements   | 5                   |
| 11. Assumption of guilt by regs.   | 2                   |
| 12. Rigidity of reporting  | 2                   |
| 13. Cost   | 1                   |

# **THE SEARCH OF SMALL BUSINESS COMPETITIVENESS ON A BRAZILIAN FOOTWEAR CLUSTER**

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## **ABSTRACT**

This paper analyses the learning and interfirm relation process in search for competitiveness of small enterprises located at a Brazilian footwear cluster, Sinos Valley, where the main Brazilian footwear production cluster is located. The enterprises analyzed are shoemaker's component suppliers. The investigation is focused on the formation and development of a consortium established for internationalization purposes. The findings are based on data that was collected through interviews held with the enterprises' managers and associations' leaders as well as on secondary data. The specific dynamics of the buyer-driven chains is taken as a theoretical support to the case analysis. The aim is to present propositions about emergent countries small business competitiveness. Three propositions are pointed as conclusions of the investigation: small business integrated as suppliers in a buyer-driven chain are in a threatening position if they do not upgrade to international competitors standard; small business integrated as suppliers in a buyer-driven chain can add value if they get closer to design, marketing and branding; on emergent countries, small business upgrading for competitiveness depend on collective action.

## **Introduction**

The development of the Footwear Brazilian Industry is related to the industrial reconversion process of the 60's, when intensive work industries moved from developed countries to more peripheral countries. International traders chose some regions in Brazil as potential producers. The most important of these regions is the Sinos Valley in South Brazil.

Sinos Valley has been considered a "supercluster" (Schmitz, 1995). The region concentrates a group of producers making the same or similar things close to each other. There is the division of labor and specialization among the firms; the provision of their specialized products and services in short notice and great speed; the emergence of suppliers, who provide raw material and components; the increase of suppliers who provide new and second hand machinery and spare parts; the emergence of agents who sell to distant national and international markets and the presence of associations, research and human resources training centers and superior education institutions.

This concentration of products and services related to Footwear production may suggest that entrepreneurship and small business establishment should be facilitated in this region. However this is not absolutely true. The Footwear production and retail is related to a complex chain. The model of buyer-driven commodity chains as proposed by Geriffi (1999) is very well adapted to explain the Footwear production and retail. A buyer-driven commodity chain refer to those industries in which large retailers, branded marketers and branded manufacturers play pivotal roles in setting up decentralized production networks in a variety of exporting countries. Buyer-driven chains are closely tied to relational rents, which refer to several families of inter-firm relationship, including techniques of supply-chain management that link large assemblers with small and medium size enterprises, the construction of strategic alliances, and small firms clustered together in a particular place and displaying elements of collective efficiency.

At Sinos Valley, as observed by Schmitz (1998), the fast growth of the export industry, especially during the 1970s and 1980s, developed to a deep structure of suppliers of products and services. Interdependence within the cluster increased. Bilateral vertical cooperation increased and multi-lateral cooperation was attempted. In a phase, which was considered the easy phase of globalization (1970s and 1980s), enterprises at all stages in the value chain have been sucked into global competition.

These features could suggest a good position of the cluster for relational rents through the integration of several small and medium sized enterprises in a similar action to the Italian Footwear cluster (Putman, 1996). However, as globalization became more challenging at the 90s, local inter-firm relationship did not become stronger. The main Sinos Valley shoemakers adopted the strategy of integrating with their main international buyers to attend market demands and reduce their dependence on the cluster for the supply of inputs (Schmitz, 1998).

How small industries dedicated to the shoemakers' supply of components and machinery keep a competitive position at this chain? How small enterprises achieve internationalization? How small enterprises fight for market share out of their dependence on the main local shoemakers? These are strategic questions for the small business entrepreneurs as much as for researchers who investigate development policies to support regional development to a historical industrial cluster such as Sinos Valley.

We describe in this paper the development of technology, marketing, design, achieved by 10 small machinery producers who participated of an export consortium. This consortium was organized by an association of components manufacturers (ASSINTECAL) helped by Brazilian government policies due to support exportation initiatives (APEX). The analyses focus on how inter-firm relations were achieved and contribute to individual learning and competitiveness of each of the enterprises, which participate in the consortium. The findings are based on the interviews held with the enterprises managers and ASSINTECAL leaders and secondary data.

In the following sessions we present: (1) an overview of the competitive environment related to the footwear industry; (2) the description and analysis of the case, which was investigated; (3) conclusions.

## **1 The competitive environment**

The global extension of the value chains must be considered on entrepreneurship related to the Footwear industry. This industry is generally based on global networks which links the full range of activities that are required to bring a product from its conception, through its design, its sourced raw material and intermediate inputs, its marketing, its distribution and its support to final consumer (IDS, 2000).

This scenery has been getting more and more accrue since the late 1960s when footwear manufacturers from industrialized countries closed down their factories, retained their know-how of marketing and design and started to shop around for low-cost sites in the developing word (Bazan & Navas-Alemán, 2001).

Sinos Valley inception into the global footwear value chain has been considered as the trigger to the vertiginous process of growth experienced by the whole Brazilian footwear industry. In two decades, the cluster transformed itself from a local footwear producer to one of the main footwear exporting regions in the world (Bazan & Navas-Alemán, 2001).

As shown in the Table 1 bellow Brazil has the third world position in footwear production.

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Table 1 here

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However based on low prices the situation of the suppliers of the main global buyers (US large retail chains) was not to be stable forever. At the end of the 1980s Brazilian producers began to suffer from the increasing competition of cheap footwear from China. In the last decade, alternatives to low prices strategies began to be developed as the searching for new markets and attempting to move up the value chain into design, marketing and branding (Bazan & Navas-Alemán, 2001).

At the last decade, some of the main Sinos Valley shoemakers began to search foreigners markets with own market strategies. Nowadays, Brazilian trademarks as Azalea, Via Uno and Dumont can be found in American and European retailers. They have small slices of these markets. Anyway, these enterprises are learning how to deal in the international market. The small enterprises that are shoemakers' suppliers have been strongly influenced by this competitive environment.

## **2 The molds producers**

The enterprises here analyzed are molds producers. There are around 200 molds producers in Sinos Valley. They are small enterprises and some of them are informal. As is common in small business, management and production processes are centralized in the manager's person who is aided by a small team of employees. The participation of members of the family in the company is quite common. Splitting is frequent as the companies enlarge.

In the Sinos Valley, the competence for molds production has developed for almost thirty years, associated to the increase of the production of footwear's with synthetic components. Molds are generally produced in aluminum or steel, through simple foundry or automated processes. They are destined to the production of footwear components as soles, ribbons, buttresses, printed leather, etc...

Molds production is very sensitive to the different strategies on footwear production. Large scale and mass production demands, which are typical for low cost products, don't need many different molds. Differently is observed in the fashion industry where small loads and many model variations, need a new mold for every single model. When the footwear industry improves, in the fashion industry, there is an increase in the molds production.

Outsourcing and the specialized knowledge needed for molds production are two important aspects on the molds business. The outsourcing of molds production has been one of the effects of the changes on footwear production. An increase on the outsourcing of molds production tends to be proportional to the closeness shoemakers are to the fashion industry.

A very specialized and partial tacit knowledge is necessary in the molds production. Learning about molds production depend on the training on the job, even when the production is partially based on automation.

In Vigevano, Italy, molds are produced in small shops similar to what happens in the Sinos Valley, Brazil. As independent enterprises, mold producers have opportunities and face challenges. They may be suppliers of other industries, in fact, some Sinos Valley mold producers also supply simple orders to local metal-mechanical chain, and they also have the opportunity to supply footwear molds to Peru, Colombia, Mexico and Argentina.

The entrepreneurs started to be challenged by global competitiveness. For example, a Sinos Valley shoemaker can buy molds anywhere. When they need more sophisticated and expensive models they can look for Italian suppliers and not at the local market.

The Sinos Valley mold producers are able to supply the local shoemakers, which are looking forward to improving with the adaptations of brand design in the intermediate market in terms of prices. However shoemakers complain they lose competitiveness on this market share because of they take too long to develop a product. As seen on an analysis of the Sinos Valley footwear chain, the mold production was pointed as the gargle for the delay on the launching of new products (ASSINTECAL, 2003).

Looking forward to facing these challenges, an exportation consortium of mold producers was established in the Sinos Valley. Below it is described how this consortium was established, its strategies and the observed effects on organizational learning.

## ***2.1 Molds by Brazil***

*Molds by Brazil* is the trademark created to represent mold producers who participate in the consortium created with internationalization purposes. It is one of the consortiums created upon a Brazilian Federal Government policy established in the mid 90's to

promote small business internationalization. The Agency of Promotion of Exports of Brazil – APEX has some rules to help small business with funds. The organization of consortiums was one of the conditions established by APEX to support marketing and promotion strategies.

The mold producers gathered in the consortium at the end of 2000, helped by their Association (ASSINTECAL). Ten enterprises belong to the group.

The agreement between *Molds by Brazil* and APEX favored two actions oriented to internationalization: (I) participation of International Trade Fairs and (ii) the certification ISO 9000. Other actions, oriented to local market, were also favored, for example, as the participation on National Trade Fairs and the sharing of management consulting.

Participation in International Trade Fairs favored the enterprises, not only to show their products, but also to learn from competitors and clients. The gaps Brazilian producers have from International standard and need to overcome began to be clearer. These gaps were mainly related to time delivery, product quality and technology. One of the first steps in the learning process was the awareness of these gaps. Propositive actions took place and they are highlighted below.

## **2.2 Time to Market**

The consortium *Molds by Brazil* created a project focused on technological development. The project was based on the assumption that mold production was the gargle on footwear production. Several studies had pointed that the achievement of competitiveness in international levels depends on the development of abilities, which could help in the response of companies to a very segmented, seasonal, dependent on variations of fashion and style demand. In such a scenery, technological and management innovation is needed. The time of product development was understood as a critical stage for the improvement of the performance of the footwear industry, considering the pressure the importers of the United States and Europe exert on the local producers. As shoemakers are looking for competitiveness in the fashion market share they need to reduce time to market (ASSINTECAL, 2003).

This project gathered producers, the producers Association (ASSINTECAL) representatives; the local University (UNISINOS); a public Association responsible for personnel training (SESI); a private group dedicated to technology innovation (CETA). A Brazilian ONG sponsored the project (SEBRAE).

The main stage of this Project was a technical mission focused on benchmarking with Italian mold producers. Representatives of the consortium, researchers, consultants went to Vigevano in Italy, in 2004, to learn from the main world mold producers. The group was in touch with different examples of footwear components and machinery production. Since the sophisticated project Euroshoe based on high automation technology and on a mass-customization principle<sup>i</sup>, until very prosaic and known handmade foundry.

Overall, the interaction with Italian mold producers highlights that the concept they have about their work is based on fashion. Italian mold producers define themselves as fashion designers, as stylists and never as foundry crafters.

The main Italian mold producers as Mobel Stampi, the Gatti & Piccolo and the FAE Stampi, all located close to Milan, support their work on sophisticated technology, but understand that their value is on their capacity of putting art on technical feasibility.

Finally, all observations and conversations during the Technical Mission converge to a new point of view related to the development of Brazilian mold production. The necessity of technological improvement based on modern machinery, software, trained personnel were confirmed. However, new suppositions emerge from this investigation, as follows:

- Time to market pressures will not find solution based only on technological improvement;
- Time to market is related to technology improvement but also on the position of the enterprise on the chain value;
- The closer the mold producers are to fashion and design, the more competitive they are in the footwear market.

### **2.3 Learning and actions**

Some points are to be highlighted from the Sinos Valley mold producers' case. Mold production is a Small Business integrated on a buyer-driver chain. Footwear as garments are globalized chains which gather enterprises located in different points of the world. These enterprises compete on a very segmented market. It is known from empirical evidence that on buyer-driven chain value come from moving up the value chain into design, marketing and branding.

Suppliers of a traditional industry, which for decades was focused only on production, and local market, are not prepared to compete on a global arena. Even supplying to already internationalized industries, local suppliers face several gaps related to technology and management when compared to international competitors. They need to overcome new challenges, improve technology and look for added value into their processes.

These actions depend on new knowledge that are hard to be acquired on their own. The experience of the mold producers' consortium shows that collective action among small enterprises to attend shared interests can bring good results in internationalization efforts.

With some support received from government the enterprises began to show up in International trade fairs. Some business were done, new clients appeared but overall they have given the first step towards the necessary learning processes for internationalization. The collective action motivated a technological improvement project. The purpose was to reduce the time of product development on all the local chain, focused on mold production improvement. From this project new actions and suppositions raised.

Specialized software was acquired with public funds. The producers association (ASSINTECAL) created a permanent *Design Forum* and made an effort to put component producers closer to fashion and design tendencies. This association is also working together with ABEST (Brazilian Association of Stylists).

A new concept of Brazilian fashion is growing based on the collective work of the producer associations who are investing on an alternative strategy for all the Brazilian

footwear industry. Getting closer to fashion, in the Brazilian case, does not only mean copying international style, but also developing a unique new style. In fact, Brazilian stylism has been getting good positions in International Fashion forums.

*Moldes by Brazil* was established as a collective trademark. It is a marketing strategy focused on added value to the Sinos Valley producers and to develop an image of Brazilian suppliers as a good alternative on molds for the footwear industry.

In summary, collective action and efforts to move up the chain into design, marketing and branding are observed as strategies to small business competitiveness improvement.

### **3 Conclusions**

The aim of this paper was to present propositions about emergent countries small business competitiveness. The questions we investigated were related to the understanding of the strategies and processes, which are helpful to put emergent countries small business on a competitive position in the international market. We analyzed especially small business, which are integrated to buyer-driven chains. This investigation took as a basic assumption that in a buyer-driven chain, value comes from relational rents and from design, marketing and branding.

We described the case of the Sinos Valley mold producers who created a consortium for internationalization. This collective action started of the learning process, which was shown to be positive to every member of the consortium and for the whole local footwear chain. The collective action allowed the achievement of international marketing and promotional actions. Collective action favored each one of the consortium participants to risk in the international market. The weaknesses and threats on this new competitive arena got clearer. New collective actions were developed to face the gaps local producers have toward international competitors.

The maneuvering among public policies, producer associations, Universities and other support associations must be highlighted as a clue network to achieve the individual results every small enterprise is looking for.

The propositions from this study are finally the followings:

- Small business integrated as suppliers in a buyer-driven chain are in a threatening position if they do not upgrade to international competitors standard;
- Small business integrated as suppliers in a buyer-driven chain can add value if they get closer to design, marketing and branding;
- On emergent countries, small business upgrading for competitiveness depends on collective action.

For further research, we suggest the development of this investigation in a survey to test these propositions in a statistical significant sample. This way cases from emergent and not emergent countries could be compared.

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**TABLE 1 – COMPARATIVE EVOLUTION AND PROJECTION OF PRODUCTION AND EXPORTATION IN THE MAIN FOOTWEAR PRODUCERS (in millions of pairs)**

| Countries | PRODUCTION |      |       | EXPORTATION |      |       |
|-----------|------------|------|-------|-------------|------|-------|
|           | 1994       | 2003 | 2009* | 1994        | 2003 | 2009* |
| China     | 3960       | 7210 | 8908  | 2369        | 4526 | 5175  |
| India     | 440        | 735  | 800   | 40          | 68   | 110   |
| Brazil    | 541        | 610  | 540   | 165         | 174  | 161   |
| Indonesia | 500        | 480  | 470   | 268         | 190  | 180   |
| Italy     | 471        | 330  | 340   | 405         | 325  | 324   |
| Thailand  | 400        | 270  | 228   | 268         | 130  | 75    |
| Mexico    | 172        | 190  | 174   | 5           | 10   | 8     |
| Turkey    | 154        | 249  | 283   | -           | 39   | 63    |
| Vietnam   | 131        | 330  | 350   | 64          | 295  | 314   |
| Pakistan  | 175        | 252  | 273   | -           | 11   | 17    |

Source: ASSINTECAL/SATRA (2004)

<sup>1</sup> More details can be found at [www.euro-shoe.net](http://www.euro-shoe.net).

<sup>i</sup> More details can be found at [www.euro-shoe.net](http://www.euro-shoe.net).

**ANTECEDENTS AND CONSEQUENCES OF MARKET, LEARNING AND  
ENTREPRENEURIAL ORIENTATION: FAMILY VERSUS NONFAMILY EMERGING  
FAST-GROWTH FIRMS**

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**ABSTRACT**

Family businesses contribute substantially on growth of economies. The present qualitative investigation extends research, suggesting nonsignificant differences between family and nonfamily fast growing SMEs in terms of business orientation, marketing capabilities, and firm performance. Qualitative research comparing family versus nonfamily fast growth enterprises is rare. In this light, how do these different types of enterprises attain market or competitive advantage and subsequently rapid growth? In line with our previous work, findings demonstrate a lack of substantial difference between these cohorts in terms of their leadership, firm orientation, culture, and marketing capabilities. Managerial competencies of entrepreneurs, which are integral, exerting a powerful impact on the direction of the business, and employees, appears to be an antecedent to firm business orientation. Consistent with previous research, these business orientations drive positional advantages in specific marketing capabilities: market-focused products and superior relationships. Customers need to regard these products/services of value, in order to purchase products, culminating in customer satisfaction and loyalty, and ultimately contributing to the bottom line through increased sales, profits, and fast growth (i.e., firm performance). Implications for managers and recommendations for future research are outlined.

## **ANTECEDENTS AND CONSEQUENCES OF MARKET, LEARNING AND ENTREPRENEURIAL ORIENTATION: FAMILY VERSUS NONFAMILY EMERGING FAST-GROWTH FIRMS**

Family businesses in Australia, and for that matter elsewhere, impact significantly on growth of economies through generation of employment, productivity, and innovation (Smyrnios & Walker, 2003). Despite their significance, there is a presumption that family firms are not growth oriented (Teal, Upton, & Seaman, 2003), employing conservative business strategies. In many aspects, family firms exhibit characteristics similar to their nonfamily counterparts, particularly in terms of business strategies (Teal et al., 2003), strategic planning practices (Upton, Teal, & Felan, 2001), and business orientations (Tan & Smyrnios, 2004b). Research comparing family versus nonfamily fast-growth enterprises is relatively scarce (Upton, Teal, & Seaman, 2003). In this light, how do these different types of enterprises attain market or competitive advantage and subsequently rapid growth?

There is little empirical evidence identifying antecedents and consequences of market, learning, and entrepreneurial orientations as sources of competitive advantage, let alone exploring similarities and differences, on these factors, between fast-growth family and nonfamily firms. A review of extant interdisciplinary literature (e.g., Chrisman, Chua, & Zahra, 2003) indicates that there is a complex array of factors associated with divergent sources of CA. However, these factors have not been made explicit (Packham, 2002). This failure can be attributed to a focus on public and large companies with scant consideration to emerging enterprises. The present qualitative investigation extends Tan and Smyrnios (2004b), suggesting nonsignificant differences between family and nonfamily fast growing SMEs, and that these orientations are driving tactical marketing capabilities (MCs), providing a position of advantage. As entrepreneurship and marketing involve a process of creating value by combining resources, this position of advantage needs to create superior customer value (CV), ultimately affecting firm performance. Given these considerations, the overarching research question is, are there certain aspects of business orientations and MCs that fast-growth family firms tend to select, compared to their nonfamily fast growth counterparts?

Our paper begins with a brief overview of the pertinent literature on family firms, what is meant by family business and fast-growth entities, the principal theory underpinning this investigation, followed by a description of the present methodology. Next, one causal network model, derived from an analysis of two detailed case studies are presented. Implications for researchers and managers are outlined, concluding with recommendations for future research.

### **LITERATURE REVIEW**

#### **Family Firms**

Gersick, Davis, McCollom, and Lansberg (1997) indicated that family enterprises account for up to 80% of businesses worldwide. Family businesses generate more than half of Australia's employment growth, and account for about 40% of Australia's private sector output (Smyrnios & Walker, 2003). Examples of well known international family-controlled companies include Just Jeans, News Corporation, and Harvey Norman in Australia; Estee Lauder in the US, Lego in Denmark; Tetra Pak and Ikea in Sweden, and Sainsbury in the UK.

There has been no accepted definition of what constitutes a family firm (Klein, Astrachan, & Smyrnios, in press). Definitional confusion is exemplified by varying degrees of specificity across studies, making comparisons of findings problematic. As a case in point, the percentage of family firms in one sample can differ between 15% to 81%, depending on the definition applied (Westhead, Cowling, & Storey, 1997). For example, Westhead (1997) defines a family enterprise as a business which is perceived as a family firm by the family (subjective view), and one when the family owns majority of the shares in the organization (ownership view). Other investigators (e.g., Chua, Chrisman, & Sharma, 1999) state that an enterprise can be viewed only as a family firm when a transfer to the next generation is intended. Astrachan, Klein and Smyrnios (2002) considers that a founder-run entity can be regarded as a specific case of a family firm. Despite these differences in viewpoints, all agree that succession adds considerable valuable business experience to a family and company. Another concern relates to investigators failing to operationalize what is meant by a family business (e.g., Kayser & Wallau, 2002).

Given these issues, a detailed review of definitions employed in studies reveals no clear demarcation between family and nonfamily businesses. *Artificially dichotomizing between family versus nonfamily firms when no such clear cut dichotomy exists creates more problems than it attempts to solve* (Astrachan et al., 2002, p. 46). Rather than simply dichotomizing, a key question involves when does the business become a family firm? In response to this question, Klein et al. (in press) believe that it is in part the influence of family that can make a difference. This concept is not new. What differentiates family firms from other profit seeking organizations is the levels of importance families place on the decision making and operations of the firm (Chrisman et al., 2003). Muhlebach (2004) linked family-business-individual interactions with resources resulting from the family influence as familiness. However, Klein et al (2002; in press) proposed a radical shift in the way that family and nonfamily firms should be regarded. These investigators suggested the application of the F-PEC scale, that is, firms should be considered along a continuum that incorporates three axes: power, experience and culture. It is the interaction between these factors that contributes to the familiness of a business.

Traditionally, family firms are not innovators (Upton et al., 2001). Ward (1997) posited that family firms are slow growing because once successful personal methods by the entrepreneur are in place, they are inflexible in seeking alternative ways for succeeding. They are also less likely to pursue wealth maximization as their dominant objective. Family firms are more likely to have important non-economic goals or constraints, such as maintaining family harmony or job creation for family members (Sirmon & Hitt, 2003). However, family businesses that display high levels of entrepreneurial orientation (Mustakallio & Autio, 2002), have a vision, and share information regarding actual company performance results versus goals or planned performance figures with all employees. They also tend to be growth oriented (Upton et al., 2001).

### **Fast-Growth Firms**

Sexton, Upton, Wacholtz, and McDougall (1997) acknowledged the economic contribution of fast-growth firms (FGFs) as *gazelles*: that is, companies that achieve a minimum of 20% annual compound sales growth over a 5-year period. Upton, Teal and Felan (2001, p. 61) define FGFs as *those willing to take risks, to be innovative, and to initiate competitive actions*. This definition seems to be identical to that of enterprises that possess an entrepreneurial orientation (Lumpkin & Dess, 2001). According to Birch (1995), *gazelles* comprise 3% of all small companies,

stimulating national employment growth and contributing favorably to global economies (Birch, 1995). In Australia, FGFs comprise approximately 10% of all SMEs, contributing substantially to national revenue (Gome, 2003, 2004). Similar proportions are reported for Europe and the US (OECD, 2002). Most net job creation and wealth creation seems to come from FGFs.

Rapid growth is often an indication of market acceptance and firm success (Timmons, 1998). Common forms of small firm growth include internal expansion (e.g., expanding capacity), franchising, mergers and acquisitions, exporting, and geographic expansion (Barringer & Greening, 1998). FGFs are not without problems, including dealing with managerial issues related to people, processes, and resources. People related issues originate from observations that these firms double/triple in size very quickly. Influx of new employees can herald high stress levels, and skill levels of new employees can be inadequate (Terpstra & Olson, 1993). Notwithstanding, Tan and Smyrnios (2005a) found that FGFs strive to target staff who have relevant skills and knowledge, as well as a distinct personality to fit firm culture. It is not surprising that employers or CEOs emphasize giving priority to individuals who are happy, creative, and likely to accommodate to an existing organizational culture.

Market orientation (MO), entrepreneurship and organisational learning constitute unique resources collectively for FGFs (Tan & Smyrnios, 2004a). Slater and Narver (1995, p. 63) argued that *MO provides strong norms for learning from customers and competitors, it must be complemented by entrepreneurship and appropriate organizational structures and processes for higher order learning*. These three sources of competitive advantage are discussed below.

## THEORETICAL CONCEPTUALIZATION

### Market Orientation

Narver and Slater (1990) defined MO as an organizational culture that comprised three behavioural components of equal importance: customer orientation, competitor orientation, and inter-functional coordination. While Kohli and Jaworski (1990) view MO as the implementation of the marketing concept, Hunt and Morgan (1995, p.11) advocate that MO is the *(a) systematic gathering of information on customers and competitors, both present and potential; (b) systematic analysis of the information for the purpose of developing market knowledge and (c) the systematic use of such knowledge to guide strategy recognition, understanding, creation, implementation, and modification*. MO is more than a reflection of the marketing concept and is considered supplementary. The marketing concept has a single-minded focus on customers. MO focuses on both customers and competitors. Marketing essentially puts customers on a pedestal (Webster, 1992).

### Learning Orientation

There are two types of learning. Single-loop learning occurs when errors are corrected without altering the underlying governing values (Argyris, 2002). This process is also known as adaptive learning (Argyris, 1977). An example would be learning from mistakes. When a firm launches a product and it is not successful, organizations will learn from reasons that cause products to fail. Double-loop learning, in contrast, occurs when organizational values are questioned leading to viewing problems from different angles, introducing ideas from other contexts, and experimenting with new approaches (Field & Ford, 1996). This type of learning should be utilized when environments are unpredictable and constantly changing. There are three main

components of organizational learning, namely commitment to learning, shared vision, and open-mindedness (Sinkula, Baker, & Noordewier, 1997).

Notwithstanding, a learning orientation (LO) is in itself difficult to implement, with many factors requiring consideration as an entire organization is affected. It has been argued that market-orientation is by itself, inadequate, and the ability of an organization to learn faster than its competitors may be the only source of competitive advantage (Dickson, 1996). Slater and Narver (1995) stated that possessing a learning oriented posture leads to superior outcomes such as superior new product success, customer retention, superior growth, and/or profitability. As an organisation learns to make sense of its markets, it develops rules for processing information about markets, which influences its internal and external organizational actions (Sinkula, Baker, & Noordewier, 1997). External actions refer to products and their promotion, distribution and pricing strategies, and tactics, all of which comprise marketing capabilities. Positive learning orientation directly results in increased market information generation and dissemination, which in turn, affects the degree to which firms make changes to their marketing strategies. Pisano (1994, p. 86) posited that *without learning, it is difficult to imagine from where a firm's unique skills and competencies would come.*

### **Entrepreneurial Orientation**

Entrepreneurship is the process of creating value by combining resources. Entrepreneurs are required to consider economies of scale, understand competitors' growth and strategies, take into account resource constraints, manage effectively internal financing abilities, and to balance customer and personal goals so that growth can be assured (Bhide, 1996). Entrepreneurial and MO are two major considerations that directly affect operational competencies. Tzokas, Carter, and Kyriazopoulos (2001) noted that these two orientations contribute synergistically to the emergence of unique marketing techniques and overall, firm performance. Lumpkin and Dess (2001) defined entrepreneurial orientation (EO) as those firms that are innovative, risk-taking, pro-active and competitively aggressive. Innovation, refers to seeking creative, unusual, or novel solutions to problems and needs and can be in the form of new technologies, processes, products or services. Risk taking involves a willingness to commit significant resource opportunities that may fail, although risks are usually moderated and calculated. Pro-activeness concerns initiating actions, and being often the very first to introduce new products or new ways of doing things (Lumpkin & Dess, 2001). Interestingly, Grant, Laney, and Pickett (1997) suggested that entrepreneurs are not risk takers, do not leave things to chance, and are willing to work hard and take action to cut losses whenever possible. Their focus appears to be on exploiting opportunities.

### **Marketing Capabilities and Firm Performance**

Chaston (1997) postulated that entrepreneurial marketing has a major influence on the performance of small firms. Vorhies, Harker, and Rao (1999) identified six processes whereby a firm's value added products and services can reach target customers. These capabilities are based on the principles of marketing, including market research, pricing, product development, channels of distribution, promotion, and marketing management. Vorhies and Harker (2000) examined the importance of learning processes in the development of MCs. MCs are attained via learning processes when employees repeatedly apply their knowledge to solving marketing problems (Day, 1994). Such developments create a set of processes enabling an organization to

achieve its strategic goals and to realize desired strategic position (Day, 1994). Firms with higher levels of product development and marketing implementation capabilities demonstrate higher levels of performance than those without these vital values (Vorhies, 1998). Hooley, Fahy, Cox, Beracs, Fonfara and Snaj (1999) observed that MCs are more important than operational ones in explaining superior performance.

According to Vorhies (1998), firm performance should be assessed relative to competing firms when multiple industries are represented in studies. Objective measures of performance will vary greatly in different industries, therefore, it would be desirable to measure factors other than economic performance. Performance measurement has been the subject of much debate in marketing literature (Hooley et al., 1999). Absolute performance figures such as return on investment and profit levels, sales volume, and market share are difficult to compare between firms that operate in different markets, using different accounting standards, and define their markets in different ways and different sizes. Market-based measurements such as customer loyalty and satisfaction should also be included (Day & Wensley, 1988). The following method section describes the present fast-growth participants, and measures and procedures adopted for our study.

## METHODOLOGY

### Participants

Participants are the 2003 and 2004 *BRW Fast 100* firms (Gome, 2003, 2004). Inclusion criteria involve: less than 200 full-time employees, turnover of more than AUD\$250,000 in 1999/2000, and a single customer must not account for more than 50% of a company's turnover. Companies provide signed audited turnover figures over four consecutive financial periods (1999-2003/2000-2004), in order to calculate average growth rates for ranking purposes. In 2003 (versus 2004), Fast 100 firms achieved an average turnover growth of 61% (versus 102%), while the top company attained a growth rate of 545% (versus 887%). The growth rate for the company ranked 100 is 32.2% (versus 35% for 2004). About 80% of companies in 2003 and 2004 operate in the services industry, which is consistent with Australian businesses overall, providing approximately 70% of Australia's GDP and 81% of employment. The average annual growth rate (1988-98) in the property and business services industry is 5.1% (OECD, 1999).

For the purposes of this study, growth is calculated via average turnover over a period of three years, using the fourth year as a baseline. For each financial period (e.g., 2000-1999), average turnover was calculated using the formula:

$$\text{Average Growth} = \sum \left[ \frac{(\text{Year 4} - \text{Year 3})}{\text{Year 3}} + \dots \frac{(\text{Year 2} - \text{Year 1})}{\text{Year 1}} \right]$$

Where Year 4 = 2004 turnover and Year 1 = 2000 turnover

70% (versus 73%) of the CEOs are aged between 31 and 50 years, with 92% being male in both years. 47% (versus 50%) of the CEOs have tertiary education. The main reason for starting their business includes saw a niche (43% versus 41%) and independence (22% versus 10%). 43% (versus 33%) note an ambition to dominate a niche, 29% (versus 15%) to be a global player, and 26% (versus 24%) to dominate the domestic market. About 52% (versus 56%) of the Fast 100

principals started their business with less than AUD\$20,000. While 72 % (versus 90%) of these firms are private companies. 20% of the 2003 and 2004 participants comprise family firms. For this study, 18 fast-growth CEOs were interviewed. Owing to word limits, only findings emanating from in-depth interviews from one fast-growth family and one nonfamily firm is included.

### **Measures**

An interview schedule derived from studies evaluating MO (Narver & Slater, 1990), LO (Sinkula et al., 1997), EO (Lumpkin & Dess, 2001), MCs and firm performance (Vorhies & Harker, 2000) was developed by the present investigators.

### **Procedure**

Tape recorded semi-structured interviews of at least 2 hours involved a checklist of areas (e.g., leadership characteristics; market, learning, and entrepreneurial orientations; MCs; CV; and firm performance compared to competitors) to cover rather than a list of pre-determined questions. Informants relayed stories and events, which were recorded, transcribed and analyzed extracting main themes and narratives. According to Hill and Wright (2001), qualitative research provides an opportunity to achieve a holistic view of complex events in organizations, and develop relevant causal network models (Denzin & Lincoln, 2000). The following section contrasts the business orientations and MCs adopted by these two types of firms, revealing their impact on business performance, and culminating in a conceptual model.

## **FINDINGS AND DISCUSSION**

**Fast Growth Family versus Nonfamily Firm: MC Labour Services versus Liaise Marketing**  
MC Labour Services (MCLS) is a supplier of supplementary labor in the commercial construction industry for the Melbourne market. Employing 9 staff, MCLS started trading in 1995. Ranked 90 and 76 in the 2003 and 2004 *BRW Fast 100* respectively, MCLS's 2004 growth rate is 44.79%, turning over AUD\$15.37 million in 2003/04. The present CEO/founder, Marc Lunedei, provides organisational direction, driving this family business orientation. Moreover, it appears that his exposure to a family firm's business environment as a child and young adult has influenced the way in which he leads his organization. Marc worked with his father in a local butcher shop, supermarket, and construction company. As a customer oriented firm, incorporating innovation and learning, this enterprise builds certain marketing competences. Their marketing advantage culminates in superior CV, ultimately affecting firm performance (see Figure 1). Below, we present a detailed discussion of the causal network model originating from this case study and that of Liaise Marketing (LM).

Marc comments that: *learning the politics of the construction industry is imperative because the union in Melbourne is one of the most militant unions in Australia.* This knowledge helped Marc to enter and consolidate his firm's position in the industry. He adds: *It's not a matter of a client ringing and saying, 'I need 2 laborers and a carpenter at my site'. All the political requirements need to be met as well. For example, they need certain union tickets.* MCLS specialises in the commercial construction industry of supplying supplementary labor, such as fork lift drivers, brick layers, and cementers. *There are a lot of large companies that just use supplementary labor. What has evolved is that we employ all the candidates. 2/3 of the laborers are employed by us, on a full-time basis, and we hire them out to our clients. As well as being our employees,*

*they are our products or assets, and that's what has been our specialty. A lot of potential workers come to us first to enter into the industry with a view that they might be directly employed by one of the construction companies as well. His early industrial experience, and knowledge of the type of builders that required labor hire has also contributed to his business success.*

MCLS is a first generation family firm. Initially running the business with his wife, other family members (sister, nieces, cousins) have been employed, at different times. According to Marc, there are different approaches that family businesses take compared to nonfamily firms. Coming from a family business environment, *I had to learn to employ someone for the purposes and delegate to them. When you are in a family firm, you tend to do a lot yourself. And after a while, it comes too much and you can't do everything. It was a mould that I had to change out of.* The issue of succession is also regarded as important. *There is a lot of sentimental value because of the effort, sacrifice and strain on the family. It affects the decision of selling, to keep it going, hand it over to the children, get them to carry on.*

As a point of comparison, LM was established in 1998 by Tony Merlino. Ranked number 47 in the 2004 BRW Fast 100, LM achieved AUD\$1.8 million sales in 2004, achieving an average turnover growth rate of 63.39% between 2000 and 2004. Previously employed as a retail buyer in two large Australian supermarket chains for 28 years, Tony began to question his professional and career status. *Why was I working this hard for a corporate? I thought to myself, if I worked this hard for myself, with the experience and knowledge I had gathered over the years, chances are, I will succeed.* Tony started the business with AUD\$2000. *You don't take ownership of stock, so we didn't need a lot of financial backing.* Being an ambitious person, Tony did not want to *stay in a boutique or a cottage industry.* He spends 80% of his time thinking about the business. *The only time I don't think of it is when I am sleeping.*

LM employs 50 staff and operates as a broker in the Australian supermarket industry. Typically, a broker represents manufacturers' products to a variety of prospective retail buyers. These buyers could be specialty stores, retail grocery chains, wholesalers, foodservice operators and distributors, drug chains, mass merchandisers, industrial users, or military installations. In trying to sell products and achieve a listing, a broker might make presentations to head offices of chains and wholesale groups. These may include merchandising (planning, promotions, keeping product on the shelf), computerized ordering, and data collection services. Brokers have personal contacts and established relationships with buyers. They also have expertise in select markets (Bosse, 2003).

LM offers the service of a sales manager and sales team to Australian manufacturers in the supermarket industry. *Manufacturers who are very good at what they do, but struggle with having a sales team, marketing manager, and all the expenses associated with having that infrastructure. We position products to cater for their growth. We work on the sizing, pricing, labelling, and conformity for the product. When the product is ready to market, we would visit the retail buyer with the manufacturer. My sales team also makes sure that products are on the best position on the shelf.*

Getting products onto the supermarket shelf is a difficult task. *You would be surprised how many competitors that you have to face when you launch a product. You may think you have an exclusive product, but chances are, someone has already been in the process of manufacturing the same thing, or has already got one in the market. One of the keys to success is to be innovative, either create a trend or product, or research overseas markets and determine whether that trend that has started to occur overseas will occur in Australia. That takes a lot of research and study.*

The supermarket industry has changed over the previous 4 years. When a manufacturer wanted to launch a new product, they would meet with retail buyers in all states. It was very costly and time consuming because the presentation and sales pitch was repeated 5-6 times. Currently, major retailers have centralized the system. If the buyer does not want to retail a manufacturer's product, the product does not make it to market. Centralization leads to a uniform shelf range nationwide. Similar to MCLS, Tony provides organisational direction, which drives firm business orientation and consequently, MCs. Their marketing advantage culminates in superior CV, ultimately affecting firm performance (see Figure 1).

Our research indicates that previous industrial or business experience is a key contributing factor for business start-up. FGF leaders are often passionate about their business, possess the desire to challenge the status quo and ultimately be the best (Tan & Smyrnios, 2005a), the qualities of which are a central starting point of any business. Consistent with this view, Lee and Tsang (2001) emphasized that managerial experience is a dominating factor affecting venture growth. High achievers have a strong desire to be successful, and setting challenging goals and standards for themselves. They are not easily satisfied with current achievements and strive to improve performance. This research also supports the contention that growth willingness is a decision largely made by owner/managers (Packham, 2002) and not dependent on whether the firm is identified as being a family or nonfamily firm (Cooney, 2002).

CEOs who possess energy, determination, and love for their business, drive the direction and strategy of their organizations (Tan & Smyrnios, 2005a). Weisner and McDonald (2000), found that environmentally sensitive interactions between management and employees provides opportunities for direct leadership, which can facilitate robust organizational cultures. Given that the majority of firms in our sample are young and emerging, without any excess baggage, these CEOs are in a solid position to shape their culture possibly more decisively. Therefore, we advocate that firm business orientation (MO, LO, and EO) proclivity is dependent on the leader's experience, and values. The next section explores findings relating to these dimensions.

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Insert Figure 1 about here

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## **Market Orientation**

**Customer orientation.** MCLS services 200-300 clients, including large Australian construction giants such as Multiplex and Grocon. These clients hold expectations with regard to the provision of hire skills and services, encompassing specific types of labor skills supplied at such short notice. *We've made sure that we are contactable live, all the time, 24 hours. Often we get calls at 10pm on a Sunday night where a site manager has just realised that he needs two guys*

*out on the site tomorrow. I think what was generally happening before, if someone had a requirement early in the morning, they would need to ring a company, and because it was after hours, they would need to leave a message, it might be an after hour service, they would have to wait for them to get back to them, and then give them the requirement. We have actually set ourselves up so we can service the clients quickly and promptly at short notice.*

Customer satisfaction is viewed as a high priority. Clients are constantly contacted for feedback on services provided. Most of the information is logged, and management analyses all data. Candidates with whom clients have reported dissatisfaction are not sent to that company again. *We have processes in place on our database, not to send certain people to our clients. We stress the importance of logging his information.* Customers are also usually quite happy and loyal. *We will make sure that they are happy all the time. Candidates that come to MCLS from competitors say that they don't get the same level that we provide them in terms of training etc. We train our full time employees.*

Customer focus and relationships are other foci, Marc states that *internally, we always discuss each manufacturers performance. Everyone is conscientiously responsible. The culture has been that we all support each other. There is a lot of joking and happiness. Probably because of my personality as a business owner, there is a very easy going mentality here. We are really focused on establishing relationships, not just to get the business from them now. There are probably 50 different contacts in the company. It's different sites, projects. I go through the list and think I'm going to call everyone from Multiplex and establishing that relationship with the site or project manager. The business consultant does that job.*

In contrast, LM caters to approximately 30 small-to-medium manufacturers of health foods, cooking ingredients, pet foods, telecommunication hardware, vitamins and fragrant aromatherapy oils. *Some of our customers just use my sales team to make sure the product is on the best position on the shelf. Sometimes we visit the retail buyers on the manufacturers' behalf and try to win contracts. For example, in any category, there might be up to 20 different manufacturers and all of them want the best position. You can influence the decision but you need to have strong arguments as to why you want your product in the best position. Generally, the buyer makes his own decision based on the profit contribution or size of packaging, visibility, or profitability. They have their own criteria.* Most of these manufacturers are long established. *Before us, they had other brokers. It was difficult to get their business but basically all we did is call them and say, this is what we can do for you. If there is an opportunity, please call me. I am trying everyday, in some form or another, just by talking to someone.* Other customers have used LM since they were first established.

Managers closely monitor levels of commitment of staff in serving customer needs. *There are a lot of barometers. Sales figures, market share, and store visit reports are evaluated to ensure my sales team are doing the right thing.* Speed to market (i.e., how quickly we can get it on the shelf) is also assessed. Measuring customer satisfaction is important. *Each individual team's performance is measured via various mechanisms. We measure their performance – each thing that one of our team members achieves in a store is recorded: movement/relocation of product, putting a product on a shelf that wasn't there before in a particular suburb store. That all gets*

*data entered and a report is given to our manufacturers on what we have achieved: whether it's a high or low achieving month - irrespective. A very honest report.*

**Competitor orientation.** Previously, MCLS dominated the whole industry, however, over the previous few years, the market has been in decline. One competitor has been trying to emulate MCLS in their success. However, the majority of competitors are working in middle trades and manufacturing, rather than the construction industry because of its volatility. In response to competitors, MCLS hired a consultant representative who visits construction sites. *We employed someone full time to visit as many construction sites as he possibly can. To see where the competitors are and what we can do to get there. They are talked about quite often lately because they have been quite aggressive.*

In the brokerage industry, there are approximately 200 brokers Australia-wide. Top brokers are at least 6-times larger than LM, employing about 250 people. *There is no documentation, journal, or written matter that indicates turnover for competitors. You hear little things along the way. I would put my company about 40<sup>th</sup> on the ladder of turnover. I guess it's measured by the value of the total sales that we look after.*

Sales people share information about competitors. Their activities are discussed in state meetings. However, competitors are not the focal point. *Contrary to what a lot of people think in business, we don't know much about our competitors. Some major leaders will testify to the fact that you need to know your competitors better than they do themselves, I know the grocery industry, but I don't know much about my competitors. I know what they do wrong, a lot of the times. It's quite visible at store level and also, because manufacturers do tend to change who they use, you find out from them.*

Being customer oriented does not entail just informing employees to behave a certain ways with customers. Customer orientation becomes impossible when employees do not perceive themselves as being there to serve customers, or recognize that a principal reason for being employed is to help the organization create value for customers (Judd, 2003). Donovan and Hocutt (2001) suggest that employees need to have a certain kind of personality to be good at service work. For example, courteous service is required, and friendly people need to be hired. It may be possible to provide employees with the technical skills necessary, but difficult to train them in how to be polite and caring. Being market oriented is a distinctive form of business culture, not a simple process and involves significant commitments in terms of time, training, and expenditure (Appiah-Adu, 1997). With respect to competitor orientation, it is necessary for MCLS to be vigilant of competitors because of market share decline, owing to industry restructuring and increasing number of competitors. In contrast, LM is not overly concerned about competition, an orientation similar to most other FGFs (Tan & Smyrniotis, 2005b).

### **Learning Orientation**

MCLS staff are encouraged to attend seminars/courses. Marc notes: *I've sent them on different accounting type courses, recruitment and consulting, and it helps them understand specific things. I think the need arises more as you grow. Learning to adapt is more important. I am open to new ideas, because I am looking to anything that helps improve our growth. You will never be at a point where you know everything and you don't need to learn from something.* In terms of

possessing a shared vision, however, Marc believes that it could be communicated better. *We are in the process of implementing and then we'll express them emphatically to the rest of the staff.*

For LM, in comparison, learning to keep ahead is considered to be essential. *We never stop learning in the grocery industry, there is always something new. New system, product, design, new this new that. We are always looking at different ideas.* Surprisingly, staff are not formally trained. *Our staff don't go on sales training, that's one of our weaknesses. We have an induction, but that's all. We discuss how each team can better themselves. Most of the team are very knowledgeable about the industry, so it's mainly, we try to teach them the humanistic side of things as far as dealing with people.*

LM makes a point of employing staff experienced in their field. *Because we are in such a steep growth curve, we can't afford the time to train people about the industry, we need them to be experienced. Most of them haven't gone to university, they have gone straight from high school into the grocery industry. A lot of them are like me, its good grounding to be able to work on both sides and if you start from the retail perspective, working on the shop floor, which is what most of our people have done, including myself, it gives you a very good understanding of the consumer and also the art of retailing I guess, and when you move out to the other side, it gives you the other side of the fence, different perspective. It makes you a more rounded knowledgeable person.* Employee turnover is low: *People don't leave this company, we probably have lost 10 people in 6 years.* Similar to MCLS, sharing an organizational vision seems to be a neglected area. *There should be a clearer direction. The only thing that anybody is aware off is how fast we are growing. I don't think everybody understands where we are going, and we have a conference coming up and one of the key agenda items in that conference is to actually detail our vision, so hopefully that will help.*

Although both firms acknowledge the importance of learning, the focus is more on individual learning rather than organizational learning. Individual learning practices are those that focus on enabling the acquisition of new knowledge, skills, and attitudes by individual employees (Birdi, Wood, Patterson, & Wall, 2004). Organizational learning, includes processes by which learning is shared vertically between individual, group, and organizational levels (Crossan, Lane, & White, 1999), the process of which is not evident in our research. Sharing an organizational vision seems to require further attention.

### **Entrepreneurial Orientation**

MCLS is a proactive business, being one of the first to introduce innovative services, such as standby. *We provide added security. Full-time employees are on standby which means if they have been on a project for 6 months and the project finishes today, and MCLS does not have a job for the candidate the next day, MCLS provides one day standby. They will be paid but need to be contactable because of the short notice requirements in industry. We know we are busy, and we have a lot of work, so we can commit to so many full time employees.*

Being a market leader also means staying ahead. However, being innovative in this industry is about getting into other markets. *There are new things like trying to find an area that is not outsourced.* MCLS is regarded as a specialist in the construction labor industry. When making decisions, each situation is systematically analysed, rather than adopting a bold “gung ho” or

aggressive posture. *For example, in terms of expanding to Sydney and Queensland, some people say that all you need to do is go and open an office there. I think, I need to thread carefully because I need to go there, pay rent, and employ people. There will probably be no returns for some time. We are more cautious rather than jumping boldly into it and saying, 'Let's spend the money and hopefully it would work!' We are doing initial enquiries about expanding to other states. One of our clients asked us before we could even ask them. Clients want to deal with one supplier nationally, and it would increase their buying power with us.*

By comparison, for LM, radical innovation is also not visible in the grocery industry. New lines have not been introduced. However, they have expanded geographical boundaries. *What has improved with us is our coverage. When we started we could only cover Victoria, now we cover every state with our own people. So it's not so much what we do, we do the same things but to a larger scale.* In terms of process innovation, LM attempts to approach its operations from different angles. For example, prior to start up, Tony asked for advice from brokers he had networked with previously. *They were kind enough to offer me advice. However, I didn't take on board a lot of what they did because I didn't agree with some of the things they were doing. I went about and did the reverse despite the fact that some of these companies were very successful. My belief that there was a lot of dissatisfaction from the manufacturing base and that these companies had succeeded despite themselves.* As an example, Tony did not follow suit by hiring part-time staff. *They only work 8 hours a week. Their numbers on the books look good, they have 250 people but if you add up the hours, it's not a lot of hours. A lot of part timers haven't spent a lot of time in the industry. Some of them are housewives, they have other commitments.* From Tony's perspective, full-timers are career driven, want to succeed, and are usually more experienced.

Tony states that organizational policies and guidelines for LM are developed in-house. *We create our own intellectual properties.* A specialised program was also developed to ease business practices. *We developed our own database. You can buy tailor made packages but that is restrictive in what it allows you to do, we keep modifying it too. There is certain information that needs to be collected from supermarkets. Both, of which we require internally and our manufacturers who we work for, also require certain elements of the information. We marry the two up, so we knew what we wanted to collect from the field. We weren't sufficiently enough computer literate to be able to build a program that will allow this data to be collected and deciphered. So we commissioned a computer expert, but we trained this person in terminologies and the ways of the grocery industry before we even got him to build the program. He was external and spent a year on it. It took us a long while for him to learn the grocery industry, and he then adapted it.*

Tony feels that LM is operating in a high risk industry. He elaborates, *when you are talking about a retail industry that has 2000 stores, you can imagine how difficult it is, you have to make sure that 2000 stores have got your clients products in stock, in the right position, in a saleable condition, with the correct ticketing.* Because the nature of their work is highly visible, a simple mistake can jeopardize a contract nationally. *All it takes is a couple of bad store visits from one of our clients.* Owing to the nature of the environment, keeping pace with the market is essential. *You can't afford to be timid or backwards. You spiral upwards in the grocery industry and you can't even stand still. It just takes you with it, like a wave. And the wave also breaks on top of*

*you, so there is always that potential. But what I have noticed is that if you are going to do something in the grocery industry, it's so big and there are so many different facets of it, from manufacturing, to selling, logistics, data collection, and merchandising. You can't help getting involved.*

By default, FGF owners are entrepreneurially oriented. As these firms grow organically, one route to growth is providing a differentiated service. Unless a product/service is *new to the world*, most of the innovation engaged by FGFs is process innovation (Tan & Smyrniotis, 2005b). Our findings are consistent with Oke, Burke, and Myer (2004) who found that there is a greater focus on incremental innovation (i.e., improvements to products, services and/or processes often in response to customer needs) than on radical innovation (i.e., new products, services and/or processes and/or new markets) for growth oriented SMEs.

According to Lumpkin and Dess (2001), an entrepreneurially oriented firm adopts a bold, aggressive, posture when confronted with decision-making situations involving uncertainty. However, in reality, different situations require leaders to adapt accordingly. Consistent with Grant et al. (1997), we find that fast-growth entrepreneurs spend time calculating risks and are not gamblers, leaving things to chance. Tony elaborates, *I have been known to be bold at times but only when I have been absolutely certain of something. But, generally, I am a bit conservative.* We have also found that FGFs in our sample do not possess a so called *undo-the-competitors posture*, which is a dimension of EO.

### **Marketing Capabilities**

**Products.** MCLS views their candidates (employees) as products. *We attract the best in industry. We have a lot of comments from people that they are amazed at how loyal people are to us. We have a reputation of being a great company to work for, we look after them. It's just about giving people individual time; treat them as a person, not as a number, and not talk down to them. People prefer to work for us, we clothe them with MCLS shirts and wind sheeters. People also like to work for us because we train them well. We send them for training and pay them for the day they are being trained. We try and establish a mind set in our guys, that they should be proud to work for our company. They need to show good representation and sell themselves to the clients. This will in turn create security for them because they are an asset, it's very performance based.* Candidates are not bound to MCLS. *Nothing is stopping the candidate from leaving. We pay them above the award. To keep them with us, we offer security, and train, more than what other companies do.*

**Relationships.** Relationships with clients and candidates are regarded as better than the competition. *With our candidates, we personally assist them. We've always believed in establishing relationships. Relationships create loyalty.* Similarly, MCLS has a close working relationship with unions, which is crucial. *We are probably the most union preferred company, which means a lot in this industry because the union is very influential. Our relationship has been established over many years. If we had a bad relationship with them, it would affect our business by 20%. However, once upon a time, 6 years ago, they were so influential and strong, they would make sure you had no work. Our approach has always been to look after the candidates, make sure they have everything. Reason for this is because they are our assets. A*

*happy satisfied worker will be a good worker, which will make the clients happy. MCLS has established themselves as the brand of being the employer to work for.*

**Services.** Services developed by LM, in contrast, are geared to increase sales for manufacturers. For example, staff are financially incentivised instead of being administration driven. *Other brokers are not truly sales focused, they are focused on recording information as to where the product is, how many facings it's got on a shelf, what the price is. Those functions aren't really driving sales. Our team members are sales focused: trying to improve the position of the product, build a display. We then reward them on sales. We pay our people a bonus incentive to achieve budgets. A lot of brokers don't do that. I think that is been one of the keys to our success. The managing director also stays close to the action. In my industry I don't know of any that has one owner one director and they are a national company.*

**Relationships.** LM possesses sound relationships with clients. *At times, it extends beyond business relationships. It becomes friendship. That sometimes is unavoidable as well. However, I don't know what sort of relationship my opposition has with their clients. I think we have a good work ethic which reflects on our image. We haven't lost many manufacturers in the last 6 years. Their relationships with other brokers weren't as close. We have a very personal touch here. People know of us because of word-of-mouth communication, and we have always been rated highly on our honesty level too. Interestingly, LM spends little time developing its' own MCs. We spend so much time marketing other people's products. It's like a car mechanic that fixes everyone's cars but his own car doesn't work properly. Strange isn't it. We don't market ourselves very well. Evident of that is the fact that our website isn't up yet. Its one of our objectives for 2005 definitely!*

MCs by their nature are difficult to duplicate. Relationships, like innovative services take time to build. MCs are characterized by high levels of tacitness and complexity, and are the product of ongoing exchanges that take place both within firms and with external stakeholders. Many of these exchanges are highly firm specific and path dependent, which prevents duplication by competitors (Reed & DeFillippi, 1990)

### **Customer Value and Firm Performance**

Finally, attaining an advantage in MCs does not exist in isolation. Prior to purchasing, customers need to perceive that services or products are of value. CV is a dynamic concept that evolves over time. Value is determined by customers' perceptions rather than suppliers' assumptions or intentions. It is not what the producer adds, but what the customer derive (Doyle, 1989). Superior CV culminates in superior firm performance (Tan & Smyrniotis, 2003).

MCLS offers value by providing customer service, which they consider to be superior (e.g., going out of the way to provide products/services under time constraints). *Customers want someone with the best price that they can, but the highest priority is the level of skill and service. They are going to need people at short notice, things are going to rise, and they need 5 guys there straight away. We guarantee them that we can provide them that. MCLS also ensures the best client-hire person fit. We have processes in place on our database, for clients, not to send certain people. We stress the importance of logging in the information.*

In terms of firm performance, MCLS remains profitable. *We are here to make money. When I look at some of the competitors rates, I think we must be more profitable.* In this industry, it is difficult to calculate return on investment. *Our investment is in our staff/candidates and it's not like, here is \$1m, I am investing in a business. It's my venture. So, it's a difficult.* In terms of market performance, customers appear to be satisfied with MCLS's offerings. However, *our marketing is not effective enough and I want to identify what would be a good marketing tool as well.* Marc attributes their success to the quality of his assets (candidates), network of relationships, and care for clients and candidates.

For LM, clients ultimately value an open and honest policy. *I try and engender the atmosphere where they are able to express themselves to see whether the value has been provided. That's about it. We both also value the same things: more sales.* In contrast to MCLS, LM has not always been profitable. *Only in the last 2 years, we started to become profitable. It is attributed to obtaining a very large contract 2 years ago, which was the break we needed. I had to build the base, meaning the infrastructure and then try and obtain contracts during the period of building the base. I wasn't making money, in fact I was losing money, that was inevitable...that needs to be done.*

#### **MODEL DEVELOPMENT: MCLABOUR SERVICES AND LIAISE MARKETING**

As elaborated earlier, management appears to be a central starting point, guiding organisational direction. For entrepreneurs, start-up is largely based on their industrial and managerial experience. A firm's proclivity towards a particular business orientation is dependent on leadership. Customers, learning, and remaining entrepreneurial are important, these values are shared throughout an organization. Logically, attaining knowledge and intelligence from the market, continually challenging assumptions, and creating innovative solutions places organizations in an advantageous position in terms of their MCs. The present findings indicate that firms that undertake process innovation are likely to develop superior products and services that customers require. After evaluating all MCs, we found that both MCLS and LM attain an advantage in terms of services provided and relationships established both internally and externally. Finally, an advantage in MCs is insufficient. Tan and Smyrniotis (2003) concluded that CA should be measured in terms of CV because customers ultimately purchase the products/services. A CV approach focuses on how people choose among competing suppliers (Gale, 1994). Consequently, superior performance is a result of providing superior CV (Tan & Smyrniotis, 2003). Firm performance is not limited to financial measures, but also market aspects such as customer satisfaction and loyalty (see Figure 1).

It is acknowledged that all variables investigated are dynamic, taking time to evolve and changes over time. Our results do not capture the dynamics of these changes as the present study is cross sectional rather than longitudinal. The current investigation is concerned with only two Fast 100 companies in different industries. Thus, findings can be generalized only to firms meeting specific constraints. Furthermore, variables examined represent a narrow set of possible predictors. Cragg and King (1988) highlighted that no study can reveal all attributes involved in making small businesses successful. Longitudinal data might be appropriate.

## IMPLICATIONS FOR MANAGERS AND FUTURE RESEARCH

Findings suggest that there seems to be no significant difference between family and nonfamily FGFs in terms of their leadership characteristics, business orientations, and MCs. This finding might relate to MCLS being a first generation entity rather than a multi generation firm involving a consortium of cousins and extended family members all contributing to the running of the business. The likelihood of running a successful business increases when business owners obtain relevant experiences prior to start-up. CEOs focused on growth are required to lead employees who can help their organization create value for customers. CEOs also need to develop and effectively communicate a vision while obtaining members' commitments to achieve that vision (Hagen & Lodha, 2004) and to become a learning oriented organization. Currently, these two FGFs only focus on individual learning. For family firms, the CEOs need to be conscious of employing staff who are suited to the job rather than relying on family members. Process innovation seems to be a differentiating factor between these FGFs and their slower growing counterparts. It is also important to constantly ask customers what they value and whether the organization provides that. Future investigations should focus on quantitative empirical studies exploring the role important entrepreneurial characteristics as antecedent to firm business orientation. Rigorous testing of key relationships obtained in this study should be pursued using larger data sets. Firms at different stages of the organizational lifecycle focus on building diverse MCs. Therefore, other drivers of MCs should be investigated along the growth continuum. Researchers should also consider studying the mediating role of CV, particularly between MCs and firm performance for slow-growth SMEs and their larger counterparts. Finally, researchers should also examine the role played by customers' perceptions of CV because customer and supplier views are not necessarily similar.

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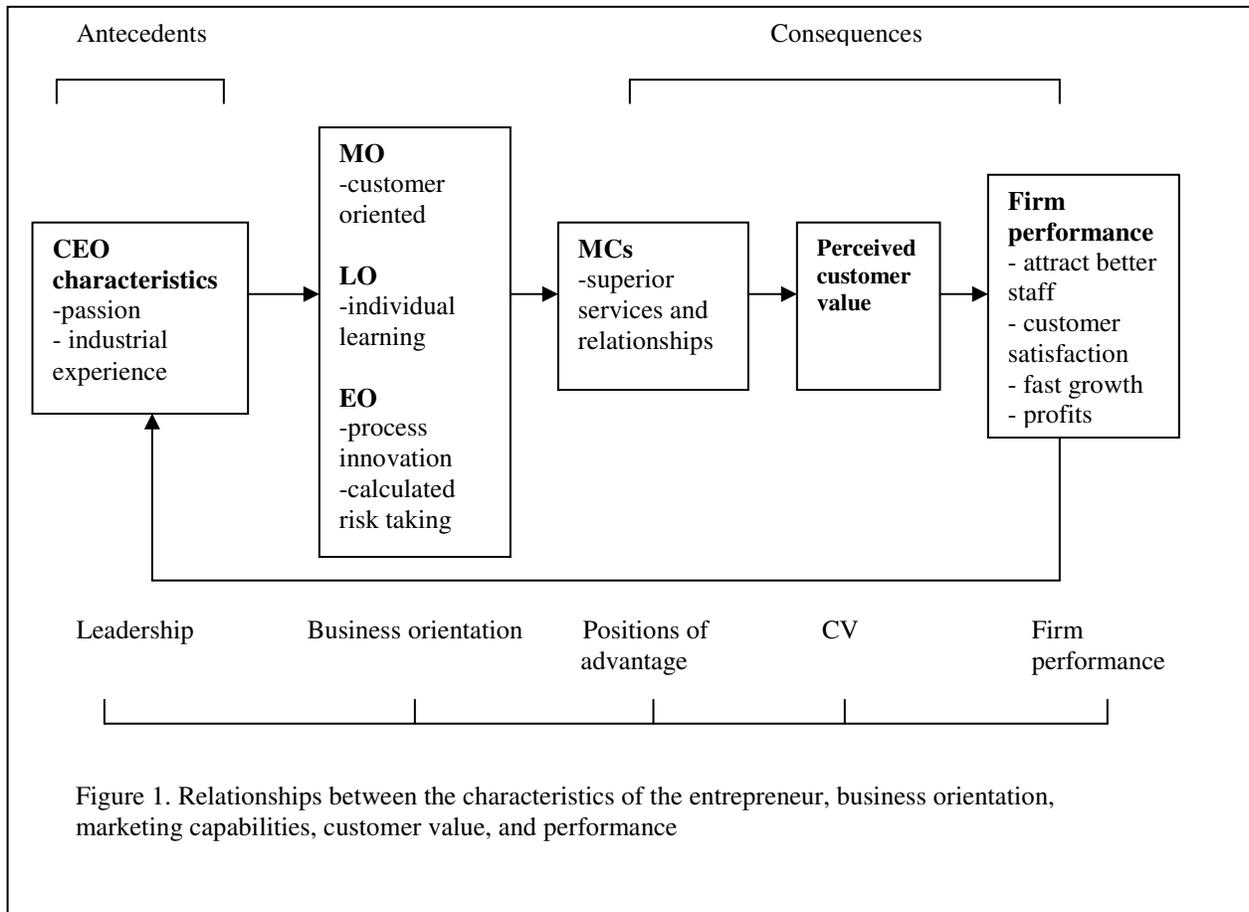


Figure 1. Relationships between the characteristics of the entrepreneur, business orientation, marketing capabilities, customer value, and performance

# **BUSINESS ORIENTATION, MARKETING CAPABILITIES AND FIRM PERFORMANCE: FAST 100 VERSUS TOP 500 COMPANIES**

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## **ABSTRACT**

This research investigates synergistic relationships between market, learning, and entrepreneurial orientations as sources of competitive advantage. These orientations are viewed as driving tactical marketing capabilities (MCs), providing positions of advantage. Disparities in growth trajectories between fast-growth firms (FGFs) and mature, medium-to-large companies highlight a need to study drivers of firm performance. Our paper compares fast growth entities with their Top 500 counterparts. Findings demonstrate that successful businesses have CEOs with particular leadership skills geared to grow their organizations, and an ability to empower employees. Empowering employees to make their own decisions and feel valued is essential for internal marketing. Moreover, FGFs gain success through continually challenging assumptions, articulating a similar vision, fostering solid relationships with stakeholders, and by providing innovative products in terms of customer value. Similarly, management drives organizational activities and ultimately firm success for medium-to-large organizations. Top 500 data identifies three principal findings: growth through acquisitions, MCs, and customer service. Specifically, participants aim to grow via acquisitions of local companies rather than having a global perspective. Growth through mergers and acquisitions can be attributed to these corporations operating in mature industries such as the floor coverings. It is not uncommon for Top 500 companies to attain advantage through the provision of superior customer service in order to maintain ongoing relationships. Furthermore, Top 500 companies are competitively aggressive seeking potential customers, utilizing distinct MCs, such as formal market research. Recommendations for future research and implications for managers are outlined.

## **BUSINESS ORIENTATION, MARKETING CAPABILITIES AND FIRM PERFORMANCE: FAST 100 VERSUS TOP 500 COMPANIES**

This investigation explores synergistic relationships between market, learning, and entrepreneurial orientations as sources of competitive advantage (CA). These orientations are viewed as driving tactical marketing capabilities (MCs), providing a position of advantage. As entrepreneurship and marketing involve the process of creating value by combining resources, this position of advantage needs to create superior customer value (CV). This study extends Tan and Smyrnios (2004a), suggesting that specific learning (i.e., shared vision) and entrepreneurial (i.e., being proactive & innovative) orientations along with particular MCs are significant predictors of Fast 100 firm performance. Specific MCs contribute to firm performance. Marketing management, pricing, promotion and marketing research are nonsignificant contributors.

Investigation of factors driving the success of entrepreneurial firms reveals no studies comparing fast growth entrepreneurial entities with their Top 500 counterparts. In Australia, fast growth firms (FGFs) tend to be emerging enterprises, usually less than 10 years of age, and comprise approximately 10% of all SMEs, contributing substantially to national revenue (Gome, 2004). Similar proportions are reported for Europe and the US (OECD, 2002). The *BRW Top 500*, by contrast, are medium-to-large private organizations, most of which were established over 100 years ago, and representing 6.4% (AUD\$143 billion annually) of Australian national revenue. Disparities in growth trajectories between FGFs and their mature companies highlight a need to study drivers of firm performance. The overarching research question addressed by this study is, in what ways are firm market, learning and entrepreneurial orientations related to organizational MCs and ultimately firm performance? Our paper begins with a brief overview of the pertinent literature, and theory underpinning this investigation, followed by a description of the methodology. Two causal network models, derived from an analysis of two detailed case studies are presented. Implications for researchers and managers are outlined, concluding with recommendations for future research.

### **THEORETICAL CONCEPTUALIZATION**

#### **Fast-growth Firms**

FGFs are like gazelles, their capabilities enables them to be nimble, quick off the mark, responsive to predators, and adaptive to changes in environmental conditions (Birch, 1995). FGFs are companies that achieve a minimum of 20% annual compound sales growth over a 5-year period (Sexton, Upton, Wacholtz, & McDougall, 1997). It is not uncommon for these enterprises to start from an initial base investment/capitalization of less than \$100,000.

Feindt, Jeffcoate, and Chappell (2002) suggested that founders play a crucial role in performance of fast-growth companies. These investigators reported that internal business processes are better organized than in low-growth companies, and growth appears to be primarily a matter of sound entrepreneurship. Nevertheless, management practices that facilitate rapid growth for larger, mature firms are different from fast-growth emerging firms (Barringer, Jones, & Lewis, 1998). There are a number of further critical factors contributing to growth, including a propensity to invest in future-oriented expenses such as marketing, building of distribution channels, and product research and development (O'Gorman, 2001). Moreover, reports indicate that FGF

owners regularly consult coaches and peer networks for advice, support, and direction (Fischer & Reuber, 2003). Exporting is yet another important characteristic. High growth and exports are often linked because most of these companies have a world-wide market. Perhaps surprisingly, exporting seems to be a precondition of growth processes (OECD, 2002). Not surprisingly however, the range and intensity of business networks are also markedly higher in firms that grow rapidly (Zhao & Aram, 1995).

### **Market Orientation**

Narver and Slater (1990) advocated market orientation (MO) as an organisational culture that comprising three behavioral components of equal importance, namely, customer orientation, competitor orientation, and inter functional coordination. Customer orientation is achieved when a firm succeeds in creating a superior value for its customers because the seller understands the buyer's entire value chain. A company needs to comprehend the cost and revenue dynamics of immediate target buyers and those of all markets beyond this point. Employees of market-oriented businesses spend considerable time with their customers, and realize a necessity of maintaining relationships with them as being critical to delivering superior CV (Slater & Narver, 1995).

The creation of superior value requires more than a focus on customers. Firms have to understand the nature of competitors, technologies and products that customers perceive as alternate satisfiers; and to identify and understand the principal competitors' short-term strengths and weaknesses and long-term capabilities and strategies. Generating competitive intelligence is the responsibility of everyone within the company (Slater & Narver, 2000).

MO also includes the coordination of personnel and other resources throughout the company to create value for buyers (Slater & Narver, 2000). For example, in the manufacturing industry, engineering and production staff should constantly discuss their capabilities and limitations with those in sales and marketing, so that capabilities can be leveraged and limitations avoided when promoting products/services (Slater & Narver, 1994). When all functions of an enterprise are geared towards enhancing buyer value in this manner, effectiveness and efficiency for customers are creatively realized.

### **Learning Orientation**

There are two types of organizational learning (OL): single and double-loop learning. The former occurs when errors are corrected without altering the underlying governing values. This process is also known as adaptive learning. An example would be learning from mistakes. However, the latter occurs when one questions an organization's values that lead to viewing problems from different angles, introducing ideas from other contexts, and experimenting with new approaches (Argyris, 1977). According to Baker and Sinkula (1999), a learning oriented firm, is an organizational commitment to higher level learning initiatives. Organizations learn as a result of experience, management development, and changes in the size of the organization. Basically, there are three main components of OL: commitment to learning, shared vision, and open-mindedness (Baker & Sinkula, 1999).

### **Entrepreneurial Orientation**

Morris and Paul (1987) stated that entrepreneurial orientation (EO) embodies three key dimensions, namely, innovation, risk-taking, and pro-activeness. Innovation, refers to seeking of

creative, unusual, or novel solutions to problems and needs and can be in the form of new technologies, processes, products or services. Risk taking involves a willingness to commit significant resource opportunities that may fail, although risks are usually moderated and calculated. Pro-activeness is an ability to implement and doing whatever is necessary to bring the entrepreneurial concept to execution. Lumpkin and Dess (2001) include competitive aggressiveness as part of EO.

MO entrepreneurship and organisational learning constitute unique resources collectively. Slater and Narver (1995) argued that MO provides strong norms for learning from customers and competitors. It must be complemented by entrepreneurship and appropriate organizational structures and processes for higher order learning. These three sources of CA are discussed briefly. Learning orientation (LO) and MO are mutually dependent factors that contribute significantly to superior performance (Farrell & Oczkowski, 2002). Given their iterative nature, these factors should not be measured in isolation. Weerawardena (2003) stated that entrepreneurial firms build and nurture MCs. Tzokas et al. (2001) also demonstrated that firms who are ready to take on risk and pursue innovative projects, and at the same time, give attention to market needs and competitiveness are more competent than those (especially smaller ones) without such qualities. Findings suggest that MO, LO, and EO are not sources of CAs independently, but rather, collectively contribute towards the creation of a unique advantage, as hypothesized by Hult and Ketchen (2001). Similarly, Hult, Hurley and Knight (2004) found that these business orientations are significant predictors of innovation, and ultimately firm performance.

### **Marketing Capabilities and Firm Performance**

Day (1994) identified the development of MCs as one of the major avenues towards achieving CA. MCs are conceptualized as an integrative process designed to apply to a firm's collective knowledge, skills, and resources to market related needs of its business, thus enabling it to add value to its goods and services. Organizational performance, in contrast, is a multi-dimensional construct, including financial, operational, and customer related performance domains (Kaplan & Norton, 1996). Given that an ultimate goal of an organization is to effectively deliver value to its customers (Day & Wensley, 1988), customer satisfaction can be regarded as an antecedent to profitability (Vorhies & Harker, 2000). For the present research, these three sources of CA were investigated to explore relationships between these three business orientations, MCs and firm performance utilizing a case study methodology.

## **METHODOLOGY**

Participants are two cohorts of CEOs/marketing managers: the 2004 *Business Review Weekly (BRW) Fast 100* SMEs and the 2004 *BRW Top 500* private companies. Respectively, inclusion involves a number of criteria, such as less than 200 full-time employees, turnover of more than AUD\$250,000 in 2000/01, and a single customer must not account for more than 50% of a company's turnover, and for Top 500 Companies, revenue of at least \$64 million. The Fast 100 cohort achieved an average turnover growth of 102% (range 35% to 887%). Revenue for the Top 500 ranged between AUD\$64 and AUD\$13,000 million. 8 fast-growth and 7 *Top 500* CEOs were interviewed. Owing to word limits, only findings emanating from in-depth interviews from one fast growth and one Top 500 firm are reported.

An interview schedule derived from previous studies evaluating MO (Narver & Slater, 1990), LO (Sinkula, Baker, & Noordewier, 1997), EO (Lumpkin & Dess, 2001), MCs and FIRM PERFORMANCE (Vorhies & Harker, 2000) was developed by the present investigators. Tape recorded semi-structured interviews with Fast 100 CEOs/founders and Top 500 marketing managers/CEOs of approximately 3-4 hours provided informants with an opportunity to relay relevant stories. Interviews were transcribed. This research utilizes case study and causal network model paradigms (Denzin & Lincoln, 2000). The following section contrasts the business orientations and MCs adopted by these two cohorts, revealing their impact on business performance, and culminating in two models.

## FINDINGS AND DISCUSSION

### **Fast Growth versus Large Corporation: Mor Cosmetics and Carpet Choice**

Mor cosmetics (MOR) is a supplier of body and bath products for the US, Australian, Asian and UK markets. Employing 30 staff, MOR started trading in 2000. Ranked 12 in the *BRW Fast 100*, MORs growth rate is 170%, turning over AUD\$4.68 million in 2003/04. MOR was founded by Deon Iuretigh and Dianna Burmas and launched at a Melbourne trade fair. Starting with 120 products, Deon stated: *We researched and done all the important business plans and the whole lot that backed the door, but sometimes you run on gut feeling as well. Getting into the market was relatively easy – it is about confidence and quality products. Being made in Australia adds a good flavour.* Deon and Dianna also spend time overseas, overlooking trends, however, being designers, *ideas come from within. Passion is what makes us competitive, we like what we do.*

In contrast, Carpet choice (CC) is an Australian national carpet retailer. Ranked number 330 in the *BRW Top 500* companies, turning over AUD\$350 million, and growing approximately 5% annually, CC was established in 1992 previously operating as both a furniture and carpet retailer. The current general manager joined the group when the company had substantial debts, and divested the furniture arm. The business started with a small base of 7 stores. By chance, another group collapsed and CC took control over 14 stores, virtually overnight. Currently, there are 130 stores nationally.

CC operates as a cooperative. Essentially, each retailer purchases a AUD\$4000 tranche of shares, and contributes AUD\$2000 per month for operating/marketing expenses. An average store achieves AUD\$1.5m of turnover, sometimes reaching AUD\$7m. Head office (HO) purchases floor coverings at a negotiated buying rate, which is a bulk deal process. Rebates are given for buying in bulk and dealing with 30 preferred suppliers. Internally, CC is run by 20 employees. There are 4 divisions: business development, marketing, information technology and finance. The organization grows by recruiting new members. The business development division *looks at individuals to see their ability to grow as a store.* According to Stoel and Sternquist (2004), retail cooperative groups increase purchasing power and gain consumer awareness through advertising and promotional campaigns.

Each CC store owner employs up to 10 employees, the majority of which are ex-carpet layers. *They don't know anything about fashion (because carpet is considered a fashion product) business operations, being proactive, and customer service.* However, people from other industries have begun to enter CC. *They are seeing it as a fashion product. They don't need to*

*know about the fibres and that sort of thing. A different attitude totally, the way they want to project their stores. It's about lifestyle images, making the customer feel fantastic in the store, beautifully lighting the store. Most retailers in industry didn't know that that was important.*

HO has to constantly educate their members to change their attitudes. For example, recently, one of the 130 stores was renovated. *Many people came in to see it straight after we did it, and this is not state of the art retail. It's a significant move from where it was. People said, "Oh, it's too up market, you've got to push the product price down, you've got to keep it cheap, it's all about cheapness". And now what's ended up happening is that he's doing very nicely, getting a lot of favorable comments from customers. Other CC stores are now embracing this new concept. It would take time but I reckon it wouldn't be in my lifetime, but in 10 -15 years you would start to see that those people who are bringing those skills into the industry and everyone else being forced to come up to meet it. You keep saying it, and they keep not listening and once they suddenly see it, they'll start moving up in their standards. It's a very trade oriented industry, it's almost like a timber type industry or very backward which is quite amazing given that it's a fashion product. I think it's starting to slowly change, we've lifted the bar a bit.*

Past work experiences can often determine the way organizations are run. For most SMEs, marketing tends to be informal, reactive, and conforming to industry norms. SME owners do not perceive themselves as marketing experts (Carson & Gilmore, 2000). Perhaps SMEs in general can learn from their fast-growth counterparts in terms of providing employees with opportunities for learning, or attracting better staff (Tan & Smyrniotis, 2005). Because each retailer is a small business, convincing members to adopt a certain business orientation is difficult. Harris (1998) postulated that in reality, the dimensions of MO may not be applicable in the small business sector. *Products purchased by the end customer are very similar across competitors, the only differentiation would be customer service.*

We posit that relationships between CA and firm performance is more complex than a simple direct relationship (Tan & Smyrniotis, 2004a). It appears that leadership is a pivotal driving force behind both types of organizations. Passion and ambition to grow and become a successful company influences organizational culture and experiences of employees. Such beliefs usually emanate from CEOs (Sinkula, 2002), elaborating that *such axioms serve to create a lens, with filtering capabilities no less powerful than those of religion, through which a business sees its environment* (p. 259). Accordingly, findings suggest that entrepreneurial beliefs, values and behavior exert a powerful influence on business orientation (i.e., LO, MO, EO).

Below we present a detailed discussion of the causal network model originating from these two case studies. For both firms, management provides organisational direction, driving firm business orientation. Being oriented towards its customers, innovation and learning, fast-growth enterprises build definitive marketing competences. For MOR, their marketing advantage culminates in superior CV, ultimately affecting firm performance (see Figure 1).

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Insert Figure 1 about here

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However, for CC, there are 130 individual stores operating independently and at the discretion of their owners. To a large extent, business success is dependent on owners' values. Operating in a so called *primitive* industry, products are similar, contributing to one main potential source of difference: customer experience (see Figure 2).

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Insert Figure 2 about here

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### **Market Orientation**

MOR communicates frequently with their customers, including end customers (prime demographics: 25-40 year old career woman), wholesalers, and retailers. *Our retail customers tell us everything. They tell us exactly what they like and don't like. On a consumer level, we keep a log of all emails and attend to them very quickly. If there is a problem with the product, you would have a phone call within the hour, and you get a return, and a few complimentary products to restore your faith. They will email us and thank us for the experience, now you have a customer for life.* Products are design driven, and customers are the focal point. Dianna explains that *inherently, we are very customer focused as a brand.* Deon adds *we are always leading our customers.*

Competitors are mostly foreign. However, competition is not only about companies in the body and bath industry. Competition is also about who you have to fight for floor space in a department store. Although competitor information is shared amongst employees: *We have an open office, and nothing gets passed anybody here, so it's a good thing from a communication point of view,* MOR does not base their decisions on what other people are doing. *I think we are pretty much lone rangers. We are too far ahead, our own competition is ourselves. We look at what we have done, and the standards we've set.*

For CC, there are two types of customers: cooperative members (individual CC store owners) and end-customers (i.e., commercial and small owner builders, the commercial sector, individual home owners). The primary objective for HO, however, is to *provide innovative services and solutions to the membership.* A secondary objective is to ensure that end customers buy. *They will be jumping up and down if no customers come in through the door.* Members are assisted in recruitment (e.g., analysing potential employee suitability for a job), sales training, market research, and other marketing activities that help members.

Similar to MOR, CC acknowledges, not being overly concerned about competition. *I don't think we sit there worrying about what they are doing. We certainly analyse the competition... We are very aggressive, and intensely competitive, but we operate more on leadership style than a follow me style.*

All functions in CC, are coordinated to deliver services that membership needs. *In the main, the structure and set up that we've got is pretty good.* Recruiting skilled personnel makes the process easier. *We have the critical mass that we can employ those people and justify the investment that*

*brings sophistication of the services that we provide to stores. Tenders for big business were put forward, and software programs were developed. These are things of that nature that we didn't previously do. The business is evolving and identifying new areas that need to improve. So you structure the business accordingly. I guess it's like a tight knit team, very intertwined. So if I make a marketing decision, I probably need to talk to the product area.*

### **Learning Orientation**

Being learning oriented recognizes the opportunities to learn from collaborations with customers, suppliers, and other potential learning partners. Deon elaborates: *We spend a lot of time overseas seeing trends, what is happening and we will get so excited about a little new technology, this new product. For us, it is to embrace technology that is coming through and different things that happen. It's really important to keep ahead.*

However, a learning oriented organisation is dependent on its employees (Tan & Smyrnios, 2005). Recruitment in MOR is about instilling a team environment. *People who work here really have to fit in and be passionate. Staff need to regularly update their skills as emphasized by Dianna: To get staff to the next level, we are always trying to nurture the staff to get them good at what they do. Everybody has their different strengths so, you try and identify their weaknesses and help them out with that too.*

Being able to reflect critically on decisions can indicate open-mindedness. Managers often need their world view to be questioned as one perspective might not be appropriate within a particular context. Encouraging employees to think outside the box and contribute original ideas helps organizations to move forward. Deon and Dianna encourage staff to question the way things are done through *healthy debates. The sales and production might disagree on something, and there would be a debate about it where all the extreme views are put on the table. It often achieves a better result, and then everyone gets excited about the next process.*

Possessing a shared vision within an organisation provides a road map for staff because they know where they are heading. Dianna adds that *it is important that staff know what they are working towards. Everyone is kept up to speed. They thrive on that: What new things are going to happen, new possibilities, and that keeps them informed. It keeps the goals common to everybody because if we were very private about that, people start feeling that there is a lack of communication.*

Similarly, CC places an emphasis on learning. *Learning is very important, both internally and externally. The general manager is encouraging us to do more learning particularly in our given fields of expertise to make sure that we get better at what we do. In the same vain, make sure that we pass through to our team members, the opportunities to better themselves with learning.*

In contrast to MOR, sharing an organizational vision seems to be a neglected area. *We are all guilty that we do the big picture ourselves. At a store level, the majority probably don't. We tend to run it as a management team and sometimes we forget that it's important to share what we are deciding on, and the visions, with all the other staff here.*

HO constantly reflects on all aspects of business. *From our lofty heights that we are at the moment, we tend to take a more positive viewpoint and say, How can we get better? What are the opportunities out there that the competition aren't doing? Should we look at our business and change its complete structure and model?*

### **Entrepreneurial Orientation**

MOR launches 120-150 new products each year, compared with 10-20 products for competitors. *We are building the range to provide retailers variation and depth.* Each retailer sells different products. Consequently according to Deon, *MOR penetrates the market better than any competitor ever would.*

In terms of process innovation, MOR also looks at different retailing avenues, that is, *going into new fashion areas: to align ourselves with fashion week. Fashion is a relatively new area for body and bath brands. We want to be associated with clothing, shoes and accessories, everything fits into a lifestyle.* MOR was contacted by Sabi, a lingerie shop, to retail the *Dolce* range, which is consistent with their product offerings. According to Deon, *We have never gone out to talk to potential retailers, we can't keep up as it is. Trade fairs are our showcase and that's it.*

Making bold decisions, such as entering the overseas markets showed that they are *not scared to try new things. It's not that hard, having the right people gets everything done.* While operations are handled internally in the US, Australia and UK, MOR uses distributors in Asia. In uncertain situations, advice from experts is regarded as essential. *In every area, whether it's legal, financial or business, we will always take advice, and if we don't have the right people, we find them.*

In contrast, the floor coverings industry is relatively conservative. Innovation is not evident in retailers' offerings to end-customers. *Customers always go for the very proven, conservative approach. For example, in terms of colors of the floor coverings, you can show some fabulous color innovations aubergines, radical things like that, but the customer won't go there.* However, CC provides innovative services to their membership. *We are seen as the initiator of most of the things. Initiatives that we do are more targeted at the store owner in terms of running his or her business, than the actual consumer that buys the floor covering.*

Firms close to their customers are well positioned to understand their market (Tan & Smyrniotis, 2004b). More importantly, for the FGF, firm orientation underpins development of market-focused products, and business relationships amongst stakeholders, contributing to perceived superior CV and firm performance. In line with this view, Smart and Conant (1994) found that business people with higher EO report greater possession of distinctive marketing competencies. Consistent with both of these perspectives, product development literature emphasises that a product advantage is a consequence of MO (Kok, Hillebrand, & Biemans, 2003). However, we contend that all three business orientations are required to drive product development success.

For CC, HO caters to 130 primary customers, who are viewed as the same entity by customers. In reality, CC is a large organization comprising many small businesses. Similar to MOR, our findings indicate that firm management drives a firm's proclivity to market, learning, and entrepreneurial oriented postures. For CC, these beliefs are disseminated easily to the 20 HO

employees whose focus is to deal with suppliers and members, and to conceptualize overall strategies. Like any large business, each department (e.g., marketing, finance, IT, business development) comprises qualified and trained expertise. Our findings, reflecting Heneman, Tansky and Camp (2000) reveal that CEOs/founders of SMEs are concerned with matching persons to firms (organizational fit) rather than utilizing traditional human resource practices, which focus on matching the knowledge, skills, and abilities, as reported to be the case in large organizations.

### **Marketing Capabilities**

**MOR's products.** Products can be more responsive to customer needs. For example, MOR has been approached by a Versace hotel to supply amenities for hotel bathrooms. Similarly, the Icelandic range was marketed to a retailer in Iceland. *Their girls are going to take it to Iceland air, and try to get products on the flights. They wanted to pitch it, and Icelandic is not even an amenity, it's just a line.*

Products do not just entail the physical body and bath products. Catalogues are an important selling tool. *We can send an 80 page catalogue to a store in another country, which costs \$7 to produce. People take us seriously. Just from the catalogue, clients would order cold from that. Our story is told through this medium.* In addition to producing quality products, each retailer carries different ranges, based on the target market. *We try and keep it as different as we can just so the customer gets options. We try and profile the customer according to the store.* For example, a store targeting younger people may carry the *Juice* range, which is *funkier*. If a store is salon based, they would carry the *Deluxe Spa* range.

**MOR's relationships.** Relationships with stakeholders are imperative for *smooth* running. For example, their UK distributor was unsatisfactory. *They didn't do store refills, were sloppy, and were over pricing the products.* When distributors misrepresent MOR, and do not *shape up*, MOR has the right to terminate the agreement. MOR is in the process of establishing their own office in the UK. For potential distributors, *we get 5 enquiries a week. We'd have a check list that they have to go through first, and see if they qualify. When they get that document, we usually never hear from them again. We have expectations: How you want to see the brand represented, your turnover, estimates of that sort of stuff. We're always prompt, active, always answering questions and getting things done for the distributors and retailers.*

MOR also has to constantly work with publicists. *We have some good relationships because we are based in Los Angeles and Hollywood, Beverley Hills, which is quite in the thick of celebrity land. You know someone, who knows someone.* For example, employees of retailers would inform MOR that Charlize Theron, Ivana Trump or Adam Sandler's wife has just come in and bought something. Oprah's producer has also contacted MOR on Oprah writing a full page on their Fig and Olive product. *We do not pay anyone for endorsements. We often get feedback from celebrities.* Thus, in terms of non-paid media, *it really has to do with our relationships. We have got close relationships with people in media, and we develop that. It's something that takes time and it's developed, you need to nurture that. Its all relationship based with the right people.*

While the focus has not been marketing at the consumer level, MOR is gearing up also in this direction. *We are trying to get better at that, and are investing money in that area. It's a*

*progressive learning curve at the moment. At the moment, MOR uses public relations to communicate with customers. We have special events where we invite them to see the new range. There was a big media event in Sydney held at a beautiful gallery for the media, where all the editors were wined and dined. There was nice food and we themed everything according to the products. So if we have food, we have elements of what the products are. Everything is connected so it's a nice experience for them and tells a little bit more about the image that we want to project. This gives them something to write about, and they learn more about the product on a one-to-one basis.*

For CC, all marketing aspects are viewed as important. Achieving the right marketing mix is essential. John Anderson, marketing manager of CC reflects this position when he said, *the way in which the products are placed in the marketplace means that you can have the very best marketing programs in the world but if the products are overpriced, they are just simply not going to fly. So, it needs to be the whole package, needs to be good quality, priced correctly, needs to be presented correctly in the store, and it needs to be communicated to the consumer.*

**CC's products.** In terms of product offerings for end customers, floor coverings from similar type retailers are not highly differentiated. They sell reputable products, which are *ultimately fluffy stuff that goes on the floor.* However, services offered by member stores are regarded as better than competitors. *We are better at providing services, we work harder at it. Most of the stores that we visited, because we also talk to our competitor group members of course, and ask them if they want to change over to us. Most of the ones we've spoken to have said they don't get the sort of services that we offer.*

One of the services provided by HO is to enhance store sales. Utilizing a profit analysis system, HO educates member retailers on ways to convert one floor coverings measure to a sale which might add an extra \$300,000 to the bottom line. *So you can show them all that in that model. The sales training manager we have here is not only telling them ways to sell in terms of giving feature benefits, how to convert your sale and things of that nature; but she also goes through product training, telling them the simple processes of taking the customer through the knowledge base without making it daunting, without making it too much information.*

**CC's market research (MR).** Competitors in industry traditionally do not conduct MR studies. Historically, high costs have deterred CC from investing in MR. However, *it's critical to carry out market research, doesn't matter what industry. In fact, in 10 years, we have done something like 3 research studies. However, over the last few years, we have employed more skilled people, and they bring their experiences. Our market research skills have definitely helped us develop effective marketing programs. Research tells us that we need to modify our behavior to make sure we meet their requirements and we are doing that currently.*

**CC's relationships.** Relationships along the supply chain are one of the most important aspects of the business. *We are told by our membership, we hear it from competitors, that we have a better relationship with our suppliers. It's a collective thing, the way in which we treat them. I think it's a very participatory relationship. It's not a 'them and us', we are not saying that product is too expensive, go away and get it cheaper. We work together. They come on our Magic Carpet Ride (a conference where all CC retailers and suppliers attend). We are giving*

*our total membership access to these suppliers to talk to, present their case. So there are a lot of things that we do to build their profile, and assist in building the relationship with our group.*

Quantitative studies (e.g., Tzokas et al. 2001) however, investigating relationships between MO and EO on firm performance with MCs as a mediating variable, contend that all MCs affect firm performance. We found that MOR emphasizes MCs specific only to their firm (i.e., product and relationship advantage). FGFs are a distinct population (Tan & Smyrnios, 2005), developing at a faster pace than the norm. Consequently, entrepreneurial marketing seems to be focused on providing products/services more responsive to customer needs and building business relationships for positive word-of-mouth. Marketing activities are dynamic, needing to evolve constantly in order to keep ahead of the market. As well, marketing practices are situation specific and dependent on several important factors such as the nature of markets served, growth stage and trajectory of the firm, types of products/services offered, and the quality of management (Hogarth-Scott, Watson, & Wilson, 1996).

In contrast, for a medium-large organization, there are certain MCs that tend to stand out. CC, for example, performs better than competitors when it comes to developing new services for their membership in order to assist retailers to attract more customers, undertaking MR on consumer behavior patterns, and relationships with suppliers. One distinct focus for this Top 500 firm is MR. Formal MR is mostly performed in large organizations. Our research supports Carson and Gilmore (2000) who reported that small firms differ to large firms in marketing because of limited resources, and specialist expertise. Suppliers are a crucial element in the successful running of any business, and good relations with suppliers is often considered to be as vital as good relations with customers (Carson, Gilmore, Grant, O'Donnell, & Cummins, 2000). In sum, there are two MC areas that both organizations focus on: developing new products/services along with building superior relationships with stakeholders.

### **Customer value and firm performance**

Finally, attaining an advantage in MCs does not exist in isolation. Customers need to perceive that services or products to be of value before purchasing. Deon and Dianna believe that customer's ultimately value beautiful pampering products. Customer perceptions are often different from retailer perceptions. *Your mind can make you feel healthy or sick. But these perceptions, it's all about a feeling as much as anything else.* CA is dependent on the values which customers attach to attaining the product/service, ultimately, CV is perceptual and dynamic. Superior CV culminates in superior firm performance (Tan & Smyrnios, 2003). In sum, all products have been successful. Feedback is provided by retailers and end-customers through emails, phone calls, and positive word-of-mouth. By all accounts, MOR is a profitable business that will continue growing, while reinvesting profits/knowledge gained in the process, back into the business.

For CC, HO provides its membership services unavailable elsewhere (e.g., sales training for retailers' employees, analytical software for monthly/yearly sales, recruitment, research data). Because many store owners were carpet layers previously, they possess limited knowledge in how to operate a floor covering business. However, if potential members are already a member of a competitor group, joining the CC chain can be complicated. It is easier, in contrast, for an independent carpet retailer to join the group. *It's just a mentality thing that says despite the fact*

*that they see and we can demonstrate all these things that we are willing to do for their business, getting them to actually make the quantum step to go out of another group into our group is very hard. Not so hard for an independent into the group. However, membership has continued to grow over the past few years. There is always the potential to take over another group which is a possibility. If we were to have a rapid rise of 50 or 60 stores, chances are, it would come from purchasing or merging with another carpet group.*

Buying carpet is also a daunting process. Because purchases are probably made every 15-20 years, end customers are bereft of knowledge when it comes to choosing floor coverings. Therefore, it is important for the salesperson to ease the process by recommending suitable products. Word-of-mouth is very important because customers rely on other people to recommend good carpet retailers. *This is largely due to a lack of information that people have. So I trust you, because I know you are not going to steer me wrong. Whereas, if I were to just go into the shop, and listen to the bloke selling it, I don't know whether he is selling the truth. Research has shown that customers are concerned that the salespeople are pushing their own barrow, for a better margin product or a trip to Bali, not necessarily giving the consumer the best advice. It's our job to try and fix that.* Therefore, sales training provided by HO helps educate shopfloor sales people to make customers feel that they are actually cared for.

In CC, CV is measured via a paid mystery shopper. They would answer a set of criteria on the store experience: Is the store clean? Does it look good? Were you greeted within 30 seconds? They measure each store based on how each *fake* customer perceives the store. In terms of firm performance, the business is profitable. Profits are reinvested into the business to enhance services provided to their membership. *We hope we deliver value to our customers but we all can do it better.* Most customers are satisfied with CC, despite being *dissatisfied with the whole industry.*

### **MODEL DEVELOPMENT: MOR AND CC**

As elaborated earlier, management appears to be the starting point, guiding organisational direction. A firm's proclivity towards a particular business orientation is dependent on leadership. Because they feel that customers, learning, and innovativeness are important, these values are shared throughout an organization. Logically, attaining knowledge and intelligence from the market, continually challenging assumptions, and creating innovative solutions places organizations in an advantageous position in terms of MCs. For example, when employees are aware of organizational objectives, they will contribute to attaining organizational goals, they are better able to negotiate with other stakeholders, leading to sound relationships with retailers and distributors. Innovation with an ability to think and manage strategically are key factors that distinguish entrepreneurial firms from a small business venture (Beaver & Prince, 2002). The present findings indicate that innovative firms are highly likely to develop superior products and services. Innovation in a highly competitive arena may lead to organization success. Innovation essentially means that firms create new uses for products/services or new products. New products can be viewed in terms of their degree of newness, ranging from totally new, or discontinuous, innovation to a product involving simple line extensions or minor adaptations that are evolutionary or incremental in nature (Brentani, 2001). Finally, an advantage in MCs is insufficient. Tan and Smyrniotis (2003) concluded that CA should be measured in terms of CV because customers ultimately purchase the products/services. A CV approach focuses on how

people choose among competing suppliers (Gale, 1994). Consequently, superior performance is a result of providing superior CV (Tan & Smyrnios, 2003). Firms that hold a CV focus, which are complemented with appropriate resources and capabilities, are best positioned to attract the capital necessary for expansion of scale or scope of activities (Slater, 1997) (see Figure 1).

For CC's HO, the model is similar to MOR. Management influences firm business orientation, leading to an advantage on certain MCs. Their aim is to continually find ways to operate efficiently and effectively. Similarly, management influences individual store owners. In addition, owners are driven by their own ambitions and purposes, but cooperative groups have to maintain a standardized image among member stores and create a strong brand presence in the mind of consumers, using common strategies such as standard products and methods of operation. The goals of independent store owners might be different from those of the cooperative, creating conflict (Stoel & Sternquist, 2004). Owners' personal values and past experiences determine the importance placed on certain business activities, such as providing innovative services or extraordinary customer experiences. Ultimately, end-customers make purchasing decisions based on the level of services provided by stores. HO also contributes to perceived end-customer value aspect by providing retailers with services which enhance sales processes. Consequently, end customers engage in word-of-mouth communication, telling their peers of their experiences, influencing potential customers. Profits attained are reinvested back into the business to support growth (see Figure 2).

#### **IMPLICATIONS FOR MANAGERS AND FUTURE RESEARCH**

Findings suggest that running a successful business entails having a CEO with leadership skills to grow an organization, the ability to empower employees, and to maintain sound relationships with stakeholders. Empowering employees to make their own decisions and feel valued is essential for internal marketing. As evident in this research, MOR gains success through continually challenging assumptions, articulating a similar vision, fostering solid relationships along the supply chain and by providing differentiated products in terms of CV.

Similarly, for CC, management drives organizational activities and ultimately firm success. The cooperative system is unique, requiring coordination of many small businesses, similar to a franchise model. By contrast, individual owners are dependent on HO to perform market intelligence analysis and to undertake innovation, particularly in the services domain. Being a large organization, the only interface with the end-customer is via individual stores and sales persons.

Future investigations should focus on exploring the mediating role of MCs and CV on firm performance in large organizations. Clearly, further research is called for in the investigation of this area, including the application of in-depth case studies for theory building purposes. Finally, researchers should consider developing scales of CV and business orientation specifically for SMEs.

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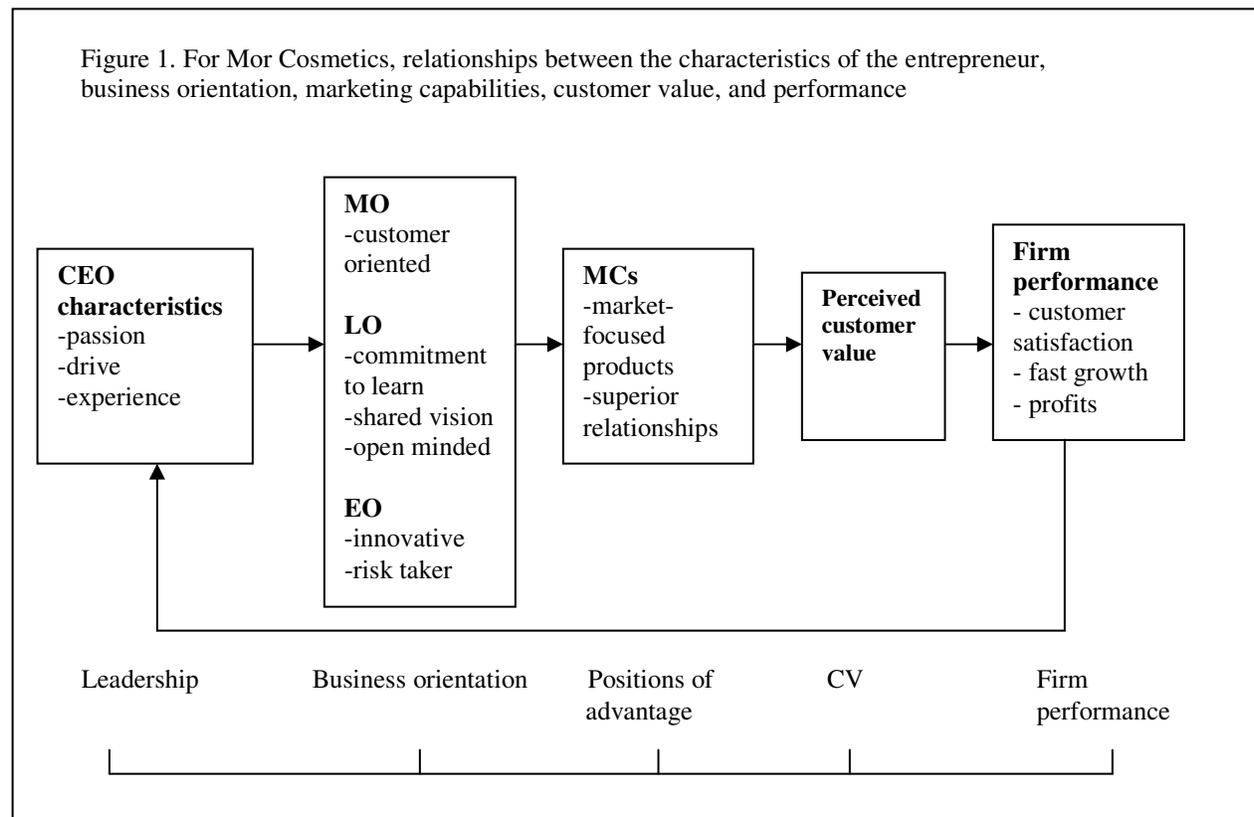
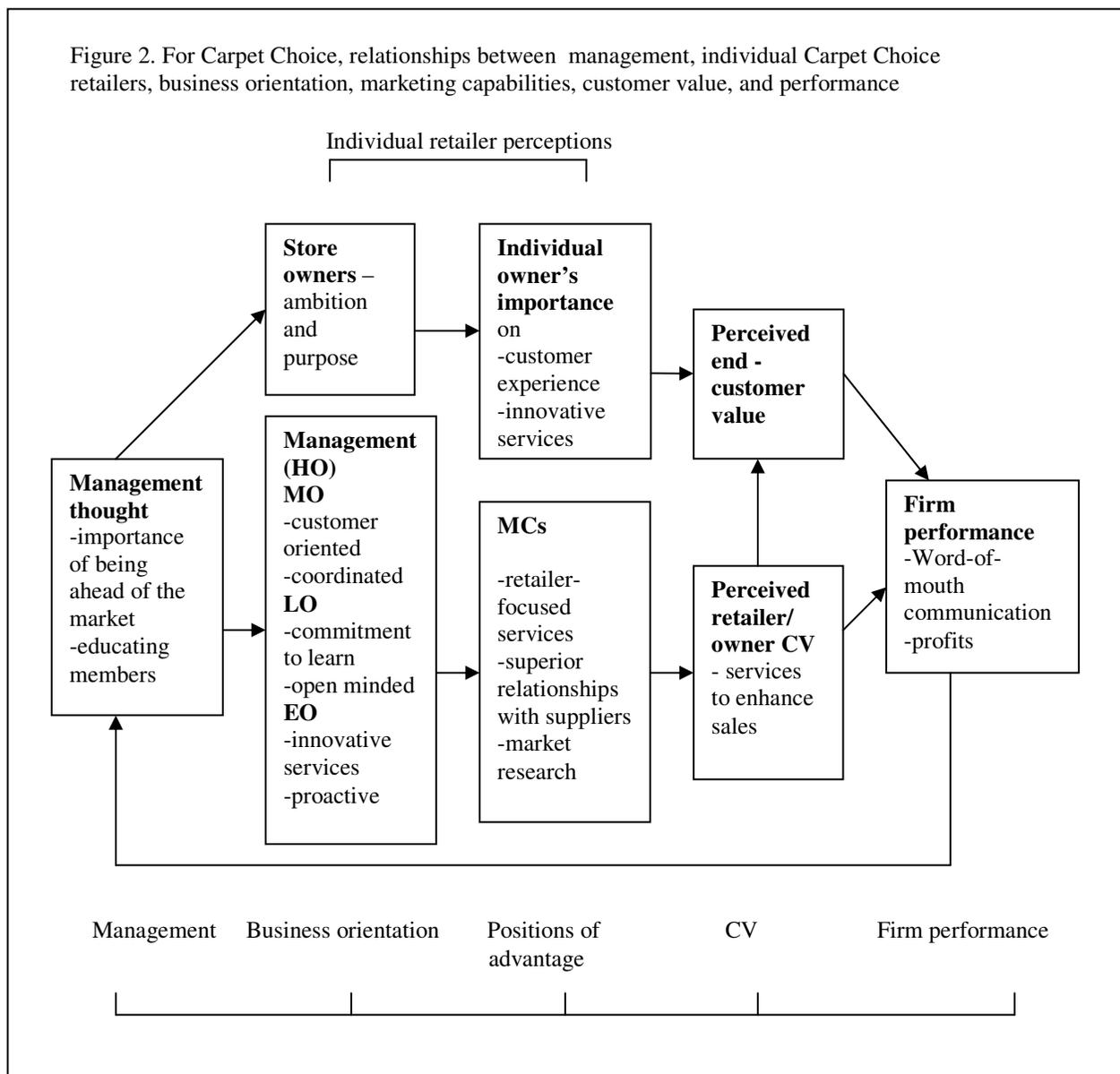


Figure 2. For Carpet Choice, relationships between management, individual Carpet Choice retailers, business orientation, marketing capabilities, customer value, and performance



## **Desperately Seeking an ENTREPRENEURIAL LEADER**

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### **ABSTRACT**

In today's connective global environment, it is impossible to isolate change by borders or industry. Flatter organizational structures, scarcer resources, changing consumer demands, the information/technology revolution, and global competition are forcing changes in the way business is conducted worldwide. Researchers describe today's markets as “dynamic markets” that feature innovation-based competition, price/performance rivalry, decreasing returns, and the 'creative destruction' of existing competencies.

Researchers are discussing the need for a potentially new type of leadership to emerge, one that is ready to lead organizations in the face of these new challenges. Some researchers started naming this new type of leadership as “entrepreneurial leadership,” explaining that it exhibits both entrepreneurial and leadership characteristics and behaviors

The purpose of this paper is threefold. First, it provides a brief overview of the importance of entrepreneurship in today's organizations and how it will help them survive today's dynamic markets. Second, the paper explains the importance of leadership in helping formulate the organization's strategy, which should incorporate the role of entrepreneurship. Third, it merges both the fields of entrepreneurship and leadership in a specific manner to help define the new concept of “entrepreneurial leadership.” Ultimately, the paper concludes with a discussion of a real corporate example of what an “entrepreneurial leader” is not, using Carly Fiorina, former CEO of HP as an example.

### **INTRODUCTION**

In today's connective global environment, it is impossible to isolate change by borders or industry. Flatter organizational structures, scarcer resources, changing consumer demands, the information/technology revolution, and global competition are forcing changes in the way business is conducted worldwide. Researchers describe today's markets as “dynamic markets” that feature innovation-based competition, price/performance rivalry, decreasing returns, and the 'creative destruction' of existing competencies (Venkataraman, 1997; Santora et al., 1999; Teece, Pisano and Shuen, 1997).

Organizational strategies and structures that might have been effective in stable markets in the past will constrain the survival of organizations trying to compete in today's dynamic markets. Researchers, keying in on this unprecedented business environment, have stressed that the escalating ineffectiveness of traditional leadership approaches to organizational strategy calls for an entrepreneurial focus to enhance the firm's performance, its capacity for adaptation, and its chances of long-term survival (Brown & Eisenhardt, 1998; Bettis & Hitt, 1995).

Researchers are discussing the need for a potentially new type of leadership to emerge ready to lead organizations in the face of these new challenges (McGrath, 1999; Teece, Pisano & Shuen, 1997). Some researchers started naming this new type of leadership as "entrepreneurial leadership" explaining that it exhibits both entrepreneurial and leadership characteristics and behaviors (Ireland & Hitt, 1999; McGrath & MacMillan 2000; Meyer & Heppard, 2000).

The concern and call for a new type of leadership, "entrepreneurial leadership," is understandable because of the uncharted and unprecedented territory that lies ahead for businesses in today's dynamic markets. Yet, is it possible to combine two distinct concepts and research fields such as entrepreneurship and leadership to create a new integrated one called "entrepreneurial leadership"? Even if it is possible to combine such concepts, then what are the characteristics of this new phenomenon and is it the sum of both leadership and entrepreneurship characteristics and behaviors? Finally, is there a relationship between this new type of leadership and the type of organization needed to survive and compete in today's dynamic markets?

## LITERATURE REVIEW

### The Need for Entrepreneurship in Today's Organizations

In the 1980's, the field of entrepreneurship exploded and involved almost all the soft and management sciences, including sociology, behavioral science and strategy. Many researchers attempted to postulate various theories regarding some or all aspects of entrepreneurship. Cunningham and Lischeron (1991) suggested that the field of entrepreneurship be structured around six points: the "great man" school, the psychological characteristics school, the classical (innovation) school, the management school, the leadership school and the intrapreneurship school. Yet, as Mulholland (1984) pointed out, the link established by Schumpeter (1928, 1934) between the entrepreneur and innovation has remained a dominant feature of the discipline.

According to Churchill and Lewis (1986), more empirical studies involving the entrepreneur's characteristics and behaviors have been conducted than almost any other type of entrepreneurship research. Gartner and Carland (1988), in regards to the entrepreneur's trait research, suggested that the study of the personal characteristics of entrepreneurs offers little hope of furthering the field. In a similar argument, Bull and Willard (1995) state that there is no typical entrepreneur.

The revival in entrepreneurship research has lead to the exploration of a new entrepreneurial paradigms and levels of analysis. Covin and Slevin (1991) identified several advantages in looking at entrepreneurship research from a firm-level behavioral perspective. They presented the concept of '*entrepreneurial effectiveness*' and argued that it is a firm-level phenomenon. That

is, the effectiveness of an entrepreneur can be measured by their organization's performance. The assumption made is that the entrepreneur is also the leader of the organization. Yet, this argument can be made by stating that the organization, regardless of the entrepreneur, can be measured on its performance and in particular its '*entrepreneurial effectiveness*.' Thus, performance can be a function of both individual and organizational level behavior. Second, individual level behavior can affect organizational actions and organizational-level behavior is a better predictor of the key entrepreneurial effectiveness criterion – firm performance. Covin and Slevin (1991) argued that it is behaviors and not attitudes that give meaning to the entrepreneurial process. That is, the entrepreneur and their firms are known through their actions and their behaviors. Thus, behavior is the central element in the entrepreneurial process. In addition, behavior is overt and demonstrable, which allows for the reliable, verifiable and objective measurement of the entrepreneurial activity.

The ability to differentiate among levels of the organization's entrepreneurial behaviors is important in developing and refining knowledge of the entrepreneurial process. Thus organizational strategies, structures, systems and cultures can be changed to improve the organization's entrepreneurial effectiveness – hence firm performance. As mentioned by Covin and Slevin (1991: 8), "the process of entrepreneurship can be less serendipitous, mysterious, and unknowable." The following section explains a key area of the new research being conducted in entrepreneurship that is applying an organizational level analysis.

In this paper, it is argued that an entrepreneurial approach to strategy might be vital for organizational success (Miller & Friesen, 1983; Miller, 1983). The importance of entrepreneurship to the organization's strategy is that it allows the organization to extend its boundaries and capabilities and be able to surpass competitors (Zahra, 1993). Burgelman (1983) stated that firms need order and diversity in strategy for ongoing viability. While structure and planning provides order, entrepreneurial activity provides the required dynamism (Brown & Eisenhardt, 1998).

Various labels have been to define the fusion of entrepreneurship into an organization's strategy. They are: corporate entrepreneurship (Zahra, 1991; Dess et al., 1999; Barringer & Bluedorn, 1999), intrapreneurship (Kuratko et al., 1990; Carrier, 1996), entrepreneurial posture (Covin & Slevin, 1991), strategic posture (Covin & Slevin, 1988; 1989), entrepreneurial strategy making (Dess et al, 1997), and entrepreneurial orientation (Lumpkin & Dess, 1996; Knight, 1997; Wilkund, 1999).

This paper will adopt Covin and Slevin's (1988) definition of the organization's entrepreneurial strategy. Covin and Slevin (1988) state that the organization's entrepreneurial strategy or as they termed it, 'entrepreneurial orientation,' could best be measured by summing together the extent to which top managers are inclined to take business-related risks (the risk-taking dimension), to favor change and innovation in order to obtain a competitive advantage for their firm (the innovation dimension), and to compete aggressively with other firms (the proactiveness dimension).

The next section will discuss the leadership (individual) construct and its influence on the organization's strategy, which influence the three elements of risk taking, innovation and proactiveness.

## **Leadership and Organizational Strategy**

Strategic management theory states that top-level managers have a strong effect on strategy formulation (Katz & Kahn, 1978). Wilkund (1999) argued that the strategic orientation of the chief-executive-officer (CEO) is likely to equal the strategic orientation of the firm. If that is the case, then how do leaders influence others in the organization to agree to their business strategies? The explanation proposed in organizational theory is varied and diverse, yet most research agree that certain individuals influence the actions of others, both individually and collectively, as leaders and managers in organizations (Bass, 1990).

In the past thirty years, the study of leadership has focused on differences in leadership and how they influence the organization. One of the significant differences that emerged is the distinction between two types of leadership known as transactional and transformational leadership (Burns, 1978). Transactional leadership is based on an economic, or quasi-economic, means of exchange between the leader and the followers. Also, transactional leadership focuses on behaviors related to basic administrative and management tasks required for groups to function well in the short term. These behaviors include ensuring followers have the knowledge, skills, and resources required to accomplish their tasks (Rosenbach, Sashkin & Harburg, 1996).

Transformational leadership, on the other hand, is based on the leader's ability to recognize the followers' needs, demands, and motivation, and satisfy the followers' higher level needs in a way that utilizes the full potential of the individual. Transformational leaders create change in organizations through behavioral patterns that are different than those exhibited by transactional leaders (Bennis, 1980; Conger, 1989; Conger & Kanugo, 1987; Sashkin, 1990).

This paper will use Sashkin & Rosenbach (1998) definition of transactional and transformational leadership. Sashkin & Rosenbach (1998) have drawn from the leadership research, especially the work of Bennis (1984), and have developed an integrative approach to leadership known as Visionary Leadership Theory. Sashkin and Rosenbach (1998) defined transactional and transformational leadership measures through their Visionary Leadership Theory as: communication, trust-building; caring; and, creating empowering opportunities for behaviors and self-confidence, empowerment, and vision. The contextual factor is culture. Please see Table 1 for a better explanation.

**Table 1**  
**Sashkin and Rosenbach (1995) The Leadership Profile (TLP)**

| <b>Type</b>                        | <b>Measure</b>                            |
|------------------------------------|---|
| Transactional Leadership Behaviors | 1: Capable Management<br>2: Reward Equity |

| Type  | Measure  |
|---|--|
| Transformational Leadership Behaviors       | 3: Communication Leadership<br>4: Credible Leadership (trust )<br>5: Caring Leadership (respect)<br>6: Creative Leadership   |
| Transformational Leadership Characteristics | 7: Confident Leadership<br>8: Follower-Centered Leadership<br>9: Visionary Leadership  |
| Transformational Culture Building*          | 10: Principle-Centered Leadership<br>(*For simplicity, scale 10, which represents the leader’s culture building actions, is treated as part of the “characteristics” group.) |

Organizations that are entrepreneurial may have CEOs that exhibit similar leadership characteristics and behaviors. The potential for identifying and reliably measuring these similar leadership characteristics and behaviors may help define and operationalize in one way the concept of “entrepreneurial leadership.” Sashkin and Rosenbach (1995) identified ten measures of transactional and transformational characteristics and behaviors (see table above) that define a visionary leader. Covin and Slevin (1988) identified three measures that an organization exhibits when it is entrepreneurial. They are: innovativeness, risk taking, and proactiveness.

This paper proposes that some of the ten measures identified by Sashkin and Rosenbach (1995) may be exhibited by CEOs that lead these entrepreneurial organizations. The following are the hypothesized leadership characteristics and behaviors that this paper proposes that CEOs may have in common. They are:

### **Transformational Leadership Characteristics**

***Confident Leadership.*** Sashkin and Rosenbach (1995) argue that the first and perhaps most basic characteristic of transformational leaders is self-confidence. For example, why would a person who lacks self-confidence bother to attempt to transform people and organizations? More important, a primary means by which these leaders transform followers into more self-directed leaders themselves is by creating empowering situations in which followers’ successes build their self-confidence. In other words, transformational leaders need self-confidence not only to engage in such leadership to begin with, but also in order to transform followers into self-confident leaders. Therefore, it can be argued that an organization that exhibits a strong or high entrepreneurial orientation is largely based upon the prevalence of confident leadership and the transformation of its staff into self-directed leaders.

***Visionary Leadership.*** In the Sashkin and Rosenbach (1995) approach, vision is based on the ability to first mentally and then behaviorally construct the future. Leaders do this

by thinking through what's happening, to determine causes, and by identifying how complicated chains of cause and effect actually work. Only then can a person figure out how to bring about desired outcomes. Visionary leaders don't simply arrive at a vision and sell it to followers. The idea of vision aligns well with the organization's entrepreneurial orientation, meaning that the leader can develop a clear vision and communicate it with their staff, which will allow the organization to be more proactive, innovative and risk taking.

### **Transformational Leadership Behaviors**

***Creative Leadership.*** This leadership behavior dimension is called “creative” because it refers to the extent to which leaders create opportunities for followers to be empowered to succeed in achieving goals for which they have been empowered. This concept aligns well with the organization's entrepreneurial strategy. If the leader of the organization achieves the right balance, then their staff will be likely to take more business risks and be more proactive which translates in the organization being more entrepreneurial-oriented.

***Credible Leadership.*** To measure, behaviorally, the management of trust, Sashkin and Rosenbach (1995) observed that leaders establish trust by taking actions that are consistent both over time and with what the leader says. Trust, of course, exists in the minds and hearts of followers and is not an obvious aspect of leader behavior. But consistency over time and between words and actions produces trust in followers by establishing the leader's credibility. If the organization embarks on risk taking initiatives, it might represent the strong staff trust of the leader.

***Principle-Centered Leadership.*** Schein (1985) has observed that it may be that the only really important thing leaders do is construct culture. Sashkin and Rosenbach (1995) titled the culture component as Principled-Centered leadership and referred to it as the degree to which a leader is effective in inculcating values and beliefs designed to shape an organizations' culture. The relationship between Principle-Centered Leadership and the organization's entrepreneurial orientation is that organizations that exhibit high or strong entrepreneurial orientation also may exhibit a strong or high Principle-Centered Leadership. The values and beliefs of the staff and leader drive them to be more innovative, risk taking and proactive.

The following section of this paper applies our definition of an Entrepreneurial Leader to a real corporate example. We will attempt to explain why Carly Fiorina, former CEO of HP, did not succeed at HP through the lens of our definition of an Entrepreneurial Leader.

### **TESTING THE ENTREPRENEURIAL LEADERSHIP CONCEPT ON CARLY FIORINA**

Carly Fiorina was hired at HP not only to turn the business around financially, but to institute a cultural change. The tasks set out before her required the task-oriented skills of the Transactional Leader as well as the skills of a Transformational Leader. All the while, she was to inject

entrepreneurial energy and creativity into what had become a relative dinosaur in the technology industry (Lavelle 2005).

As pointed out by Lavelle (2005), Carly did not succeed for several reasons. And what perhaps caused her downfall more than anything else was the relative success of P&G, UTC and IBM, three large corporations that faced similar daunting challenges. So, why did Fiorina not succeed where others did? Three simple rules were ignored. They were (1) Make it about the company, not you; (2) Know your company inside and out; and (3) Hold people accountable – including yourself.

Fiorina's abilities as an "entrepreneurial leader faltered because she ignored the above three rules. One, she failed to follow the rule to "make it about the company, not you." Fiorina was an extremely high-profile executive, which might have placed undue pressure on her to succeed. She irked the mid and high-level executives as well as the low level programmers because she made HP the image of her. The entire company should have shared in her initial success – not just attribute any successes to one person.

In our definition of "entrepreneurial leadership," we discussed the importance of ***Principle-Centered Leadership***. We argued that the only really important thing leaders do is construct culture. What Fiorina did can be argued that she tried to change the culture of HP into the her image. By attempting to alter the culture of HP into her own image she managed to alienate her staff.

Two, she did not appreciate the importance of "knowing your company inside out". Fiorina did not have an engineering background. Either because of her insecurities or because of her management style, she did not have a strong #2 with a high tech background. For this reason she failed to grasp the inner workings of the company and was unable to make slim, needed changes.

In our definition of "entrepreneurial leadership," we discussed the importance of ***Visionary Leadership***. We argued that vision is based on the ability to first mentally and then behaviorally construct the future. We also stressed the point that visionary leaders don't simply arrive at a vision and sell it to followers. Even if Fiorina had a clear vision of what HP should be, she lacked the know-how on how to achieve it. Her lack of technical skills and her refusal to hire a person that could implement such a vision was the reason she was not able to communicate or influence the HP staff with her vision.

Three, Fiorina did not understand the rule of "holding people accountable – including yourself." She fired three top executives for not meeting expectations, but she apparently did not hold herself accountable for the relatively poor performance of the company.

In our definition of "entrepreneurial leadership," we discussed the importance of ***Credible Leadership***. We believe that trust is gained through consistency over time and through the words and actions of the leader. Fiorina fired three top executives when HP fell short of quarterly targets. There are definitely times when top level executives need to be fired, however, it was perceived that Fiorina did this to smooth over Wall Street and place absolute blame on the three officers. Our definition of "entrepreneurial leadership" would not include pointing the

blame unless blame was due, and by the reaction of the company, it is not clear that these executives were at fault. If Fiorina were an “entrepreneurial leader,” she would have done one of two things. First, she may have assumed some of the blame and turned the missed targets into a “we” thing, causing a strategic change; or if the three executives were truly at fault, she would have had an understandable and communicated rationale to support the firings. Either way would have proved to be more accountable than her actions she took. The staff interpreted her action as that of a CEO who does not hold them equally accountable and that breaks the trusting relationship that staff and CEOs need to build and maintain.

In our definition of an “entrepreneurial leader,” we believe the leadership part requires that the leaders fully believe in their cause, not as a means to the top or to personal wealth, but as a means to company success. Often it comes down to how a leader gains the support and trust of the employees, board members and owners. “Entrepreneurial leaders” work in a way that transforms those around them into leaders. Such leadership gives ownership and responsibility to the employees, but more importantly, it gives them worth.

## CONCLUSION

Clearly, much remains to be done in clarifying the role and characteristics of tomorrow’s leaders. New organizational designs, new thinking patterns, and new information systems will require new leadership styles. “Entrepreneurial leadership” offers one answer.

There are those who will argue that entrepreneurs are not necessarily “good” or successful leaders. Such doubters can find support in the literature for the iconoclastic characteristics found in many entrepreneurs that are inconsistent with “good” leadership characteristics. For doubters, the term “entrepreneurial leadership” is seen as an oxymoron, a combination of terms that is contradictory to what we have been accustomed in the past. Successful entrepreneurs, however, have provided the risk-taking, achievement orientation and creativity that have led to the birth and growth of numerous major firms in the U.S. and globally, and they continue to do so. Entrepreneurial thinking is being increasingly demanded in even the largest corporations.

As stated above, more research in this area is essential. For example, future studies may include surveys that contain rank order preferences of the characteristics of leaders and entrepreneurs. Such studies will permit a rank order or other statistical analyses of the characteristics of leaders and entrepreneurs, helping further to define what we believe are the characteristics needed for entrepreneurial leadership.

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# **Generating Growth Strategies for a Part-Time Mother-Run Business: An Application of Goldratt's Thinking Process**

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## **ABSTRACT**

Eliyahu Goldratt's Theory of Constraints and Thinking Process have been applied to numerous types of situations and processes in order to identify root causes of problems. This problem-solving approach is extremely useful in providing practical solutions to some of the problems faced by small business owners and entrepreneurs. In this case study, Goldratt's process is applied to a self employed, part time business run by a mother who is faced with the typical role conflict of taking care of children while trying to establish a customer base. The process involves a determination of the undesirable effects (UDE's) in order to construct the Current Reality Tree (CRT). The UDE's revealed in this case study support previous research concerning role conflict in women-owned businesses. The CRT reveals several conflicts between the above statements that need to be eliminated. Goldratt advocates usage of Evaporative Clouds (EC) in determining factors that solve the core problem. In this case, seven key factors (injections) were identified to help solve the root problem.

## **BUSINESS BACKGROUND**

The situation examined in this paper involves Linda, an Independent Beauty Consultant for Mary Kay Cosmetics. Linda is a stay-home mother of a two-year-old daughter and is expecting her second child within the next few months. Her decision to start a home-based business was made a year ago. The reasons cited were to supplement the family income and to do something for her.

Mary Kay Cosmetics is a Dallas based personal products manufacturer and one of the nation's largest cosmetic companies. The company is well known for selling its beauty products via direct selling. The sales agents are predominantly women and are referred to as "Independent Beauty Consultants". Each consultant works for herself and has control over her time schedule. They purchase the products direct

from the company at wholesale prices and sell them at a prescribed retail value. The profit made is kept by the consultants and there are no contracts other than a yearly minimum purchase requirement (currently \$100.00). There are about 170,000 beauty consultants worldwide.

Linda is determined that she will not work full time and not utilize her degree in forensic psychology until her kids go to school. She wants to be available to her kids at any given time and be a major part of their early lives. Her husband is working full-time for an oil and gas company, and the family has just enough income to support their family on one salary. For these reasons, she decided to work only part-time. However, she wants to sell more than the defined maintenance level to contribute to the family income and establish a viable business.

After almost one year in business, an assessment of the business revealed some problems. The business is struggling to generate sales and recover the initial investment. Like many women business owners, her plans to “have it all” by growing the business and raising children are at conflict (Lundstrom, 1999). With time and role conflicts, she has experienced an inability to diagnose the relevant tactics that will help her establish and grow her business given the self-imposed constraints.

The business was initiated in April 2003 with a moderate initial inventory investment. The marketing for the new business is done by calling family and friends and arranging skin care classes. The goal of these classes is to showcase the products and make sales. Another goal is to meet potential customers through the people who agree to host a class, and schedule future classes with the newly acquired acquaintances. Recruiting new consultants is another goal as the recruiting consultant gets a fixed commission of the sales generated by their recruits. This commission is paid directly by the company and has no effect on the recruits' earnings.

The initial success of this style of marketing was fair with the generation of fewer than expected customers mostly limited to family and friends. By the end of 2003, an assessment of the business revealed that the business failed to recover the initial investment, and failed to generate enough new customers to sustain the business. Attempts to change the outcome were implemented by the end of 2003 by focusing on selling the most popular in-stock products rather than accumulating large inventories. She also started to explore avenues through which she could be exposed to potential customers without spending too much time away from her family. Her husband was called in to assist with marketing and took a proactive approach by mentioning his wife's business every opportunity he had and distributing business cards.

## **METHODOLOGY**

While Linda was using these efforts to save her business, she was approached with the idea of applying the techniques developed by Goldratt (1992, 1994) to help

diagnose her root problems. Linda had no previous exposure to or training in the methods developed by Goldratt, but she was asked to develop the limiting factors (i.e., the problems she is facing in establishing her home based part-time business). These problems, Undesirable Effects (UDEs) were developed using input provided by Linda and another Mary Kay beauty consultant having similar family and business issues.

Linda clearly felt that she needs to dedicate more time to her business if she is to be successful in reaching her financial goals. This was an admirable, but conflicted with the decisions made by the couple about Linda's level of commitment to family and work. She and her husband agreed that she should not spend more time on her business, especially with the prospects of a new addition to their family approaching. They also strongly favored an approach that would use her limited time effectively.

The end-of-year assessment pointed out that the business needed more sales to generate enough cash flow to recover the investment, and sustain the business. This would also help to expand the business by allowing purchase of additional inventory without being financially over-extended. Given the current situation, more sales require more time spent on the business. Clearly unacceptable, the couple took on the challenge of exploring ways to increase sales without sacrificing the time Linda spends taking care of her family.

## **THE THEORY OF CONSTRAINTS AND THE THINKING PROCESS**

Eliyahu Goldratt (1984) introduced the Theory of Constraints (TOC) to a large audience. The TOC is a method for achieving better productivity by eliminating a system's constraints. This is accomplished by focusing on the system as a whole rather than focusing on specific components of a system. The TOC was originally developed for manufacturing plant environment but its application is versatile and can be adapted to many different situations and business environments.

The TOC answers the questions the following major issues in a system: What to Change, What to Change to, and How to Cause the Change. The steps in the process are:

1. Identification of the system's constraint,
2. Decision on how to exploit the system's constraint,
3. The subordination and synchronization of everything else to the above decisions,
4. Elevation of the performance of the system's constraint, and
5. If any shift occurs in any of the previous steps, re-start the process (Pastore, Sundararajan, and Zimmers (2004).

In TOC, the constraints or bottlenecks control the rate of the system's production. To maximize the system's productivity, such constraints have to be improved or be eliminated. The remainder of the system should be synchronized and regulated to

the processing speed of the constraint. The five tools that make up the Thinking Process are;

1. The Current Reality Tree (CRT)
2. The Evaporative Cloud (EC)
3. The Future Reality Tree (FRT)
4. The Pre-Requisite Tree (PRT)
5. The Transition Tree (TT)

According to Goldratt, the core problem of the system should be identified and attention should be given to eliminate it by taking logical and intuitive approaches. The focus of the Thinking Process is the continuous performance improvement by maintaining a process of ongoing improvement. The symptoms of a core problem are undesirable effects (UDE's) which are in reality caused by the core problem itself. Efforts should be directed to identify and eliminate the core problem. Goldratt suggests that, cause and effect type relationship should be employed in to link UDE's and help define the core problem. By doing so, one can generate a logically constructed Current Reality Tree (CRT) which highlights the core problem.

## **UNDESIRABLE EFFECTS**

The following undesirable effects (UDE's) were compiled as the first step in constructing a Current Reality Tree (CRT). These UDE's, developed based on interviews with the two Mary Kay Beauty Consultants, are present in the current system.

### **1- I do not want to have conflicts between the duties of being a mother and being self-employed.**

This type of conflict is very commonly faced by women business owners (MacEwen and Barling, 1988).

### **2 - I need emotional support from family to help ease my concerns.**

Linda is going through a very important stage in her life as a young mother and needs emotional support from her family on the decisions she makes. Such support is critical for women business owners (MacEwen and Barling, 1988).

### **3 - I do not want to have added stress (on top of maternal stress) due to starting a new business.**

Barnett (1982) points out "having a preschool age child typically indicates significant involvement in the role of mother, thus, at this stage of life cycle any negative effects of involvement in paid work on well-being should be apparent".

### **4 - I want to contribute to family income with minimal financial risk.**

"Individuals become self employed for a variety of reasons: to increase income, to be their own bosses, to establish job security or to develop their own idea" (Jackson and Goodman, 2000).

**5 - I need to choose my own hours and balance career and family without sacrificing either.**

Due to her determination of attending her family, any work Linda would do has to give her flexibility to choose her own hours. Many women who choose to align with Mary Kay Cosmetics feel that the company allows them to accomplish this in a supportive environment (Incentive 1991).

**6 - I want to raise my children even it means less financial security.**

Linda has a very traditional view of family and sees raising her kids at home as an investment for their future. She is determined to be available to them full time at least until they attend school. This brings some financial restraints on her family, but they can get by with her husband's salary.

**7 - I do not want any job that might make me unavailable to my children.**

This UDE is actually a complimentary statement to UDE 6. The driving idea behind Linda's decision to be a stay home mother is to be available to her children. This is important to many parents (Schellenbarger 1994).

**8 - I need time support from my family.**

Due to her husband's full time job, he is not readily available to take on family care responsibilities readily. Linda, on the other hand, is caring for a toddler, which consumes most of her time. This brings a shortage of time and energy to devote to the business.

**9 - I need to be comfortable and creative in marketing myself to potential customers.**

Linda has never worked in a sales environment before and lacks the experience of a sales person. Jurick (1998) reports that marketing was the most disliked and feared task of self employed home workers. It is stressful and is regarded as a distraction from real work.

**10 - I need to increase my exposure to opportunities to make sales and gain recruits.**

Because of Linda's reservations on self-marketing, she has a problem in creating opportunities for making sales and gain access to potential new recruits. This is a major obstacle for her in generating new customers outside her family and friends.

**11 - Majority of my existing customers are out-of-town.**

Linda moved to Midland three years ago due to her husband's job. Since their move, she did not have enough time or opportunities to make new friends and business contacts.

## **12 - I do not have enough cash flow as a part time business owner in a new town.**

The cash flow problem caused by limited sales is a major factor in recovering the initial investment. This problem is especially important for a home based part-time business (Schindebutte, Morris, and Brennan, 2003).

### **CURRENT REALITY TREE**

After the UDE's are established, the next step is to build a Current Reality Tree (CRT). Two or more UDE's which seem to be related are connected using effect-cause-effect relationships. In a CRT, the UDE's are placed in boxes with rounded corners. This process is repeated until all the UDE's are connected in a logical way. Sometimes clarities are needed between UDE's in order to make makes things easier to follow. Insufficiencies are also added to the UDE's in an effort to organize them in a logical and easy to follow manner. The clarities and insufficiencies are injections that help the construction of CRT. Once the UDE's and the necessary injections are completed, a CRT will emerge in the shape of a tree with the bottom UDE being the "core problem". That core problem is the source of the conflict in the system.

The Current Reality Tree analysis reveals that UDE 12, "I do not have enough cash flow as a part-time business owner in a new town' as the core problem and is located at the bottom of the tree. The core problem answers the first question, "What to Change". See figure 1.

The CRT is read from bottom to top by using "if - then" syntax.

- If I do not to have conflicts between the duties of being a mother and being employed, and if I do not want to have added stress (on top of maternal stress) due to starting a new business, then I need emotional support from my family to help ease my concerns.
- If I need emotional support from my family to help ease my concerns, and if I need time support from my family and if the family support is limited, then I can only work part-time.
- If I do not want any job that might make me unavailable to my children, and if I want to raise my children even if it means less financial security, then I need to choose my own hours and balance career and family without sacrificing either.
- If I want to contribute to family income with minimal financial risk, and if I need to choose my own hours and balance career and family without sacrificing either, then I need to be self employed with minimal financial exposure.
- If I can only work part-time and if I need to be self employed with minimal financial exposure, and if I do not have enough cash flow as a part-time business owner in a new town, then I need sufficient customers to generate necessary cash flow.
- If I need sufficient customers to generate necessary cash flow, and if I do not have them, then I need to be more visible to potential customers.

- If I need to be more visible to potential customers, then I need to increase my exposure to opportunities to make sales and gain recruits.
- If I need to increase my exposure to opportunities to make sales, and gain recruits, and if I do not know enough people (potential customers) in a new town, then I need to be comfortable and creative in marketing myself to potential customers.
- If the majority of my customers are out-of-town, and if making sales to drive back and forth for sales and recruiting is an issue, then again, I need to be comfortable and creative in marketing myself to potential customers.

## **EVAPORATIVE CLOUD**

Goldratt's process advocates usage of an Evaporative Cloud (EC), in eliminating the core problem. The EC is used in a fashion that challenges the assumptions underlying the conflict and tries to find solutions to it. If there is a core problem, then there is the opposite of the core problem. The core problem is solved by achieving the opposite of the core problem. This opposite becomes the objective of the EC. The EC is read from the objective at left to right utilizing, "in order to ... I must" syntax. See figure 2.

The objective of the EC is depicted to "have enough cash flow to support a part time business." This is the opposite of the core problem. In order to have enough cash flow to support a part time business, I must generate new customers, and at the same time customers must be available and aware of my services. In order to generate new customers, I must actively market my business and capitalize on opportunities while being part-time. Also, in order to have customers be available and aware of my services, I must be full-time. This brings out the obvious conflict that needs to be eliminated. These are solved with injections. Seven injections were used in order to break the conflict. See figure 3.

INJ 1 – Involve husband in marketing

INJ 2 – Work around husband's schedule optimize his time spent taking care of family

INJ 3 – Involve Linda's mother in marketing for customers in prior location

INJ 4 – Call existing customers regularly and follow up on their needs

INJ 5 – Make telemarketing calls to acquaintances

INJ 6 – Get involved in groups with potential customers (i.e., mothers' networks)

INJ 7 – Continue to work part-time

Once the injections of the Evaporative Cloud are implemented, the Undesirable Effects are converted into Desirable Effects and again applying cause and effect relationships, a Future Reality Tree (FRT) can be constructed.

## FUTURE REALITY TREE

According to Goldratt, it is the Future Reality Tree (FRT) that enables one to find a solution without creating new UDE's. The FRT is constructed by placing the injections into the appropriate UDE's thus converting them into desirable effects. Clarities and insufficiencies can also be used when extra information is needed. The FRT also applies cause and effect relationship to connect desirable effects. It tests the validity of the injections in a logical way and determines whether the proposed solution is achievable. The FRT is read from bottom towards top using "if - then" syntax similar to CRT and replaces the negative tone in CRT with a positive tone. See figure 4.

The FRT is read from bottom to top by using "if - then" syntax.

- If I work around my husband's schedule and optimize his time spent taking care of family, then I will not have conflicts between the duties of being a mother and being employed.
- At the same time if I work around my husband's schedule, and optimize his time spent taking care of family, then I will not have added stress (on top of maternal stress) due to starting a new business.
- If work around my husband's schedule, and optimize his time spent taking care of family, then I will have time support from my family.
- If I will not have conflicts between the duties of being a mother and being employed, and if I will not have added stress (on top of maternal stress) due to starting a new business then I have emotional support from my family to help ease my concerns.
- If I have emotional support from my family to help ease my concerns, and if I have time support from my family, then I can work part-time.
- If I continue to work part-time, then I can raise my children (even if it means less financial security).
- If I continue to work part-time, then I will be available to my children.
- If I can raise my children, and if I am available to them, then I can choose my own hours and balance career and family without sacrificing either.
- If I can choose my own hours and balance career and family without sacrificing either, and if I can contribute to family income with minimal financial risk, then I can be self-employed.
- If I involve husband in marketing, then I will have opportunities to increase cash flow.
- If I get involved in groups with potential customers, then I will have opportunities to increase cash flow.
- If I can be self-employed, and can work part-time, and at the same time have opportunities to increase cash flow, then I will likely to have sufficient customers.
- If I have sufficient customers, and if I make telemarketing calls to acquaintances, and if I call existing customers regularly and follow up on their needs, then I will increase my exposure to opportunities to make sales and gain new recruits.

- If I involve my mother in marketing for most out-of-town customers, then majority of my out-of-town customers are reached.
- If majority of my out-of-town customers are reached, then making time to drive back and forth for sales and recruiting is not any more an issue.
- If I get involved in groups with potential customers, then I will meet enough people (potential customers) in a new town.
- If making time to drive back and forth for sales and recruiting is not any more an issue, and if I meet enough potential customers in a new town, and if I increase my exposure to opportunities to make sales and gain recruits, then I would have optimized marketing to potential customers.

## **CONCLUSION**

As pointed out by the Future Reality Tree, many of the changes are easily applicable and Linda has agreed that these are immediately employable tactics. The injections provide clear guidelines to how to apply the changes and still be self-employed and work part-time while generating new customers and increase cash flow. This would allow Linda to fulfill her desire to be stay home mother while contributing to family income.

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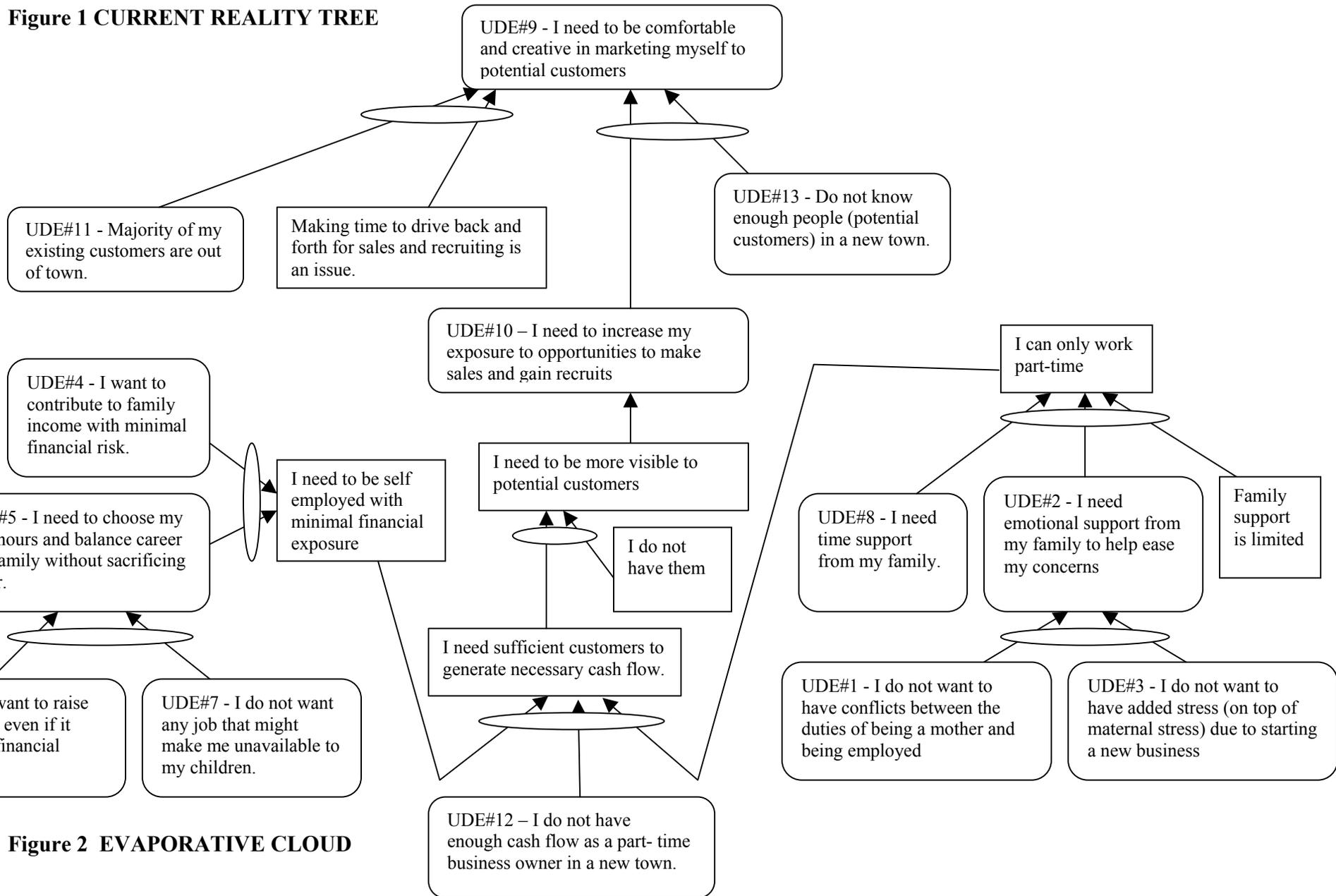
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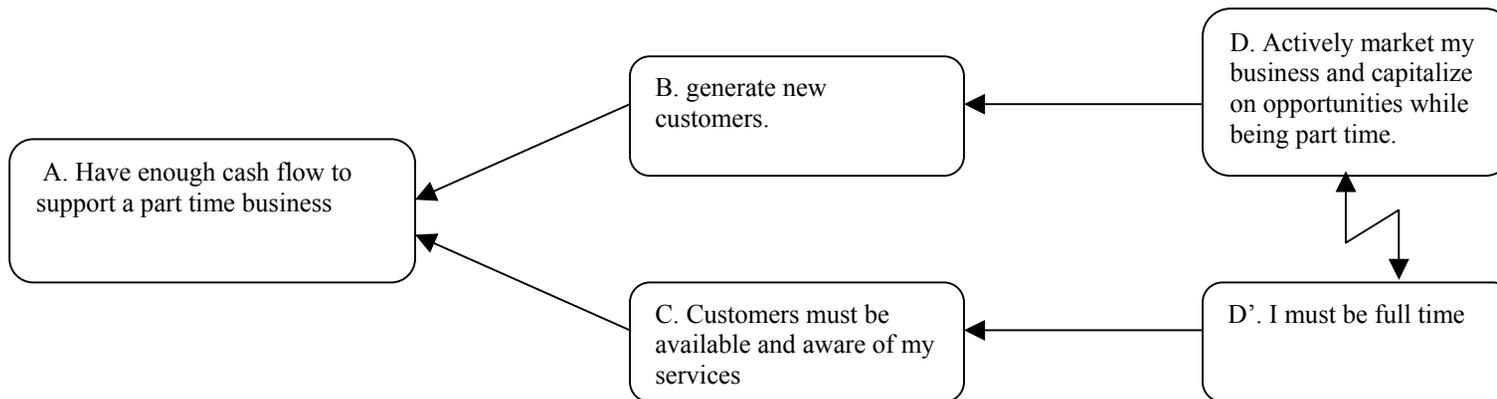
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**Figure 1 CURRENT REALITY TREE**



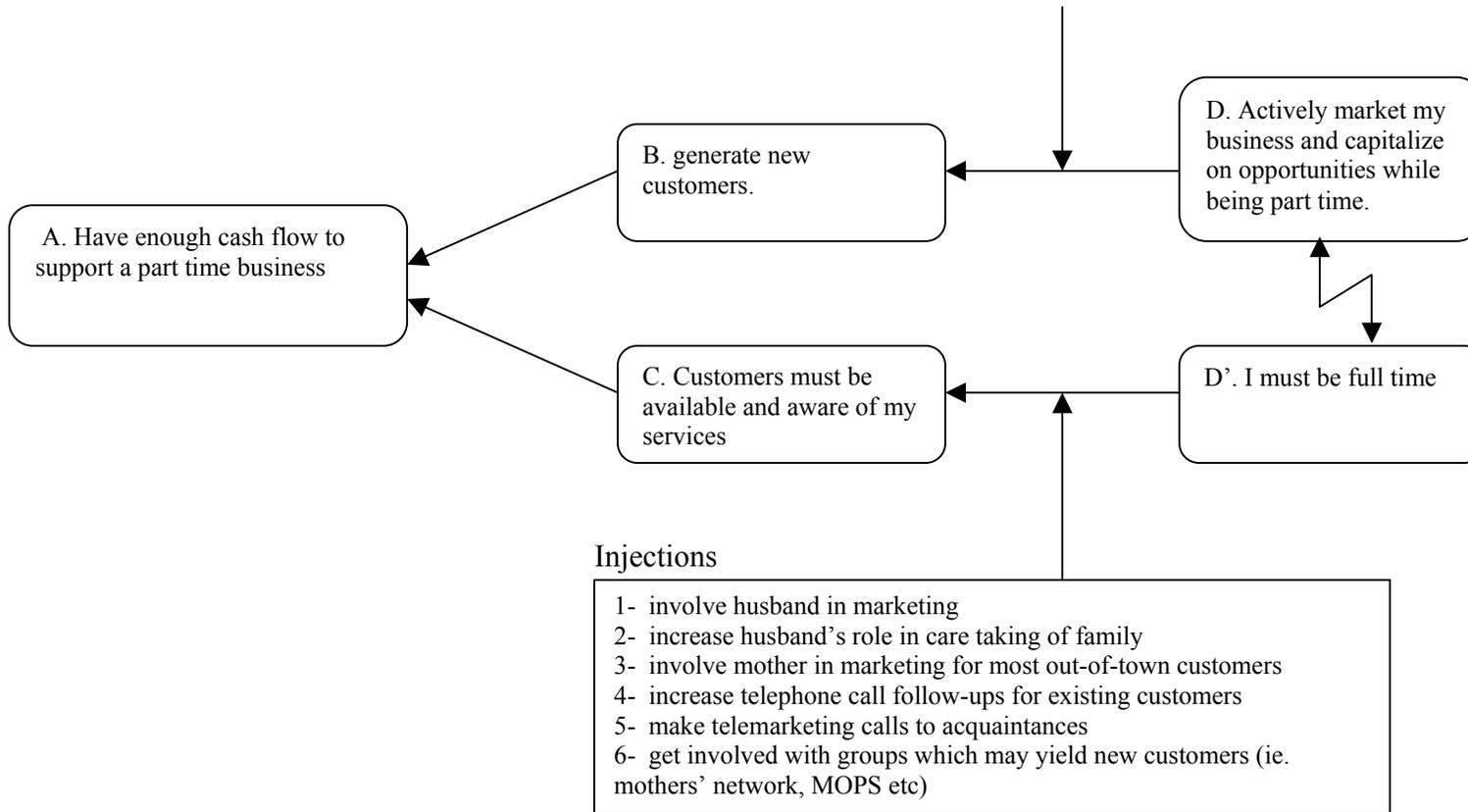
**Figure 2 EVAPORATIVE CLOUD**



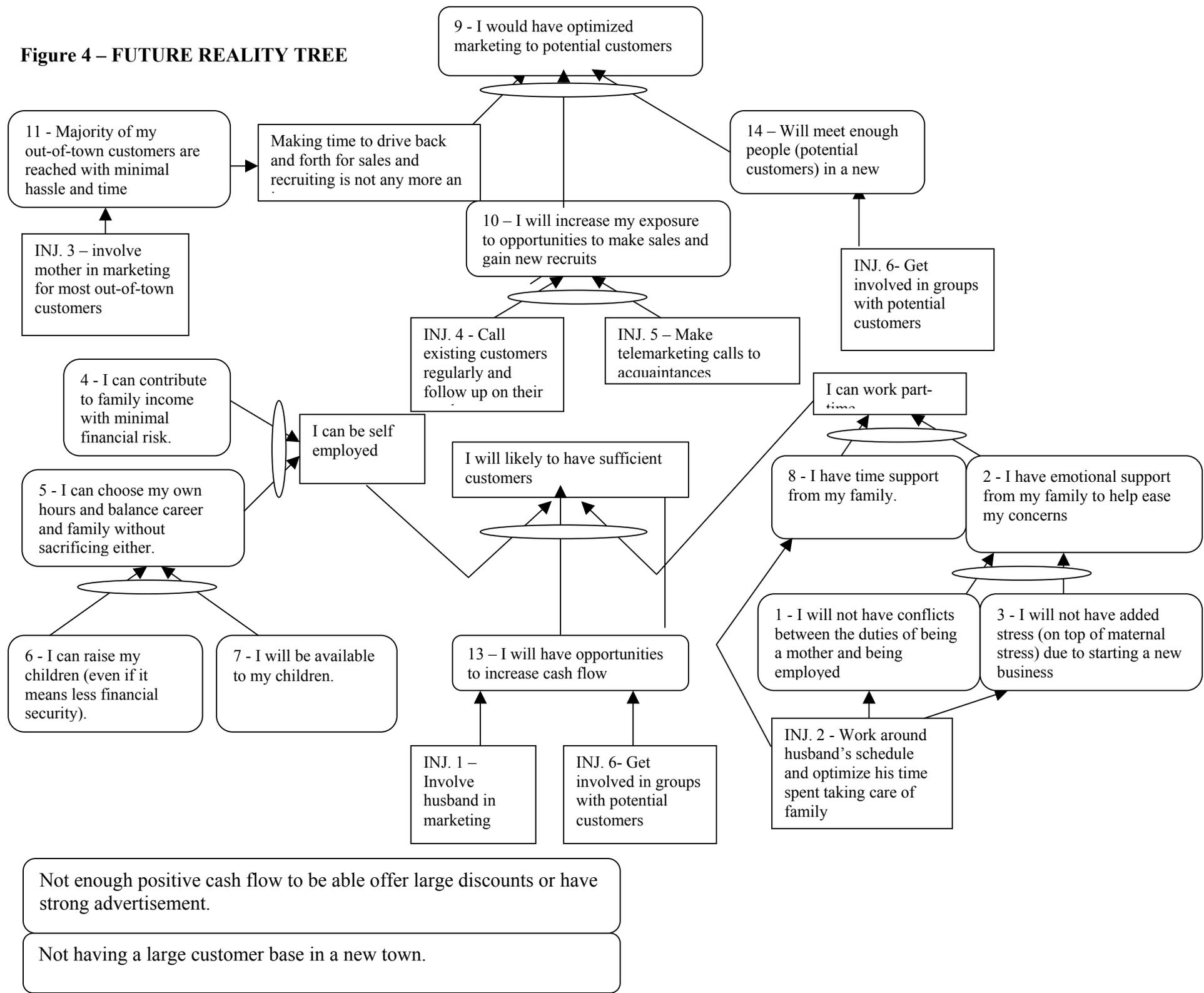
**Figure 3 EVAPORATIVE CLOUD WITH INJECTIONS**

Injection

7 - continue to work part time



**Figure 4 – FUTURE REALITY TREE**



# **TOP MANAGEMENT TEAM COMPENSATION AND REWARD SYSTEMS IN RAPIDLY GROWING NEW VENTURES**

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## **ABSTRACT**

This paper provides an examination of the various compensation systems that may be used to reward the Board of Directors, top management team, key executives, and other employees of a rapidly growing new venture. Drawing on the accounting literature, we first identify and describe six primary compensation and reward systems that have been used to motivate and retain corporate executives. These compensation and reward systems are (1) director stock option plan, (2) cash bonus plan, (3) future performance plan, (4) stock option plan, (5) stock purchase plan, and (6) 401(K) retirement plan. Next, we describe four key categories of the venture team to be considered in this research which include the (1) board of directors, (2) top management team, (3) key executives, and (4) most other employees. Through an analysis of Initial Public Offering documents of 126 rapidly growing new ventures we identify the type of compensation and reward systems offered to each of the key categories of the venture team. Shareholder value, a measure of firm performance, is used to classify ventures as “unsuccessful,” “marginal,” “successful,” or “highly successful” for each type of compensation and reward system across each category of the venture team membership.

## INTRODUCTION

How corporations compensate and reward their top managers is of increasing interest to stakeholders. Shareholders, the business press, and employees frequently complain that CEO's, members of the Board of Directors, and corporate executives are paid far in excess of the value that they have contributed to the corporation. Whether a CEO is leading a major corporation or a new venture, he or she is moving in uncharted territory and few, if any, signposts or manuals are available for guidance. What, then, is fair compensation for these leaders? While this question is complex and is likely to be debated extensively, an aspect of the question concerns the types of compensation and reward systems that are available for use.

The purpose of this paper is to examine the various compensation systems that corporations use to reward their top management teams. Drawing on the accounting literature, we first identify and describe six primary compensation and reward (C&R) systems that have been used to motivate and retain corporate executives. Through an analysis of the Initial Public Offering documents of rapidly growing new ventures, we determine the type of compensation and reward systems that were offered to the Board of Directors, corporate officers identified by name in the "Management" section of the IPO (Initial Public Offering), other key executives, and employees. The paper concludes with a report of these findings.

## BACKGROUND

Although there is much interest and talk about CEO compensation, these discussions frequently focus on large, multinational firms that have been in existence for many years. While the CEO and top management team of a new venture may not garner such interest from the business press, the compensation of these individuals is of great interest to those who work with entrepreneurs, such as venture capitalists and bankers, and those academic practitioners who study entrepreneurs. However, there are very few studies that have closely examined the compensation offered to the top management teams of rapidly growing new ventures. Further, other than the previous studies we have reported (Teal & Hofer, 2001) no studies have expressly examined the link between team compensation and new venture performance.

Factors such as the impact of the founding entrepreneur (Roure & Keeley, 1990; Roure & Maidique, 1986; Virany & Tushman, 1986) and available financial capital (Cooper, Gimeno-Gascon & Woo, 1994) have been suggested in the literature as having an influence on new venture success. Although some studies have found limited support for some of these concepts (Cooper, Gimeno-Gascon & Woo, 1994; Roure & Keeley, 1990; Roure & Maidique, 1986; Virany & Tushman, 1986), thus far there has been little *overall* empirical evidence documenting either the influence that "other" variables may have on new venture performance, or the magnitude of any relationships that may exist.

Gartner (1989) noted that, among other problems, the definition of the key variables in the study and how the traits, characteristics, and behaviors of the entrepreneurs were measured were sources of constant problems in many of the studies that he reviewed. In ground-breaking research Sandberg (1984:243) acknowledged that variables other than the ones that he examined might contribute to new venture performance. Both Gartner (1989), Sandberg (1984), and

Sandberg and Hofer (1987) have suggested that future research should focus on the behaviors of entrepreneurs, although all admit that such research is inherently difficult to accomplish.

This study is an extension of our previous research and is part of our continued attempt to understand the behaviors of entrepreneurs by examining a potential motivator for an entrepreneurship: the compensation and reward of the top management team of rapidly growing new ventures.

## **NEW VENTURE COMPENSATION AND REWARD**

In this study we analyze the compensation and reward systems of rapidly growing new ventures. Drawing on accounting literature (Larker, 1983) we consider the presence or absence of six specific types of C&R systems. These plans are (1) director stock option plan, (2) cash bonus plan, (3) future performance plan, (4) stock option plan, (5) stock purchase plan, and (6) 401(K) retirement plan. A director stock option plan involves the granting of a specified number of stock options to directors of the new venture. This plan is offered only to directors, and it is not necessarily the same plan that is offered to other categories of employees.

The other five compensation and reward systems may or may not be offered to all employees, and, if offered may be in varying degree to different categories of employees. Thus, in this study "employees" may refer to the top management team, key executives, or most other employees. A cash bonus plan is generally a quarterly or annual payment of cash that is based on the employee, team, or corporation meeting some specified short-term corporate goal. Payment under a future performance plan is based on meeting specified future, long-term performance goals of the corporation. A stock option plan involves granting employees the right to purchase stock in the corporation on some future date at a specified price, which is at or below the current stock price as of the date of the option. A stock purchase plan allows employees to purchase stock in the corporation directly without going through a broker, thus avoiding brokerage fees. The company generally facilitates this purchase of stock by collecting contributions from the employee's pay, pooling these contributions over some period, and then making a group purchase of stock. If offered, a 401(K) retirement plan must, by law be offered equally to all qualifying employees. A 401(K) retirement plan allows the employee to redirect a portion of their earnings (within certain guidelines) into a 401(K) retirement account. These deferred earnings may be "matched" by the corporation up to a specified amount. Although substantial penalties for early withdrawal apply, the deferred compensation is not subject to Federal income tax until it is withdrawn for retirement purposes.

Prior research within the field of accounting (Larker 1983:4-5) has categorized executive compensation as either "short-term" or "long-term." Using the guidelines that were developed by Larker, the cash bonus plan would be identified as a short-term compensation plan. The director stock option plan, future performance plan, and stock option plan would all be identified as long-term compensation plans.

The measure of C&R systems was designed to assess the type of systems in place at the time of a venture's IPO to provide for the compensation and reward of four categories of top management team members: the Board of Directors, the top management team, (both of which are identified

by name in the "Management" section of the IPO), other key executives (who may be identified by name in the IPO but are not generally so listed), and other employees.

Both the form and type of executive compensation is disclosed in the IPO. The specific C&R systems approved by each venture's Board of Directors are disclosed in the "Management" section of the IPO under the heading "Executive Compensation." Benefit plans, if any, and to whom they are offered (including employees) are also described in the "Management" section under the heading "Benefit Plans." These disclosures are regulated by law and are carefully screened by the SEC (U.S. Securities and Exchange Commission) during the IPO process. Thus, the inclusion of a description of C&R systems for directors and employees at the time of the IPO indicates that the entrepreneurial team recognized the value of such systems and developed them to support strategy implementation and growth.

### **SAMPLE**

The sample for this research was drawn from the 1992, 1993, and 1994 annual *Inc. 100* listing of America's fastest growing small public companies. The final sample upon which this research is based includes 126 new ventures, all of which have been recognized for rapid growth. The compound annual growth rate for these firms ranged from a low of 78% to a high of 403%. Thus, the firms in the sample were growing at a rate of twenty to one hundred times the rate of growth of the United States Gross National Product, which averaged 4.1 % from 1984 to 1991 (U.S. Department of Commerce, 1992).

Data for the dependent variable was obtained from Standard & Poor's COMPUSTAT. To calculate shareholder value for each venture, the researcher obtained the venture's stock price over a 24-month period as well as cumulative dividends and the related COMPUSTAT adjustment factor. Shareholder value was then calculated for each site and recorded in the database. To develop the data for the independent variables for this research, the researcher obtained and read the IPO of each of the 126 ventures and coded the required data in a "Data Collection Summary Form." This data was then recorded in the database. The measure of Shareholder Value was used to evaluate the performance of the rapidly growing new ventures. Shareholder Value (SV) was then classified as "Unsuccessful," where  $SV < -.05$ ; "Marginal," where  $SV -.05 \leq .05$ ; "Successful," where  $SV .05 \leq .30$ ; or "Highly Successful," where  $SV > .30$ . For a more complete description of the development of the sample, data gathering, and the calculation of the performance measure, shareholder value, please see Teal & Hofer (2001).

### **RESULTS**

Using this database of new ventures examined at the time of their Initial Public Offering (IPO) and a measure of performance over a 24 month period, we then evaluated the C&R systems in place at the time of the IPO to determine the extent to which each type of system was offered to each category of director, top management team member, key executive, and most other employees.

Although this study of the C&R systems of rapidly growing new ventures involved an extension of the research of Cooper, Gimeno-Gascon, and Woo (1994), Joyner (1995), Sandberg

(1984,1986), Roure and Maidique (1986), Roure and Keeley (1990), Stuart and Abetti (1987, 1990), and Virany and Tushman (1986), none of these prior studies had included a measure of compensation systems. Thus, none of the compensation and reward systems measures that were examined in this research had been examined in previous empirical research in entrepreneurship.

The following tables report the number of ventures providing the specified C&R system across the various categories of employees.

Table 1. Compensation and reward systems/ Director stock option plan

|                              |  | (1)<br>Unsuccessful<br>SV < -.05 | (2)<br>Marginal<br>SV -.05≤.05 | (3)<br>Successful<br>SV .05≤.30 | (4)<br>Highly Successful<br>SV >.30 | Total |
|------------------------------|--|----------------------------------|--------------------------------|---------------------------------|-------------------------------------|-------|
| Insufficient information = 0 |  | 0                                | 0                              | 1                               | 0                                   | 1     |
| No systems = 1               |  | 16                               | 3                              | 4                               | 8                                   | 31    |
| Systems in place = 2         |  | 46                               | 7                              | 18                              | 23                                  | 94    |
| Total                        |  | 62                               | 10                             | 23                              | 31                                  | 126   |

Table 2. Compensation and reward systems/ Cash bonus plan

|                              |      | (1)<br>Unsuccessful<br>SV < -.05 | (2)<br>Marginal<br>SV -.05≤.05 | (3)<br>Successful<br>SV .05≤.30 | (4)<br>Highly Successful<br>SV >.30 | Total |
|------------------------------|------|----------------------------------|--------------------------------|---------------------------------|-------------------------------------|-------|
| Insufficient information = 0 | Top  | 0                                | 0                              | 0                               | 0                                   | 0     |
|                              | Key  | 0                                | 0                              | 0                               | 0                                   | 0     |
|                              | Most | 2                                | 0                              | 0                               | 0                                   | 2     |
| Subtotal                     |      | 2                                | 0                              | 0                               | 0                                   |       |
| No systems = 1               | Top  | 24                               | 3                              | 5                               | 6                                   | 38    |
|                              | Key  | 47                               | 8                              | 12                              | 23                                  | 90    |
|                              | Most | 59                               | 9                              | 19                              | 31                                  | 118   |
| Subtotal                     |      | 130                              | 20                             | 36                              | 60                                  |       |
| Systems in place = 2         | Top  | 38                               | 7                              | 18                              | 25                                  | 88    |
|                              | Key  | 15                               | 2                              | 11                              | 8                                   | 36    |
|                              | Most | 1                                | 1                              | 4                               | 0                                   | 6     |
| Subtotal                     |      | 54                               | 10                             | 33                              | 33                                  |       |
| Total                        |      | 186                              | 30                             | 69                              | 93                                  | 378   |

Note: This table includes three levels (top, key, & most) for each of the 126 ventures in the sample. Thus, there are 378 (126 x 3) total observations reported in this table.

Table 3. Compensation and reward systems/ Future performance plan

|              |     | (1)<br>Unsuccessful<br>SV < -.05 | (2)<br>Marginal<br>SV -.05≤.05 | (3)<br>Successful<br>SV .05≤.30 | (4)<br>Highly Successful<br>SV >.30 | Total |
|--------------|-----|----------------------------------|--------------------------------|---------------------------------|-------------------------------------|-------|
| Insufficient | Top | 0                                | 0                              | 0                               | 0                                   | 0     |

|                      |      |     |    |    |    |     |
|----------------------|------|-----|----|----|----|-----|
| information = 0      | Key  | 0   | 0  | 0  | 0  | 0   |
|                      | Most | 0   | 0  | 0  | 0  | 0   |
| Subtotal             |      | 0   | 0  | 0  | 0  |     |
| No systems = 1       | Top  | 54  | 10 | 20 | 25 | 109 |
|                      | Key  | 58  | 10 | 22 | 29 | 119 |
|                      | Most | 61  | 10 | 23 | 31 | 125 |
| Subtotal             |      | 130 | 30 | 65 | 85 |     |
| Systems in place = 2 | Top  | 38  | 0  | 3  | 6  | 17  |
|                      | Key  | 15  | 0  | 1  | 2  | 7   |
|                      | Most | 1   | 0  | 0  | 0  | 1   |
| Subtotal             |      | 54  | 0  | 4  | 8  |     |
| Total                |      | 186 | 30 | 69 | 93 | 378 |

Note: This table includes three levels (top, key, & most) for each of the 126 ventures in the sample. Thus, there are 378 (126 x 3) total observations reported in this table.

Table 4. Compensation and reward systems/ Stock option plan

|                              |      | (1)<br>Unsuccessful<br>SV < -.05 | (2)<br>Marginal<br>SV -.05 ≤ .05 | (3)<br>Successful<br>SV .05 ≤ .30 | (4)<br>Highly Successful<br>SV > .30 | Total |
|------------------------------|------|----------------------------------|----------------------------------|-----------------------------------|--------------------------------------|-------|
| Insufficient information = 0 | Top  | 0                                | 0                                | 0                                 | 0                                    | 0     |
|                              | Key  | 1                                | 0                                | 0                                 | 0                                    | 1     |
|                              | Most | 2                                | 0                                | 0                                 | 1                                    | 3     |
| Subtotal                     |      | 3                                | 0                                | 0                                 | 1                                    |       |
| No systems = 1               | Top  | 3                                | 0                                | 0                                 | 2                                    | 5     |
|                              | Key  | 4                                | 1                                | 0                                 | 2                                    | 7     |
|                              | Most | 46                               | 10                               | 17                                | 26                                   | 99    |
| Subtotal                     |      | 53                               | 11                               | 17                                | 30                                   |       |
| Systems in place = 2         | Top  | 59                               | 10                               | 23                                | 29                                   | 121   |
|                              | Key  | 57                               | 9                                | 23                                | 29                                   | 118   |
|                              | Most | 14                               | 0                                | 6                                 | 4                                    | 24    |
| Subtotal                     |      | 130                              | 19                               | 52                                | 62                                   |       |
| Total                        |      | 186                              | 30                               | 69                                | 93                                   | 378   |

Note: This table includes three levels (top, key, & most) for each of the 126 ventures in the sample. Thus, there are 378 (126 x 3) total observations reported in this table.

Table 5. Compensation and reward systems/ Stock purchase plan

|                                    |      | (1)<br>Unsuccessful<br>SV < -.05 | (2)<br>Marginal<br>SV -.05≤.05 | (3)<br>Successful<br>SV .05≤.30 | (4)<br>Highly Successful<br>SV >.30 | Total |
|------------------------------------|------|----------------------------------|--------------------------------|---------------------------------|-------------------------------------|-------|
| Insufficient<br>information =<br>0 | Top  | 0                                | 0                              | 0                               | 0                                   | 0     |
|                                    | Key  | 0                                | 0                              | 0                               | 0                                   | 0     |
|                                    | Most | 0                                | 0                              | 0                               | 0                                   | 0     |
| Subtotal                           |      | 0                                | 0                              | 0                               | 0                                   |       |
| No systems =<br>1                  | Top  | 46                               | 6                              | 18                              | 22                                  | 38    |
|                                    | Key  | 46                               | 6                              | 18                              | 22                                  | 90    |
|                                    | Most | 46                               | 6                              | 19                              | 22                                  | 118   |
| Subtotal                           |      | 138                              | 18                             | 55                              | 66                                  |       |
| Systems in<br>place = 2            | Top  | 16                               | 4                              | 5                               | 9                                   | 88    |
|                                    | Key  | 16                               | 4                              | 5                               | 9                                   | 36    |
|                                    | Most | 16                               | 4                              | 4                               | 9                                   | 6     |
| Subtotal                           |      | 48                               | 12                             | 14                              | 27                                  |       |
| Total                              |      | 186                              | 30                             | 69                              | 93                                  | 378   |

Note: This table includes three levels (top, key, & most) for each of the 126 ventures in the sample. Thus, there are 378 (126 x 3) total observations reported in this table.

Table 6. Compensation and reward systems/ 401(K) retirement plan

|                                    |      | (1)<br>Unsuccessful<br>SV < -.05 | (2)<br>Marginal<br>SV -.05≤.05 | (3)<br>Successful<br>SV .05≤.30 | (4)<br>Highly Successful<br>SV >.30 | Total |
|------------------------------------|------|----------------------------------|--------------------------------|---------------------------------|-------------------------------------|-------|
| Insufficient<br>information =<br>0 | Top  | 0                                | 0                              | 0                               | 0                                   | 0     |
|                                    | Key  | 0                                | 0                              | 0                               | 0                                   | 0     |
|                                    | Most | 0                                | 0                              | 0                               | 0                                   | 0     |
| Subtotal                           |      | 0                                | 0                              | 0                               | 0                                   |       |
| No systems =<br>1                  | Top  | 41                               | 8                              | 14                              | 14                                  | 38    |
|                                    | Key  | 41                               | 8                              | 14                              | 14                                  | 90    |
|                                    | Most | 41                               | 8                              | 14                              | 14                                  | 118   |
| Subtotal                           |      | 123                              | 24                             | 42                              | 42                                  |       |
| Systems in<br>place = 2            | Top  | 21                               | 2                              | 9                               | 17                                  | 88    |
|                                    | Key  | 21                               | 2                              | 9                               | 17                                  | 36    |
|                                    | Most | 21                               | 2                              | 9                               | 17                                  | 6     |
| Subtotal                           |      | 63                               | 6                              | 27                              | 51                                  |       |
| Total                              |      | 186                              | 30                             | 69                              | 93                                  | 378   |

Note: This table includes three levels (top, key, & most) for each of the 126 ventures in the sample. Thus, there are 378 (126 x 3) total observations reported in this table.

## CONCLUSION

The next step in this research project will involve an analysis of the data. While our sample focuses specifically on new ventures that have exhibited rapid growth, compensation systems do not necessarily vary as a result of the age or rate of growth of the firm. Further, as indicated in the data tables, although the sample was made up of rapidly growing new ventures, the majority of the ventures (57%) are classified as “unsuccessful” or “marginal.” Thus, careful data analysis is required to determine appropriate findings in this study.

This study may be useful both to and beyond the entrepreneurship community as it provides a report of the C&R systems that were used by this sample of rapidly growing new ventures at the time of IPO. As a result of this study, we hope to provide a clearer understanding of the various types of C&R systems and the frequency of their use in rapidly growing new ventures.

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**BUSINESS SUCCESSION:  
ECONOMIC DISASTER OR A BLESSING IN DISGUISE?**

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## **ABSTRACT**

This decade one third of all SMEs in the European Union will engage a business transfer. We challenge the gloomy assumptions in research and government policies that transfer means crises for SMEs and a threat to economy and growth. We like to get a clearer sight on perspectives by policymakers and consultants. Finally we challenge family succession as the main focus in SME transfers.

We conducted three studies: a qualitative study, a cross sectional study on 1300 SME after transfer and a longitudinal panel study on performance after transfers. Our results indicate that transfers have a positive effect on turnover, innovation and productivity, but leads to less employment. The effect on profit is inconclusive. Family succession is less favourable for economy, because family successors tend to under perform.

There is a shared perspective: finding buyers, the lack of (financial) knowledge, financial resources for buyers and staff as and important stakeholder are shared concerns. All parties shy away from the emotional aspects of business transfers.

The consultants' role has neutral or even negative effects on the business success after transfer in The Netherlands. The consultancy style by working on commission stimulates a fast transfer time of 6 – 12 months. The emotional process of letting go is avoided, which may cause considerable delay in business transfers.

Explicitly for policymakers and researchers we recommend a focus on transfers outside the family, addressing the emotional aspects the owner faces in transferring the business and major improvements on capital conditions for buyers.

## **INTRODUCTION**

This decade one third of all SMEs in the European Union will engage a business transfer (European Commission, 2002). These business transfers may result in a major restructuring of many industries, and, they could lead to substantial destruction of (tangible and intangible) capital, in case successors and buyers cannot be found in sufficient numbers. Within this context, the European Commission tends to see business succession as a threat to the survival of small and medium-sized firms, and, as a threat to overall employment and economic growth.

This paper challenges the gloomy scenarios and typical assumptions in research on business succession in small and medium-sized firms. Three major themes are discussed:

- The complexity, the long time needed for the transfer and the hardships of the transfer process, which is supposed to be even more complex within family business (Miller et al, 2003).
- The focus on family succession in SME literature, research and policies (Howorth et al 2004). This seems odd, because only 30% of the transfers in the USA and an estimated 22% in The Netherlands are family successions.
- The endangered economic and employment capacities of SMEs after business transfers. One could argue with Dyck et al (2002) that change of ownership enhances the vitality and performance of SMEs and is an opportunity instead of crises.

These three themes are challenged by three independent and fresh studies. The first study is a HvU qualitative study on policymakers and consultants on problems and solutions with business transfer. The second study, a cross sectional ING survey among 1300 SMEs in The Netherlands, Belgium and Germany, deals with the success and development of SMEs after change of ownership. Finally the third study, a longitudinal EIM panel study of 100 transferred SMEs, looked into turnover, productivity, innovation and number of employees after transfer.

## **PERSPECTIVES ON BUSINESS TRANSFERS**

### **Introduction**

The aim of the HvU study is to get a clear picture on perspectives of policymakers and consultants on business transfer. Do policymakers and consultants have a shared vision on the main problems and solutions? There is reason to believe that different parties have different perspectives. Le Breton-Miller et al(2003) show striking differences in perspective between consultants/practitioners and theoretical and empirical articles from researchers/scientist. Consultants systematically give more attention to process and contextual variables. Does this apply in the Dutch situation?

And what is the average time of succession or transfer? Many authors agree on a lengthy preparation and a 5 year period or longer is recommend (Morris et al, 1997; Kommers & van Engelenburg 2003; Sharma et al, 2003; Le Breton-Miller et al 2004).

Sharma et al (2001) indicate that the business owner inability of letting go is the single most cited obstacle to effective succession. Kommers & van Engelenburg (2003) also mention the psychological aspect as the most decisive, but offer no suggestion or solution. How do different parties in The Netherlands deal with the emotional aspects of the entrepreneur passing on his business? We like to know this because research has shown that emotional aspect leads to indecisiveness and delays transfer (Landsberg, 1999; Flören, 2002).

### **Method**

15 senior officials were interviewed. They have strategic or leading positions representing the largest SME employers' umbrella organisations, the dominant government agencies, main research centres, major firms of business consultancy and one major bank. The interviews were held during the spring of 2004.

### **INSERT TABLE 1**

To prevent bias from dominant themes in theory and research the interviewers had no prior knowledge of the subject and worked with a set of open questions to start the conversation. The answers were categorised before having a scheme (van Teeffelen, 2004). Statements were not necessarily mentioned by all members of a category. In our overview we left out the bank because we had only one observation and no reference material.

To compare the answer with the EC expert report (2002) we selected Kommers & van Engelenburg (2003). They translated and deepened this report for the Dutch situation.

## Results

### INSERT TABLE 2

It is clear that Kommers & van Engelenburg categorisation is comprehensive. Lack of (financial) knowledge seems a common denominator. However they overlook factors as “finding buyers”, “insufficient buyers financial knowledge or resources” and “staff” as main problems. And surprisingly the complex legislation and procedures wasn’t seen as a main problem by any party.

The transfer time of 5 years was countered by the researchers and the business consultants. Researchers say it is done within a year. Business consultants stress that 6 – 12 months is the average time when owners are committed to transfer. All necessary steps can be taken in this period.

Only researchers and business consultants mention the emotional factor as a main problem. Especially business consultants and employers’ organisations are expected to have the ability to deal with this factor. They answer however that it’s not their business or they don’t deal with it.

Clearly researchers tend to focus on the owners side. Business consultants, as well as the employers’ organisations and government agencies, take more stakeholders into account like the buyers and staff. This confirms Le Breton-Millers et al findings that consultants have a broader perspective than researcher.

Staff of SMEs is considered as a major stakeholder by nearly all parties. Le Breton-Miller et al don’t mention this variable.

Researchers and government agencies see the importance of planning and preparations. Typically business consultants don’t mention this as an important problem. This is contrary to the findings of Le Breton-Miller et al The methods most business consultants use in our sample (question 5) account for our findings. After a few interviews they set out a plan with the business owner. If the business owner postpones necessary steps, business consultants tend to advice the owner to make up his mind and pause or even stop the assignment when this doesn’t happen. Most business consultants work partly or largely on commission and their financial interest is in a short transfer time.

Looking at the suggestions/solutions we can see that Kommers & van Engelenburg recommendations are shared by government agencies. They tend to focus on the proper conditions for the business owner and less on the business owners own attitude. Employers’ organisations and researchers disagree with their suggestions and focus more on the attitude and skills of the business owner and tax legislation for buyers/successors. Government agencies and business consultants are clearly service oriented but also have their own agenda. The government agencies offer advice but at the same time have to generate more proof of well spend money in

times state budgets are reduced. The business consultants don't like competition from government agencies.

## **Conclusion and discussion**

Our objective was to compare perspectives from policymakers and consultants in the field of business succession. Our small sample is common for qualitative research. By choosing persons on key positions, we tried to get valid information. We can't rule out personal opinions though. Triangulation with peers, colleagues in the same organisation and a somewhat larger sample would have strengthened the validity.

Within our sample there are shared perspectives: finding buyers, the lack of (financial) knowledge or financial buyers resources, staff as important stakeholder are main problems mentioned by most parties. Complex (tax) legislation and procedures is not mentioned as a major problem. And the transfer time is limited to 6 – 12 months or unknown.

There are also differences in foci. The results confirm Le Breton-Millers findings that consultants have a broader perspective than researchers. Researchers focus only on the owner, consultants involve staff, buyers and match making variables. This broader perspective is not unique. It is shared by employers' organisations and government agencies.

At the same time our results contradict Le Bretons-Millers findings. Researchers (and government agencies) instead of business consultants emphasis on planning and preparation. Business consultants prevent this problem by their methods and commission payment. National differences in routines and payment might account for this contradiction. Also a new stakeholder emerges: staff in SMEs.

Surprisingly all parties shy away from the emotional aspects, except for a specialised foundation. SME business owners experiencing a major transition in their professional and private situation seem a neglected group. Partly this could be explained by the attitude most SME business owners have towards external consultants in The Netherlands. They tend to be reluctant to involve external consultants in general, but for accountants (Silvius, 2003). The commission system of business consultants works out well for business owners in this respect. Also the considerable time involved (Reece, 2003) in coaching works against a short transfer time. And finally business consultants, having a financial or economical background, might lack the skills to coach business owners properly.

## **CHANGE OF OWNERSHIP: BETTER BUSINESS RESULTS IN THREE EU REGIONS**

### **Introduction**

The main purpose of the ING study (Geerts et al, 2004) is to understand developments in companies after the change of ownership. Change of ownership is defined as the transfer of the ownership of a company to one or more individuals or to another company who plan to continue the commercial activity of the enterprise. Does a change of ownership in fact give a new lease of life to companies in the SME sector? And what is the influence of the type of change - family

succession, management-buy-out (MBO), management-buy-in (MBI), takeover, merger - in this respect on success after transfer? And does family succession create more difficulties than other transfers?

Against the background of an ageing population and the fact that entrepreneurs are far less inclined than formerly to tie themselves to the same company for life the number of business transfers will increase further in the coming years. The number of companies transfers in the Netherlands, Flanders and Germany amounts to 100,000 (European Commission 2002). At the same time the ratio of business transfers within families to transfers to outsiders is declining. The share of family successions declined in the Netherlands from an average of 35% between 1994 and 1999 to an estimated 22% in 2003 (Kommers & van Engelenburg, 2003). Interestingly, the number of business transfers within the family still is significantly higher in Germany 50% of the total (IfM 2003). There are no further details for Belgium.

## **Method**

The study is based on the results of a large-scale telephone survey of the new owners of 1300 companies that changed hands in the last ten years in three regions, the Netherlands, former West Germany and Flanders. The research has been conducted using a random stratified sample, with stratification concerning sector and number of employees. The companies were either active in the business services sector or the manufacturing industry. With respect to company size we distinguished 5 groups (1-10, 10-50, 50-100, 100-200 and 200-250 employees). Within these groups the selection of respondents was at random. This approach produces homogeneous groups of companies which allows for a good comparison between the regions. The survey covers only companies that were still in business. This might create a bias. The gross sample was about 4.800 respondents, so the non response to the questionnaire was around 70%. The reasons for non cooperation were refusal to participate in research as company policy, the absence of the right respondent and the preference for written questionnaires. The survey was conducted during fall 2003

## **Results**

In the Netherlands and Flanders growth of turnover turns out to be the most important goal for the acquirer. Improving product/market-combinations is the most often mentioned goal in Germany. The type of transfer has an effect on the ambitions of acquiring parties. Family successors are often relatively less interested in growth and more in continuity. To gain insight in the relation between the ambition level (in terms of goals) and degree of success after the change of ownership we split up the sample in three groups; leaders, middling companies and laggards. The criteria used for ranking the respondents were first growth of turnover, then profit growth and then growth of the customer base.

Interestingly in the Netherlands and Flanders the decision to acquire a company with growth potential (starting from a loss-making situation of otherwise relatively inferior starting condition) positively affects the success of the change of ownership. In Germany no relation was found between starting condition and success.

The use of consultants by the acquiring parties differs from 83% in Germany, to 91% in Flanders and 94% in the Netherlands. While there was no relationship between the use of consultants and success in the Netherlands, there seems a positive relationship between the use of consultants and securing a place in the group of leaders in Flanders and Germany.

#### INSERT TABLE 3

Even the widespread use of consultants cannot prevent acquirers from encountering problems during the transfers. On average two third of all transfers meets difficulties. The most common problems in all three regions are financing difficulties and problems with the staff and culture. Legal regulations were hardly mentioned. This confirms our findings about staff as important stakeholder in transfers and legislations as minor problem in our prior quantitative study.

Especially entrepreneurs involved in an MBO or an MBI experience financing as a major problem. The rate of entrepreneurs with problems is lowest for family successors; the majority does not encounter any problems (especially in Flanders). The family successor has usually worked in the company and is familiar with all the ins and outs (culture) and normally has a good relationship with the former owner. This contradicts the assumption of many authors reviewed by Le Breton-Miller et al, 2004 that family transfers are more complex and difficult.

#### INSERT TABLE 4

Despite the difficulties experienced, the results achieved give cause for optimism. In the majority of cases the companies achieved growth in turnover, profits and new customers. With respect to employment the picture is less clear cut. The organisational restructuring after the acquisition often leads to a leaner organisation in the years close to the transfer.

Right after the transfer of ownership, around 80% the acquiring parties set their stamp on the organisation by implementing their new plans. In line with the low degree of appearance of problems, family successors tend to be more conservative and take less action than their counterparts. The actions taken by new owners of all categories mostly concerned the organisational structure, the (employability of) staff and the quality of products and services offered. We found that leaders show a far greater inclination to make changes than laggards.

Looking at the types of change of ownership on the basis of their results after the acquisition, we find that family successions and mergers are not in the group of leaders in any of the regions.

#### INSERT TABLE 5

### **Conclusion**

Our goal was to get informed on the developments in companies after a transfer of ownership. In our quantitative research we did not test on significance, but with these large amounts of observations even a small difference is likely to be significant.

The results for the three regions show that the intentions of the entrepreneur and his ability to implement fast changes in the company is the decisive factor behind the success of a business

acquisition. The ambitions stated in the goals of the entrepreneur already set the tone for the results. The use of consultants is widespread. In Flanders and Germany the use of consultants is positively related to success. In the Netherlands there is no relation.

Albeit that a majority of the acquiring parties is confronted with problems – for buyers financing, staff & culture, but no legislation - this does not stop them from becoming successful. Leaders do not encounter fewer problems than laggards. A vast majority of the new owners takes immediate action to improve the organisation, the personnel and the quality of products and services. Ultimately the efforts of new owners lead to more sales, profits and customers in most companies.

Family succession leads to a smoother transfer, most of them with no problems.

The ultimate breakdown between leaders, middling companies and laggards is interesting. When family companies remain in the family the percentage of leaders is clearly lower than when the acquirer does not come from within the family (MBOs, MBIs, mergers and takeovers). An important reason seems to be that in the case of acquisitions within the family the focus is overwhelmingly on the continuity of the company. This emerges from the answers received from family-owned companies in the three countries. The results show that after the business is transferred the family-owned companies often fall into the group of laggards (Germany and Flanders) or are among the middling companies (Netherlands).

## **PERFORMANCE AND PERFORMANCE INDICATORS AFTER TRANSFER**

### **Introduction**

The EIM-study investigates the consequences of business transfer on business performance (Meijaard and Uhlaner, 2005). Our objective in this study has been twofold: identify the performance of recently transferred firms, and to identify the determinants of the success of business transfers.

Success can have several dimensions. First of all, the survival of the firm is the ultimate success factor. Continuity of the business is a necessary condition for the transfer to be successful. Secondly, success may be determined by the degree to which different stakeholders are satisfied with the business transfer. The satisfaction with the business transfer corresponds to possible changes in the commitment to the business and the motivation of the different stakeholders to continue the business (Sharma et al, 2003). The third aspect is the success in terms of profits, sales and growth. Note that the subjective measure of success (the satisfaction with the transfer) and the objective measure of success (changes in firm performance) can yield very different results. For example, a business transfer that results in increased profits need not be perceived as satisfactory by all stakeholders.

### **Method**

The results are based on the analysis of a sample of 100 business transfers that occurred in the period 1998-2003. Data were available on the firms both before and after the business transfer.

For these specific firms we have a balanced panel of data between 1998 and 2004. Detailed financial data are available, because the firms participate in a survey based panel maintained under the commission of the Dutch Ministry of Economic Affairs.

## Results

In this section we discuss the results of the analysis of performance between 1998 and 2003 for the various firms. To improve readability the numbers of the estimates have been omitted and replaced by signs (95% confidence) and double signs (99% confidence). A 'sign' means significant difference from zero.

### INSERT TABLE 6

Firstly, employment in transferred firms shows a negative development. Apparently, in the first few years of new leadership jobs and employment are reconsidered. 1999 appears in this context to be an (coincidental) exception, probably due to the growth in the overall economy.

### INSERT TABLE 7

In terms of sales growth, business transfers show a positive effect, at least in the short run. In the longer run, the effect remain to be positive, but fading.

### INSERT TABLE 8

Sales per employee (a measure of productivity) grows in the years after business transfer. Line of reasoning in this respect may be that the new entrepreneur manages to take away the most clear productive inefficiencies. More work can be done with less employees, but gaining new customers is a bit more problematic. The new entrepreneur manages to give the firm new youth.

### INSERT TABLE 9

The profit to sales ratio does not develop as positively after the business transfer. The entrepreneur has to make investments in restructurings, strategic refocusing and innovation, which lowers profits.

### INSERT TABLE 10

Most interestingly, the *innovativeness* of the firms clearly grows in the first years after the business transfer. Next to employment, sales and the other business processes will be tackled. Suboptimal and path-dependent imperfections may be taken away by the new management. Overall the revived innovation efforts are substantial.

### INSERT TABLE 11

Based on a linear regression analysis of factors influencing performance, it is clear that education, management experience and management training show positive effects on the success of business transfers. A written succession plan and planning in general deliver positive

results as well. Furthermore, such preparation decreases the negative employment effects of the business transfers. Contrarily, the use of external consultants in the transfer process has negative consequences on performance.

Notably business transfer within the family gives zero or negative effects on sales and productivity. This corroborates our ING findings that family transfers don't belong to the leaders in growth and turnover.

#### INSERT TABLE 12

In comparison to “regular” business start ups, recently transferred firms create less jobs, but they are much more productive and innovative (cf. Bosma et al, 2000). The better surviving rate of transfers approximately 96% (European Commission, 2002), compared to the start-ups of only 50% in five years (Kommers & van Engelenburg, 2003) secures employment better in transferred businesses.

### **Conclusion and discussion**

In conclusion, the dynamics in terms of business performance around the occurrence of business transfers appears to have positive, rationalizing and innovative effects.

Turnover, productivity and innovativeness increases. Employment and the profit to sales ratio don't develop as positively. The entrepreneur has to make investments in restructurings, strategic refocusing and innovation, which lowers profits and staff.

Even compared to start ups transfers lead to more productivity and innovation, less but more secure employment.

These results correspond to earlier studies into the development of productivity in small firms (Verhoeven, 2002, 2004; van Dijken et al, 1996). The business transition is accompanied by a rise in productivity. Growth of sales can be combined with a reduction in employment. Willard et al (1992), Huergo and Jaumandreu (2002), Bangma et al (2000) found similar patterns in the innovativeness and performance of firms. Also our ING study corroborates these findings.

From this sample alone, it is premature to conclude that business transfer within the family should be discouraged. But together with the ING study it indicates that family transfers are less favourable for economy. It is feasible that the effects are quite different in the long run. Nevertheless the results are notable.

### **CONCLUSIONS, DISCUSSION AND RECOMMENDATIONS**

This paper wanted to challenge the gloomy scenarios and typical assumptions in research on business succession in small and medium-sized firms. Our studies confirm Dyck et al (2002) that succession is a strategic opportunity instead of crises and even suggest it is a blessing to economy.

Our two quantitative studies indicate that business transfers have positive effects on turnover, innovations and productivity, but leads to less employment. The ING study shows increased profits. This could not be corroborated by the EIM study financial data which have been collected for many years. Since the ING sample is 13 times bigger, the EIM study might show a bias. On the other hand the EIM study is more focused and did not rely on ex post accounts on profits. Also transfers seem to have advantages over start-ups. They are more innovative, have better productivity and a much better survival rate, which secures employment.

Family succession might be less favourable for economic development. In our studies family transfers tend to under perform, although the transfers process itself is without the complications non-family successors witness.

From the ING and EIM study it shows that the consultants' role has a neutral or even negative effect on the business success after the transfer in The Netherlands. This might indicate a different style of working per nation, because in Belgium and Germany it was beneficial to success after transfer. We know from our qualitative study that the Dutch consultants seldom facilitate the emotional process. The Dutch business consultants may have a fine eye to pick out business owners who have made up their mind yet. Hence, the relative short period they report on the complete transfer process. Possibly there is also a correlation between the a priori performance of the firm and the use of external consultants in the business transfer process.

The complexity, the long time needed for the transfer and the hardships of the transfer process are set in a different light. Both the HvU and ING study indicate that there seems to be a shared perspective on problems of business transfer: finding buyers, the lack of (financial) knowledge or financial resources for buyers and staff as and important stakeholder. Complex (tax) legislation and procedures are not mentioned as a major problem.

There are also differences in foci. Le Breton-Millers findings are confirmed that consultants have a broader perspective than researchers. But at the same time business consultants put no emphasis on planning and preparation, which contradicts Le Breton-Miller. They solve this problem by their work methods and payment on commission. Instead researchers and government agencies stress the importance of planning en preparation. Not only business consultants but all other parties shy away from the emotional aspects. Not addressing the emotional aspects is known to delay the transfer process (Landsberg, 1999; Flören, 2002).

Given the revitalising capacities of business transfers to economy, policy attention seems all the more important. We like to highlight five aspects:

1. Build awareness regarding the revitalising capacities of business transfers to economy and its advantages over start-ups.
2. Stimulate transfer (planning) outside the family and research for non-family takeover models.
3. Improve general knowledge for buyers and sellers.
  - a) This could be done by connecting databases, marketplaces and work methods of business consultants. Improvements at the national level have priority (coupling various databases).

- b) It could be useful to create national and European standards for the information provided in such databases, including financial performance, client satisfaction and network ratings (of business consultants).
- 4. Provide and promote a national program or training which deals with the emotional barriers for succession for sellers to overcome unnecessary delay.
- 5. Improve financial knowledge for sellers and buyers and capital conditions for buyers. This could be done by:
  - a) Improving abilities for buyers and sellers to look into several scenarios to finance the transfers.
  - b) Stimulating banks to provide new entrepreneurs with the capital needed for business transfers. Survival rates are great.
  - c) Alleviating barriers to bring in venture capital for transfers and enable shared risk bearing.

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Table 1 Participating organisations and questions

| <b>Employers' Organisations</b> | <b>Government Agencies</b>   | <b>Research Centers</b>                          | <b>Business Consultant</b>                               | <b>Finance</b> |
|---------------------------------|------------------------------|--|--|----------------|
| MKB Nederland                   | Ministry of Economic Affairs | Nijenrode University, Center for Family Business | KPMG Corporate Finance                                   | ING Bank       |
| AWVN, VNO/NCW-member            | Chamber of Commerce          | EIM Business and Policy Research                 | MKBase   |                |
|                                 | Synthens                     | Tilburg University                               | Troostwijk Introman                                      |                |
|                                 |                              | Erasmus University                               | Single operating consultant<br>Foundation The Succession |                |

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1. What are the main issues regarding business succession?
2. Which factors do account for difficulties regarding business succession?
3. Do you have suggestions or solutions to overcome this difficulties?
4. How do you deal with the emotional aspects of the transfer?
5. Which methods do you use for business transfers (only asked at business consultants)

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Table 2: Succession times, main problems, solutions and results

| <b>Parties</b><br><b>Themes</b>          | <b>EC report</b><br><b>(Kommers)</b>   | <b>Employers'</b><br><b>organizations</b>   | <b>Government</b><br><b>agencies</b>  | <b>SME</b><br><b>Researchers</b>  | <b>Business</b><br><b>Consultants</b>   |
|--|--|---|---|---|---|
| <b>Transfer time</b>                     | 5 years required   | Unknown   | Unknown   | 1 year found  | 6-12 months usual   |
| <b>Main problems</b>                     | <p>Lack of owners (financial) knowledge</p> <p>Lack of owners and buyers preparation</p> <p>Delay in owners decision on emotional grounds</p> <p>Scattered information and advice</p> <p>Implementing many business changes in the process of and after transfer</p> <p>Complex (tax) legislation and procedures</p> <p>No prior experience with selling</p> | <p>Buyers financial resources</p> <p>Buyers dependency on banks</p> <p>Underestimating staff's knowledge</p> <p>Lack of entrepreneurship in general</p> | <p>Finding buyers</p> <p>Lack of owners and buyers knowledge</p> <p>Lack of advice for owner</p> <p>Neglecting staff's as source of innovations</p>   | <p>No owners awareness of business value</p> <p>Lack of owners planning/preparation</p> <p>Emotional owner attachments, disrupting the transfer process</p> <p>No culture of selling one's business</p> <p>Risk avoiding behavior</p> | <p>Finding buyers</p> <p>Unrealistic expectation of value and selling price</p> <p>Letting go of the business</p> <p>Match making: a detached second at negotiations</p> <p>No acceptance of the new owner by staff</p> |
| <b>Suggestions or possible solutions</b> | <p>Integrated advice</p> <p>Tax reforms for owners</p> <p>Platforms for buyers and sellers</p> <p>Systematic research</p>  | <p>Leave it to the owners. No extra policies are needed, except for:</p> <p>Tax changes for buyers</p>  | <p>Offer advice and a platform for business owners by our agencies.</p> <p>Research on effects of different approaches to improve, substantiate and evaluate our policies and advisory services</p> | <p>Better planning</p>  | <p>Offer some free advice in first interviews or meetings.</p> <p>Leave it to the market and to us.</p> <p>No interference of government agencies.</p>  |
| <b>Dealing with emotional aspects</b>    | <p>No solutions or suggestions given, whereas it is considered as the most decisive factor</p>   | <p>Not our job, it's for psychologists. The the owner has to find his own way.</p>  | <p>We don't address them</p>  | <p>We know it's an issue but we don't really deal with it</p>   | <p>Not our job (except for one specialized foundation).</p> <p>The owner has to make up his own mind.</p>   |

Table 3 Major problems

|                          |                 | <b>Netherlands</b> | <b>Flanders</b> | <b>Germany</b> |
|--------------------------|-----------------|--------------------|-----------------|----------------|
| <b>Family succession</b> | No problem      | 53%                | 70%             | 63%            |
|                          | Financing       | 36%                | 16%             | 19%            |
| <b>MBO</b>               | Financing       | 47%                | 60%             | 29%            |
| <b>MBI</b>               | Financing       | 46%                | 39%             | 29%            |
|                          | Staff & Culture | 17%                | 0%              | 25%            |
| <b>Takeover</b>          | Staff & Culture | 29%                | 31%             | 20%            |
|                          | Financing       | 26%                | 27%             | 11%            |
| <b>Merger</b>            | Staff & Culture | 37%                | 31%             | 48%            |
|                          | Financing       | 14%                | 19%             | 4%             |

Source: ING Economics Department

Table 4 Result by Region

|                               | <b>Netherlands</b> | <b>Flanders</b> | <b>Germany</b> |
|-------------------------------|--------------------|-----------------|----------------|
| Turnover (greatly) increased  | 65%                | 69%             | 59%            |
| Number of customers increased | 68%                | 59%             | 58%            |
| Profit increased              | 58%                | 63%             | 62%            |
| Employment increased          | 43%                | 40%             | 31%            |

Source: ING Economics Department

Table 5 Leaders, Middling companies and Laggards

|                    | <b>Netherlands</b> | <b>Flanders</b>                | <b>Germany</b>              |
|--------------------|--------------------|--------------------------------|-----------------------------|
| Leaders            | MBI, Acquisition   | MBO                            | Acquisition                 |
| Middling companies | Family succession  | MBI, Merger                    | Merger                      |
| Laggards           | MBO, Merger        | Family succession, Acquisition | Family succession, MBO, MBI |

Table 6 Changes in employment

|  | 1999 | 2000 | 2001 | 2002 | 2003 |
|--|------|------|------|------|------|
| Year of transfer                       |      |      |      |      |      |
| 1998                                   | -    | 0    | 0    | 0    | -    |
| 1999                                   | +    | +    | 0    | -    | -    |
| 2000                                   | +    | 0    | -    | +    | +    |
| 2001                                   | +    | 0    | --   | -    | 0    |
| 2002                                   | +    | +    | 0    | --   | -    |
| 2003                                   | +    | 0    | 0    | 0    | 0    |
| Non-transferred firms (as a benchmark) | +    | 0    | 0    | 0    | 0    |

Table 7 Changes in real sales

|  | 1999 | 2000 | 2001 | 2002 | 2003 |
|--|------|------|------|------|------|
| Year of transfer                       |      |      |      |      |      |
| 1998                                   | +    | +    | +    | 0    | +    |
| 1999                                   | ++   | 0    | +    | +    | +    |
| 2000                                   | +    | 0    | 0    | 0    | +    |
| 2001                                   | +    | 0    | +    | +    | +    |
| 2002                                   | +    | 0    | 0    | 0    | 0    |
| 2003                                   | 0    | -    | 0    | 0    | +    |
| Non-transferred firms (as a benchmark) | +    | 0    | 0    | 0    | +    |

Table 8 Changes in productivity (real sales per employee)

|  | 1999 | 2000 | 2001 | 2002 | 2003 |
|--|------|------|------|------|------|
| 1998                                   | +    | 0    | 0    | 0    | +    |
| 1999                                   | ++   | -    | 0    | +    | +    |
| 2000                                   | +    | 0    | +    | -    | ++   |
| 2001                                   | +    | 0    | ++   | 0    | -    |
| 2002                                   | +    | -    | -    | +    | ++   |
| 2003                                   | 0    | -    | -    | 0    | +    |
| Non-transferred firms (as a benchmark) | +    | -    | -    | -    | 0    |

Table 9 Profit to sales ratio's

| Year of transfer                       | 2001<br>(compared to 1999) | 2003<br>(compared to 2001) |
|--|----------------------------|----------------------------|
| 1998                                   | 0                          | 0                          |
| 1999                                   | 0                          | 0                          |
| 2000                                   | --                         | 0                          |
| 2001                                   | --                         | -                          |
| 2002                                   | 0                          | -                          |
| 2003                                   | +                          | 0                          |
| Non-transferred firms (as a benchmark) | 0                          | 0                          |

Table 10 Changes in innovativeness

| Year of transfer                       | 2001 | 2002 | 2003 |
|--|------|------|------|
| 1998                                   | 0    | 0    | 0    |
| 1999                                   | 0    | 0    | 0    |
| 2000                                   | +    | 0    | 0    |
| 2001                                   | +    | +    | 0    |
| 2002                                   | -    | +    | +    |
| 2003                                   | -    | 0    | +    |
| Non-transferred firms (as a benchmark) | -    | 0    | 0    |

Table 11 Linear regressions: firm features on business performance

|  | dln(sales) | dln(employment) | dln(sales/<br>employee.) |
|--|------------|-----------------|--------------------------|
| Constante                                  | +          | 0               | +                        |
| Education                                  | +          | -               | 0                        |
| Experience                                 | +          | --              | ++                       |
| Management training                        | 0          | -               | +(LT)                    |
| Insider (more than 5 years in the company) | +(LT)      | 0               | -                        |
| Written business plan                      | ++         | +               | -(LT)                    |
| External consultants                       | -          | +               | -                        |
| Intensity of Transfer Planning             | +          | 0               | +/-                      |
| Family owned (> 50%)                       | 0          | -               | -(LT)                    |
| Ln size                                    | 0          | -               | 0                        |
| Ln age                                     | 0          | 0               | 0                        |
| Dummy Only transfer of leadership          | 0          | 0               | 0                        |
| Dummy Full ownership                       | 0          | 0               | 0                        |
| Dummy Forced transfer                      | +          | 0               | 0                        |

Based on separate regressions year-by-year. Effects occur 1 or 2 years after transfer, unless in brackets (LT) is included. In that case the effects occur after 3-4 years. N=20-40 per transfer year. R<sup>2</sup> is typically between 0.30 - 0.60 for each of the regressions. F-statistics for full regressions are always clearly significant.

Table 12 Performance of start-ups and transfers in the first years

|  | Start-ups | Transfers |
|--|-----------|-----------|
| Employment                             | 0         | -         |
| Turnover                               | +         | ++        |
| Productivity (real sales per employee) | -         | ++        |
| Profit per sales                       | +         | -         |
| Innovativeness                         | 0         | +         |

## WHEN THEY GO TOGETHER: ALLIANCES IMPLEMENTING BY THAI FIRMS

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### Abstract

Following the specialized literature, strategic alliances should be considered as an alternative mechanism to the traditional modes of organization that could improve business' performance under certain conditions. That is the reason why this paper has studied the implementation of strategic alliances by Thai firms, focusing on the relation among the behavior of partners, the governance structure and the satisfaction outcome of firms participating in them.

Regarding the theoretical framework, this relation has been developed integrating the Transaction Cost Theory (TCT), the Property Rights Theory (PRT), and the Transactional Value Theory (TVT). Based on this framework we wonder if collaborative alliances (Joint Ownerships - JOs) were more likely to be effective as the governance form when collaborations were highly complex in terms of uncertainty, whereas Separate Ownerships (SOs) were preferred when the level of trust was high between partners. We can also analyze if SOs were more likely to be selected when the highest probability for opportunistic behavior was compensated by the expected future benefits and, finally, we can also identify the role that reciprocity and ex-ante investments in assets can play in the selection of the structure for organizing a strategic alliance.

The hypotheses were contrasted on the basis of a survey to 503 firms in industrial districts in Thailand. Logistic regression and ANOVA analysis results generally supported the model and hypotheses. From our perspective, one of the most interesting contributions is to prove that firm's satisfaction with alliances is independent of the implemented structure when this has been selected taking into account aspects from the TCT, the PRT, and the TVT; in other words, when the selection takes into account ex-ante investment aspects, trust, reciprocity and future benefits.

## 1. INTRODUCTION

In Thailand, the external and internal factors led the Thai economy to an economic crisis, have motivated Thai industries to look for new ways of adjusting their strategies to compete with their rivals and to survive, strategic alliance has been seen as an important tool by which Thai businesses could be enhanced. Consequently, nowadays the industries and the strategic alliances within firms relationships are addressed from a wide array of disciplines and perspectives. However, in regards to developing countries, studies are still very limited in number despite their valuable contribution to regional development and specially to the need to become globally competitive.

Therefore, the focus of this paper is on the exchange relationship between firms, the structure of allied firms, and the one that account for the satisfaction of firms that enjoy strategic alliance. This aspect will refer to this partner or the allied firm as competitors' and/or customers. Finally, the study will examine the level of satisfaction outcome, and the perception of the partner's behaviour, whereas most prior studies have examined only one or two elements in this complex relationship. As a whole, this paper tries to answer five important questions that are; how many firms are engaging in strategic alliance activity; which are the types of cooperative relationships are chosen; is this activity related to firm size?; how satisfied are the firms with their efforts and results; and how is the degree of satisfaction influenced by perceptions of partner behaviour?

To answer these research questions, we operationalized integrating the Transaction Cost Theory (TCT), the Property Rights Theory (PRT), and the Transactional Value Theory (TVT).

TCT views alliances as intermediate hybrid forms between the extremes of markets and hierarchy (Williamson, 1985) that occur when transaction costs associated with a specific exchange are too high for an arm's-length market exchange but not high enough to mandate vertical integration (Hennart, 1988). From this view, a major assumption of transaction cost theory (TCT) is the bounded rationality and opportunism of human behaviour. Bounded rationality means the human behaviour is rationally motivated but also limited. Opportunism refers to a lack of candor or honesty in transactions. TCT argues that given the interaction of bounded rationality and opportunism, the organization must choose between markets (external purchasing) and firms (internal production) for input or output of goods or services. Transaction costs represented in an organization's procurement of external resources can explain the organization's decision regarding their preferences for either hierarchies or markets (Wey & Gibson, 1991). TCT can be widely applied to studies focused on strategic alliances for example; the structuring aspect, the aspect of choosing governance structures, the aspect of motivation of firms to interorganization & international venture, and etc. Although, the literature has reviewed the wide advantages of TCT, limitations have also been found.

The property rights theory has criticized transaction cost for presenting some limitations: accurate predications about the structure of the collaboration arrangement, for example when there are R&D activities implied in the relationship are not fully accomplished. Transaction cost generally anticipates structures closer to hierarchy but some empirical studies have not found this relationship at all (Rialp & Salas, 2000; Rialp et. Al., 2001). In other words, TCE has emphasized the costs of using the market to govern exchange, but has not provided a rigorous explanation of the cost of the firm as a governance structure, in this case, PRT approach. TCT perspective is also limited in its ability to explain interorganizational strategies. For example, TCT's neglect of the interdependence between exchange partners, as shown in an analysis of the transaction approach to vertical integration, and TCT's

intellectual kinship to another branch of the industrial organization literature. In this case, that TVT could be used advantageously to explain the long-term relationship between partners. In order to accomplish our proposed objectives, this paper is organized into three sections, following this first section delineates the problem statements, while the second provides theory and hypothesis used. The last section addresses the empirical part and discusses the findings of this paper concludes by identifying practical implications and future research.

## **2. THEORETICAL MODELS**

Before presenting theoretical framework, It is necessary to point out the classification of governance forms. In this study governance forms can be classified in two main groups attending to how residual decision rights are allocated:

- Separated ownership: ownership of the assets is distributed among transacting parties. Each party participating possesses decision rights individually over some of the assets participating in the relationship. The degree of involvement among the parties is not always the same when the ownership is separated. When this degree is high, although the ownership remains separated, the parties can agree to establish penalties for certain behavior or explicit dispute resolution mechanisms. Therefore, we could consider separated ownership with and without safeguards. For example, Oxley (1997) distinguishes between “bilateral” (less safeguards) and “multilateral” (more safeguards) contracts.
- Joint ownership: each of the two or more transacting parties has veto power on the use of the assets. A 50 – 50 equity joint venture between two firms will be a form of joint ownership. In this case, the fact that a new firm is created suggests that the joint venture is substituted in the market by the hierarchy. Notice, however, that this governance form differs from that of pure hierarchy (hierarchical governance) because, in the later, assets on both sides of the transaction are owned by a single party; single ownership.

Obviously, this classification considers two groups of collaboration agreements. In the literature, it is possible to find many of examples of this (see, for example; Parkhe, 1993; Osborn & Baughn, 1990). This classification is considered objective and allows for clarity rather than confusion caused by terminology. Furthermore, it fits perfectly with the theoretical framework presented in the next section because, as a component, this framework contains the property right theory.

### **2.1 The Transaction Costs Theory**

The concept of Transaction Cost is prominent in strategy and organizational theory research, especially with regard to why firms diversify, engage in joint ventures and multinational alliances, buy goods and services in the open market, and rely on informal agreements in conducting business transactions (Monteverde & Teece, 1982a, 1982b; Walker & Weber, 1984; Palay, 1985; Masten et.al.,1989; Osborn & Baughn, 1990). Gomes & Casseres (1989, 1990), for example, used TC arguments to explain that multinational enterprises will use foreign direct investment when it is inefficient to transfer capabilities through contracts.

Transaction Costs Economics (Williamson, 1991, p. 277) considers that transactions could be governed by three generic governance structures: market, hybrid or hierarchy. In this study the term “hybrid” refers to “interfirm collaboration”, defined as any non transitory relation among independent companies involving exchange and/or sharing of resources and capabilities to obtain mutually beneficial outcomes.

One type of hybrid form (which can be considered closer to the market because it presents similar rules for acting (see Imai and Itami (1987)) is based on simple contracts. In fact, contract is addressed as a governance device limiting opportunism by either party (Hallen et al., 1991). However, as uncertainty increases, for example under the presence of resources specificities which create bilateral relationships, intense interdependencies and high coordination is needed, contracts have to be necessarily more incomplete and exit can not longer protect efficiently against ex-post bargaining and opportunism (Oxley, 1997).

On the other hand, opportunism is one of the behaviours of the parties that has a significant influence in the results obtained in the collaboration relationship. It is defined by Williamson (1979: 234) as self-interest seeking guile. That is, businesses and individuals will sometimes seek to exploit a situation to their own advantage. Opportunism extends the conventional assumption that economic agents are guided by considerations of self-interest, to make allowance for strategic behaviour. As we have mentioned before, the behaviour of opportunism could vary depending on the form of contract chosen. When the likelihood of opportunistic behaviour is higher, a simple contract cannot be the most efficient structure for managing the relationship.

Consistent with these assumptions about opportunism, when contracts can no longer protect efficiently against ex-post bargaining and opportunism, one alternative for firms is to rely on some “voice” mechanism to induce the parties to participate in the transaction. Joint ownership, that could imply the creation of a new firm, includes voice rights and, at the same time, rights over residual income, so some alignment between individual and collective interests is also achieved. With joint ownership the likelihood of more complex collaboration being completed (those with a higher likelihood of opportunistic behaviour) increases (Kogut, 1988; Osborn and Baughn, 1990; Gulati and Singh, 1998). Therefore:

*H1: Joint ownership as a governance structure is likely to be more effective as a governance form when collaborations are highly complex in terms of uncertainty, resources specificities, interdependencies, opportunism behaviour, etc. (in other words: where incentive problems and coordination needs are highly severe).*

Low complexity implies that the attributes of the transaction are such that prices are sufficient statistics to guide adjustment and coordination, and individual incentives are compatible with global efficiency. A Contract is an efficient mechanism for organizing the relationship. The introduction of Joint Ownership would imply the use of resources to perform coordination, supervise activities and measure inputs or outputs (visible hand).

### **2.1.1 Role of reputation and trust**

One possibility open to an alliance partner is to rely on the record of its counterpart's cumulative past behaviour as a guide to future behaviour, or to use reputation as a proxy for knowledge of opportunistic intentions. Parkhe (1993) stated in his study that actors will try to avoid entering an exchange with another actor who has a questionable reputation and, if avoidance is not viable, they will demand that the potentially opportunistic party absorb bonding costs when they enter into an exchange with them. In addition, the other actors will have to bear monitoring costs in order to detect opportunism. The bonding and monitoring costs will absorb much of the expected benefit from the alliance, so that “the value created by exchanges involving actors of questionable reputation is significantly reduced by the need to set up safeguards to limit opportunism” (Hill, 1990: 505, emphasis in original). Nevertheless, frequently, information on a potential partner's past behaviour does not exist in the public

domain. Thus, in an environment of questionable reputation, or in the absence of any reputation at all, the design of appropriate governance structures should be a function of the perceived probability of opportunism.

Another possibility is trust. The term trust has widely varying connotations (Luhmann, 1979; Barber, 1983; and Gambetta, 1988). Doney et. al. (1998) stated that trust is a valuable contributor to many forms of exchange. In interfirm relationships, researchers credit trust with lowering transaction costs in more uncertain environments (Dore, 1983; Noordewier, John, & Nevin, 1990), thereby providing firms with a source of competitive advantage (Barney & Hansen, 1994). Trust also facilitates long term relationships between firms (Ganesan, 1994; Ring & Van de Ven, 1992) and it has been considered an important component in the success of strategic alliances (Browning, Beyer, & Shetler, 1995; Gulati, 1995).

Nooteboom (2001) claimed trust is neglected in the assumption that in the governance of relations we need to safeguard against opportunistic behaviour. Moreover, if opportunities for opportunism cannot be eliminated, one can aim to reduce inclinations to utilize such opportunities by reducing the incentives to do so in the governance form of relational contracting. Each governance form implies alternative ways of solving the coordination and incentive problems, different amounts of explicit resources employed in such solutions, and different residual or opportunity losses. The contribution of transaction costs and dimensions of the different governance forms, such that a reduced cost function can be identified relating transaction costs and attributes of the transaction, for each possible governance forms (Rialp & Salas, 2000). Consistent with these interpretations it is proposed that:

*H2: Joint ownership is less likely as a governance structure if the firm trust in its partner.*

In this paper, Trust as “a type of expectation that alleviates the fear that one’s exchange partner will act opportunistically” (Bradach & Eccles, 1989; and Gulati, 1995). Trust itself can be difficult to observed and measured. We agree with Gulati (1995) in using a factor that is likely to produce trust as its proxy, this factor could be prior alliances between the firms (Zucker, 1986).

### **2.1.2 Reciprocity and its role in strategic alliance relationships**

Reciprocity implies that one is morally obligated to give something in return for something received (Ring & Van De Ven, 1992).

Mauss (1925) surfaced the concept of reciprocity through studies of primitive societies grounded in basic “give and take” obligations. Malinowski (1926) agreed that give and take was the basis for the entire social structure in such societies. Alliance theory expanded on these early works and suggested that reciprocal exchanges represent not only the foundation of human social structure, but also the fundamental quality of the human mind. For instance, Levi-Strauss (1949) proposed a hierarchy of goods/services to be exchanged for a balanced exchange achieved without deliberate calculation by either party. Part of the balance may be made up of intangibles, such as political and territorial rights and relative prestige (Leach, 1951).

This study conceives the concept of Gibson et al (1997) that reciprocity encompasses the alliance partners ability to demand an equal exchange as a safeguard against potential opportunism. When high levels of reciprocity are built into cooperative relationships, the “fear of possible retribution against those who engage in self serving and devious behaviour”

provides a strong guarantee against opportunistic behaviour. The guarantee of an equal exchange of both benefits and penalties, while reducing a participant's willingness to behave opportunistically, also reduces expectations of cost associated with such behaviour from a partner.

The reciprocity can have advantageous governance structure benefits. For these reasons, it is therefore proposed that:

*H3: When partners expect low levels of reciprocity in a cooperative relationship, joint ownership is more likely as the governance structure.*

## **2.2 Property Rights Theory**

The property rights approach can be understood as an attempt to formulate empirically meaningful optimization problems by associating the utility function with the individual decision maker and then introducing specific content into the function. The PR approach helps to understand the cost of ownership. Some point noted is that PR do not refer to relations between men and things but rather, to the sanctioned behavioral relations among men that arise from the existence of things and pertain to their use. Obviously, it can include: (a) the right to receive the residual after all other inputs have been paid their contractual amounts, (b) the right, however qualified, to terminate or revise the membership of the team (i.e., the possessor of these rights is a central party to a set of bilateral contracts), and (c) the right to sell those rights specified under (a) and (b) (Furubotn & Pejovich, 1972). Some literature (Hart & Moor, 1990) related to PR emphasizes that "ownership matters," where the rights of ownership of an asset take three parts: the right to use the asset, the right to appropriate returns from the asset, and the right to change the form and/or substance of an asset. Once the issue of property rights is clearly agreed and set, it is commonly assumed that asset utilization will thereafter track the purposes of its owners. This will obtain if (1) the legally sanctioned structure of property rights is respected and, (2) human agents discharge their jobs in accordance with instructions.

In this sense, Rialp & Salas (2000) explain why sometimes it is more efficient, for example, to keep ownership of non human assets separate among the different transacting parties than create a new firm with each partner holding 50 per cent of the shares (joint ownership/JO): separated ownership (SO) induces more investment in ex-ante specific human capital than JO. Generalizing this assumption, it is proposed that:

*H4: when one party has made important ex-ante investments in assets, inter-firm collaborations that imply Joint Ownership are less likely than those which keep ownership of assets separate among the collaborating parties.*

From the PRT perspective, therefore, joint ownership may be less attractive than SO at high levels of complexity (uncertainty and resource specificities). Consequently, in the case of joint ventures (a clear case of JO), we may have to weigh the potential benefits of introducing administrative systems, which help to solve coordination needs, against the direct costs of these systems and with the indirect costs due to the choice of an inefficient governance form, from the point of view of the allocation of ownership rights.

### **2.3 Transactional Value Theory: The Effect of The Net Value Gains**

Under the TVT the selection of the structure for developing a collaboration agreement is more a function of anticipated value gains rather than anticipated losses due to the cost of constraining opportunism. Moreover, the TV framework considers joint value maximization, rather than single-firm cost minimization, and the process by which exchange partners create and claim value. Therefore, under this approach, the crucial issue in a collaboration is not merely a single organization's concern for minimizing transaction costs, but rather both organizations' concern for knowing the partner's preferences as a basis for exchanging and mutual gain. The partners in one alliance would like to discover ways in which similarities or shared interests can be exploited to maximize cooperative joint gains that would accrue to both parties (Zajac & Olsen, 1993; Rialp et al., 2001).

This crucial issue of the TVT fits perfectly with the concept of forbearance, which occurs when a partner presented with the possibility to engage in opportunistic or self-interested behaviour, declines such action. Behaviour associated with forbearance primarily emerges when alliance partners take a long-term view of their relationships and believe that future gains from present cooperative behaviour outweighs the potential immediate gains of cheating (Gibson et al 1997).

In summary, the basic condition for forbearance (tacit collusion) to be sustained would be for each firm to perceive that the payoff for engaging in tacit collusion or forbearance is likely to be greater than what can be gained by reneging on an implicit agreement and that other firms share the same belief (Jayachandran, 1999). When a firm trusts its partner (it is sure that the partner would not engage in opportunistic behavior), such perceptions will not lead to a organizing the collaboration agreement through joint ownership structures. In the same sense, when a firm perceives that its party is decided to act in the spirit of cooperation, not cheating, and not withholding helpful action (Smith & Barclay, 1997), therefore it is displaying forbearance from opportunism, such structures are not needed. Therefore it is proposed that:

*H5: when incentive problems and coordination needs are highly severe joint ownership is less likely as a governance structure, if alliance partners take a long-term view of their relationship and believe that future gains from present cooperative behaviour outweigh the potential immediate gains of cheating.*

### **2.4 Structure of The Collaboration and Satisfaction**

This criteria could lead to a position far away from the structure that should be selected under the criteria of the TCT and/or PRT i.e selecting the most efficient structure (Rialp et al., 2001). As Zajac and Olsen (1993) and Stinchcombe (1985) show, the pursuit of greater joint value could require the use of governance structures that are less efficient from a transaction cost perspective.

However, it is convenient to say that although the TV approach represents another theoretical framework, it is consistent with the implicit intent of the TCT in some ways. Transaction costs are a subset of total costs to be aggregated and compared with the set of total benefits/gains in an overall calculation of the value of the collaboration. In this way, the second aspect related to the approach of the TV (to consider the process by which exchange partners create and claim value) becomes relevant, because it can result in a transformation that leads to greater expected net benefits for both parties (Rialp et al., 2002). That is the reason why it can be said that the TVT should be complementing the explanations of the TCT

and the PRT of the selected structure for developing a collaboration agreement, and, thinking about the objective of this dissertation, the overall theoretical framework allows for behavior, structure, and satisfaction to be related (see Figure 1).

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Figure 1 about here

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It follows, then, that the type of analysis required is one that considers how parties attempt to create and claim value within a relationship over time (Lax and Sebenius, 1986).

Once the individual firms establish which is the preferred structure considering the characteristic of the collaboration *per se*, the investments required and their relationship with previous investments made by the firm, the characteristics of its partner, its reputation, the possibility of trust and forbearance and the expected value that they see in the relationship (firms engage in the process of projecting exchange into the future (Macneil, 1983), and constructing net present valuations of alternative collaborations); the implementation of this structure will determine the behaviour of the firms in the collaboration process. In fact, the processing stage decreases conflict issues, defined here as the perceived divergence of interest (Pruitt and Rubin, 1986). As a consequence, there is not obstacle to value maximization what is increasing the likelihood of cooperative relationship over multiple rounds (Axelrod, 1984). Partners will feel a growing confidence in the expectations of the future, trust is being developed, and they can behave as if the expected value of interdependent activity were stable over the course of an uncertain future. In other words:

*H6: Satisfaction of the firm with the collaboration should be independent of the implemented structure if it has been selected taking into account aspects from the Transaction Cost Theory, the Property Rights Theory and the Transactional Value Theory.*

### **3. EMPIRICAL ANALYSIS**

#### **3.1 Sample selection**

In Thailand, there are 28 industrial districts under the industrial authority of Thailand. There are 2,136 firms who have the right to run their business on these industrial districts but only 1,327 firms have established businesses there. This research has considered all these firms in these industrial districts as units to be analyzed. Therefore, the units for this study consist of large, medium and small size domestic and foreign companies.

With the purpose of testing the questionnaire, 20 firms in the northern industrial district were personally interviewed by the researcher and 2 trainees. Once the questionnaire had been tested, 1,307 questionnaires were distributed to all the firms that exist in the industrial districts nationwide by mail. In total, 1,327 firms were interviewed.

However, a lot of questionnaires have not been mailed back (in these cases they were followed up again by phone). This study found that some firms did not pay any attention but some did. Finally the valid number of firms participating in our research is 503.

## 3.2 Variables

### Dependent Variable

The dependent variable is the governance form of the collaboration. The coding of this variable proceeds as follows:

- i) Separated Ownership (SO) = 0, when the collaboration is an Exchange Agreement
- ii) Joint Ownership (JO) = 1, when the collaboration involves a Joint Venture.

### Explanatory variables

Table 1 summarizes the explanatory variables initially considered for being used in the analysis and provides basic descriptive statistics for each of them.

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Table 1 about here

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The number of independent parties involved in the transaction will affect the complexity of such a transaction as the number of potential interactions, and therefore interdependencies among them, will increase with greater numbers. So, the number of partners is considered to have a positive influence on the coordination needs. Furthermore, the problems of measuring individual contributions to the collective action, which facilitate free riding behaviour (Alchian and Demsetz, 1972), will also likely to be increased. Therefore, it will increase the risks of expropriation, compared with those between two firms. So, it is possible to associate these observed attributes with higher degrees of opportunistic behaviour.

The possible opportunistic behaviour of the partner/s in the alliance was captured by using three variables. Thai firms were asked if:

- i) their partners seem to feel that to do anything within their means that will help further their organization's interest is acceptable,
- ii) their partners carry out their duties even if they do not check up on them and,
- iii) their partners have promised to do things without doing them later.

Other attributes affecting the complexity of the transaction is the realization of R&D activities (1), compared with the absence of such activities (0).

One condition that favor reputation and social pressure effects as sustainable of implicit contracts, are proxies by the variables nationality of the collaborating part. Social norms are more likely in culturally homogeneous social communities. Moreover, geographical proximity will facilitate the observation of the behavior of the partners and check whether such behavior is consistent or not with the premises. The partner nationality variable is divided in two categories: Foreign (0) or Domestic and Foreign partner (1).

Two variables that could be approximating the possible reciprocity and the Thai firm consideration of the value of the financial returns produced through the collaboration relationships. More precisely, Thai firms were asked:

- iv) if their partners were smaller, larger or the same size. It was considered that when firms participating in a collaboration agreement were the same size none of them was in a disadvantageous situation.

- v) an assessment, in a five position scale (from extremely poor to extremely good), of the financial returns produced by the firm's alliance relationships.

### Control

- *Economic Sector*

The Natural sources, Services, Basic Manufacturing and High Technology sectors are widely represented. It is acknowledged that patent protection differs across industries (Oxley, 1997; Gulati and Singh, 1998), so the legal system will protect to a different degree the interests of the parties depending upon the economic sector where the collaboration is developed.

- *Age of the Firm*

The age of the firm may have an influence on the firm's ability to learn about allied firms relationships and their behavior. Also Kale et.al. (2000) emphasized that it could be argued that the greater the duration of the alliance, the greater the learning would be from the alliance partner. At the same time, the longer duration would also increase the likelihood of losing proprietary assets to the partner firm. Audio et.al. (2000) suggested that older firms may have an experience advantage, or, alternatively, younger firms may have a higher capacity to take in new knowledge. This study, consistent with these researchers, includes the age of the firms as a control variable.

- *Firm Size*

The size of a firm can affect its market power and thus its ability to dominate the partners in an alliance. Because of this, large firms are likely to seek different types of characteristics than smaller firms in alliance partners. Although different proxies could be considered for capturing the size of the firm, the total number of employees or the revenues are the most common. Furthermore, total number of employees is often highly correlated with total annual revenue. Therefore, the number of employees as a control variable has been used in this research.

### **3.3 Methodology**

Logit model has used to test the hypotheses. Let  $x_i$  be the synthesis of a collaboration agreement  $i$  where:

$$x_i = \beta y_i + \epsilon_i$$

The vector  $y_i$  includes all the variables (proxies) representing opportunistic behavior (together with possible control terms); the vector  $\beta$  includes the weights attached to each variable representing such opportunistic behavior; and  $\epsilon_i$  is the error term.

The theoretical model assumes that the unobservable variable  $x_i$  determines the choice of one governance form as it falls in one of the following discrete intervals:

- i) If  $x_i < \mu_0$ , Separated Ownership (=0) is selected
- ii) If  $\mu_0 \leq x_i$ , Joint Ownership (=1) is selected

The logit statistical analysis estimates the vector of parameters  $\beta$  taking into account the observed characteristics of the collaboration  $y_i$ . It assumes that the underlying probability distribution of  $\epsilon_i$  is normal. The logit choice model provides statistical methodology which is based upon the comparison of the utilities associated with each of the alternative governance forms, given a vector of the collaboration's characteristics. In probabilistic form, the model is expressed as follows:

$$P_{ij} = P(G = j / y_i) = e^{\alpha_j y_i} / \sum_k e^{\alpha_k y_i}$$

Where  $P_{ij}$  is the probability that collaboration  $i$  is governed by structure  $j$ ,  $j = 0, 1$ ;  $\alpha_j$  is a vector of coefficients which determine the impact of the explanatory variables on the probability that each of the governance forms will be selected. The variation of  $\alpha_j$  across governance forms is consistent with the assumption that the utilities are different for each of them.

To estimate the coefficient  $\alpha_j$  the utility of one of the alternatives is used as a normalization value. In this case, the alternative will be the Separated Ownership. Therefore, the parameters of the other alternatives have to be interpreted in reference to the omitted one. A particular value of one estimated coefficient  $\alpha_{ij}$ , indicates the extent to which the attribute  $l$  of the collaboration contributes to the utility of governance alternative  $j = 1$ , beyond the contribution that this attribute would have in determining the utility of the base option, Separated Ownership. If the base option for comparison is Separated Ownership, then it should be expected that the likelihood of choosing the other governance form different from the base option at lower levels of opportunism decreases. At the same time, the likelihood of choosing Joint Ownership compared with Separated Ownership, as opportunistic behavior increases, should increase; therefore,  $\alpha_l > 0$  is expected.

### 3.4 Results

The statistical package SPSS was used for the estimation. Table 2 presents the final explanatory variables considered in the analysis and their relationships with the hypotheses established in the previous section. Based on the previous comments about the content of the variables, the sign of the effect of the variable indicating if the probability of implementing Joint Ownership instead of Separated Ownership increases or decreases, is also indicated.

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Table 2 about here

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Three variables related to opportunistic behavior and reciprocity were measured in the Likert scale of seven positions. Basically, each respondent was asked to indicate the extent to which he/she disagreed or agreed with the given statement, such that 1 = Very Strongly Disagree and 7 = Very Strongly Agree.

When multiple-item scales are used to measure latent constructs and a composite score based on these items could be used in further analyses, it is important to assess the validity and reliability of the scales used (Gerbing and Anderson, 1988). Selection of scale items on the basis of prior literature, fieldwork, and pretesting of the survey instrument helped ensure content and face validity. Therefore, to assess scale reliability, Cronbach Alpha<sup>1</sup> was computed.

In fact, the three items measuring partners' opportunistic behavior presented a Cronbach Alpha equal to 0.676. Nunnally (1967) pointed out that the minimally acceptable reliability

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<sup>1</sup> Cronbach's Alpha is a generalized measure of the internal consistency of a multi-item scale and it has become one of the foundations of measurement theory. Moreover, it is a generalized intraclass correlation coefficient, so it can be derived from the theory of true and error scores, as well as from the domain sampling model (Peterson, 1994). With these reasons coefficient alpha has been used as the measure of choice for estimating the reliability of a multi-item scale in this study.

for preliminary research should be in the range of 0.5 to 0.6 and these should be well above the cut-off value of 0.7 in each case (Nunnally, 1978; Peterson, 1994; Rialp, 2003). Therefore, it can be confirmed that the three items are referred to the same construct: opportunistic behavior of the partner. To avoid colineality problems in the logistic regression it is assumed that the variable representing “if Thai firms’ partners seem to feel that to do anything within their means that will help further their organization’s interest is acceptable”, will be the one reflecting the opportunistic behavior in the model.

To capture the idea of opportunism, avoiding colineality problems in the model, two variables are considered enough: number of partners and R&D activity. The coefficients of both variables are expected with a positive sign (H1).

Nevertheless, the presence of R&D activities are also being used for contrasting H4. For those firms collaborating in R&D activities, there are person embodied specific human capital investments. The theory predicts that separated ownership of physical assets would be more efficient than joint ownership. Therefore, a negative sign would be expected for the estimated coefficient of this variable finding evidence in favour of H4 formulated from the theory of the boundaries of the firm based in the property rights approach.

In fact, the results show, in the first column of Table 3, is partially confirmed. Therefore, Joint Ownership seems to be preferred over Separated Ownership as having more possibilities of observing opportunistic behavior<sup>2</sup>. This paper has just referred partially confirmed because the coefficient of “Number of Partners” is not statistically significant, so the variable does not seem to significantly affect the level of coordination problems, according to the data. However, in the line of H1, the positive coefficient ( $\hat{\beta}_{R\&D} = 3.45$ ) for the variable measuring the presence of R&D activities in the collaboration is obtained. Consistent with this hypothesis, the estimated coefficient means that those collaborations performing R&D activities imply a relatively high level of coordination problems compared with those which do not perform this type of activity, and consequently they also have a higher likelihood of incorporating hierarchical controls. On the other hand, this positive sign allows us to reject H4. In other words, this H4 cannot be supported as no significant relationship was found

Considering the estimated coefficients of the control variables, the probability of Joint Ownership in High-tech sector is significantly higher than in sectors related to Natural Sources and Basic Manufacturing.

On the other hand, for younger firms, Joint Ownership is less likely to be implemented than Separated Ownership.

Finally, considering the size, larger firms implement structures related to Joint Ownership, more than smaller firms.

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Table 3 about here

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The logit model is estimated to incorporate the idea of trust affecting the choice of the governance form, H2 (second column<sup>3</sup> of Table 3). When the alliance is established with a

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<sup>2</sup> In other words: with more interdependencies, uncertainty, resources specificities and measurement problems.

<sup>3</sup> To estimate this second model, the control variable indicating the sector has not been added because it is related to the nationality of the partner/s participating in the collaboration agreement.

domestic partner or, at least, another domestic partner participates, JO structure is less likely to be selected, as it was supposed in H2. Firms seem to be more reluctant to choose SO with non-domestic partners, which would be consistent with this prediction that cultural, social and physical proximity are conditions which restrict opportunistic behavior because it is more likely to have social pressure from norms, and reputation is more valuable.

In the third column of Table 3, the model considering reciprocity, H3 has been estimated. In fact, the estimated coefficient for the variable measuring the reciprocity deviates from the prediction: being in a disadvantageous situation has a negative and significant coefficient. As a consequence, SO structures are preferred rather than JO when partners expect low levels of reciprocity in a cooperative relationship.

Finally, the idea related to forbearance, H5, is added into the model. The fourth column of Table 3 presents the model including the consideration of financial results as independent variable. The estimated coefficient for the variable measuring the financial returns is negative and significant. Therefore, SO structures are preferred rather than JO when benefits are considered.

Furthermore, the last column of Table 3 looks at the issue of possible complementarities between future value of the collaboration and opportunism. It appears that future results and technological activities increase the likelihood of SO. So this evidence reinforces H5.

Analyzing the global usefulness of the different estimated models, the last three models (Model 3,4,5) present the best results. More precisely, the fourth model achieves the best classification rate: globally 92.6% of the structures are well classified and this percentage is divided into 98.3% if we focus on SO and 90,4% when we talk about JO.

It can be answered that these results allow us to defend the theoretical model considering the TCT, the PRT and the TVT as a good theoretical framework for analyzing the selection of structures for implementing collaboration agreements. In the next section an attempt will be made to relate empirically the selected structure with the satisfaction.

#### Satisfaction with the implemented structure

Satisfaction was measured by three items. We used five Likert scales to measure, which each respondent was asked to indicate the extent to which he/she disagreed or agreed with a given statement, such that 1 = Extremely Poor and 5 = Extremely Good. The three items measuring partners' satisfaction present a Cronbach Alpha equal to 0.7418 (a value above the cut-off value of 0.7 - Nunnally, 1967, 1978; Peterson, 1994; Rialp, 2003). Therefore, it can be confirmed that the three items are referred to the same construct: satisfaction of Thai firms with their collaboration agreements.

With the aim of obtaining a measure of satisfaction, these three variables were summarized in just one new dimension applying factor analysis<sup>4</sup>. The eigenvalue of the new dimension is equal to 2.024 and the percentage of variance this new dimension explains of the initial three variables is 67.47%.

The assumption is that satisfaction with collaboration agreements must be independent of the structure of the agreement if the structure has been selected considering possible opportunistic behavior, property rights' aspects, trust, reciprocity and the possible benefit related to the collaboration. H6 is confirmed with the data (See Table 4).

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<sup>4</sup> Although the number of variables is low, the KMO and Bartlett's Test of Sphericity allows this kind of analysis to be made (KMO=0.45; Sig Bartlett's Test < 0.01).

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Table 4 about here

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It can now be summarized here that hypotheses 1, 2, 5, and 6 were found to support these relationships and in the expected direction, while hypotheses 3 and 4 were not significant and were rejected.

#### **4. DISCUSSION AND CONCLUSION**

We have been written with the purpose to integrate the TCT, the PRT related to the boundaries of the firm, and the TVT to explain the choice of a governance form in interfirm collaborations. It is believed that this theoretical framework clarifies the costs of introducing what have been called hierarchical controls, and considers the value of the net benefits in the selection of the structure.

Logistic regression analysis results generally supported the model and hypotheses, suggesting the need for a greater focus on the TCT, the PRT, and the TVT to study the relationship of partners' behaviour, governance structure, and satisfaction of allied firms. Specifically, this study found that collaborative alliances (JOs) were more likely to be effective as the governance form when collaborations were highly complex in terms of uncertainty, whereas SOs were preferred when the level of trust was high between partners. The findings also showed that SOs were more likely to be selected when the highest probability for opportunistic behavior was compensated by the expected future benefits. This study did not find a relationship between JO and reciprocity, therefore it could be predicted that SO was preferred over JO when firms expected low levels of reciprocity.

This section and the results obtained, although encouraging in terms of opening new avenues for empirical work on the boundaries of the firm, have limitations due mainly to the nature of the data. The information relating to the collaborations is quite limited both in terms of the actual features of the selected governance form and in terms of the attributes which are identified as sources of complexity in the transaction. This difficulty is often recognized in the literature, Oxley (1997, p. 391), nevertheless it is important to recall it and introduce some caution into the conclusions. However, this paper hopes that the preliminary evidences presented in this sector will encourage future efforts to collect more data and verify the robustness of the results. Despite these limitations, this study contributes to understanding the satisfaction that firms can experience when they decide to participate in collaboration agreements. Specifically, this study suggests that the partners satisfaction with the alliance will depend on the characteristics of the partners themselves and other factors associated with the relationship. This study considers that, the relationship between satisfaction and the structure of the strategic alliance should not be directly analyzed because the structure is endogenous to the characteristics of the alliance. Based on these characteristics, the structure is selected. Therefore, no relationship can be obtained between one concrete structure and satisfaction.

This is a particularly interesting result because in light of all the programs available to help firms to establish Joint Ventures, for example, perhaps they are motivating the failure of the relationship between the parties because that structure is not the most appropriate for that relationship.

As a whole, it is possible to say that this study will enhance the current knowledge of strategic alliances in developing countries and the results can be useful for scholars who are interested in this field, and entrepreneurs will be able to apply this information to their business strategies.

## 5. FUTURE RESEARCH

Although the analyses in this research generally confirmed the hypotheses tested, and thus may provide a good starting point, there is definite conceptual and practical merit in moving towards testing more complex theories involving unanswered, deeper questions about causality. For example, how is trust between Thai firms and foreign firms generated inside a collaboration agreement? There are many other resources of the firms that have not been explored here, for example, the effect of human capital, and social capital. Godfrey & Hill (1995) argued that the best way to cope with unobservable in theory is “to focus on observable variables that determine the degree of unobservability of a rare and valuable resource”.

Future research could significantly raise the level of theory development in alliance structures by going beyond correlational analyses to path analysis and causal modelling that may permit a deeper understanding of the causal structure of relationships among crucial variables in interfirm cooperation. Moreover, as reviewed in many studies (e.g. Grant, 1996; Mehra, 1996; Miller & Shamsie, 1996) the theory, *resource-based view* (RBV) theory has been proposed to account for the emergence of strategic alliances as well as their operation. Some theorists (for example; Amit & Schoemaker (1993); Roth (1995; 1996); Mehra, (1996)) suggest that the RBV of strategic alliances could be a very interesting research avenue. This study believes that its application to strategic alliances is under-explored in the literature even though such alliances are rapidly increasing in importance in today’s competitive landscape (Doz & Hamel, 1989; Das & Teng, 2000). However, the application of the RBVs perspective to strategic alliances covers only limited aspects (e.g. Rouse & Daellenbach, 1999). Therefore, an aspect that could be very interesting to analyse is the possible integration of the RBVs perspective in theoretical framework.

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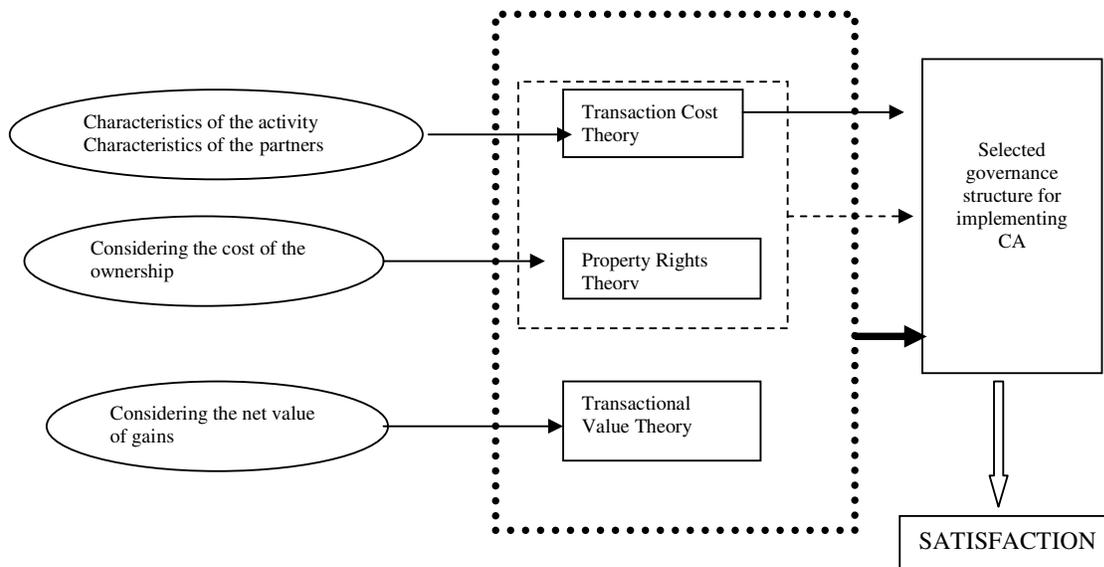
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## APPENDIX

**Figure 1. Theoretical framework**



Source: Own elaboration

**Table 1. Descriptive Statistics of the Variables (a)**

| Variable  | %    | Mean | Standard Deviation |
|---|------|------|--------------------|
| Kind of activity (%)  |      |      |                    |
| 0. Other kind   | 41.7 |      |                    |
| 1. R+D  | 58.3 |      |                    |
| Number of partners  |      |      |                    |
| 0.2 partners  | 41.2 |      |                    |
| 1. More than 2  | 58.8 |      |                    |
| Partner seems to feel that to do anything within their means that will help further their organization's interest is acceptable |      | 4.42 | 1.44               |
| Partner has promised to do things without doing them later sometimes  |      | 3.76 | 1.404              |
| Carry out their duties even if we do not check up   |      | 4.09 | 1.625              |
| Nationality (%)   |      |      |                    |
| 0. Foreign  | 47.1 |      |                    |
| 1. Domestic or domestic and foreign   | 52.9 |      |                    |
| Reciprocity   |      |      |                    |
| 0. No disadvantageous situation   | 42.1 |      |                    |
| 1. Disadvantageous situation  | 57.9 |      |                    |
| Financial returns produced by firm's alliance relationships   |      | 3.43 | 0.611              |
| Sector (%)  |      |      |                    |
| 1.Natural sources   | 11.9 |      |                    |
| 2.Services  | 6.4  |      |                    |
| 3.Basic Manufacturing   | 75.5 |      |                    |
| 4.High Technology   | 6.2  |      |                    |
| Age of the firm   |      |      |                    |
| 0. More than 10 years old   | 75.3 |      |                    |
| 1. Less or 10 years old   | 24.7 |      |                    |
| Size of the firm: number of employees   |      |      |                    |
| 1. 0-50   | 6.4  |      |                    |
| 2. 50-200   | 38.6 |      |                    |
| 3. 200-500  | 50.1 |      |                    |
| 4. >500   | 5.0  |      |                    |
| Total of firms  | 503  |      |                    |

**Table 2. Descriptive Statistics of the Variables (b)**

| Variable  | Hypothesis           |
|---|----------------------|
| Kind of activity (%)  | H1 , H4              |
| 0. Other kind   | +                    |
| 1. R+D  | -                    |
| Number of partners  | H1                   |
| 0.2 partners  | +                    |
| 1. More than 2  |                      |
| Nacionality (%)   | H2                   |
| 0. Foreign  | -                    |
| 1. Domestic or domestic and foreign                         |                      |
| Reciprocity   | H3                   |
| 0. No disadvantageous situation                             | +                    |
| 1. Disadvantageous situation                                |                      |
| Financial returns produced by firm's alliance relationships | H5                   |
|   | -                    |
| Sector (%)  | H4                   |
| 1.Natural sources   | -                    |
| 2.Services  | -                    |
| 3.Basic Manufacturing                                       | -                    |
| 4.High Technology   | (Reference category) |
| Age of the firm   | Control Variables    |
| 0. More than 10 years old                                   |                      |
| 1. Less or 10 years old                                     |                      |
| Size of the firm: number of employees                       |                      |
| 0. Less than 200  |                      |
| 1. 200 or more  |                      |

**Table 3. Logit Estimation of the Choice of Governance**

|   | Model 1              | Model 2               | Model 3               | Model 4               | Model 5              |
|---|----------------------|-----------------------|-----------------------|-----------------------|----------------------|
| Intercept   | 23.810<br>(34.819)   | 21.183<br>(22.457)    | 21.667<br>(16.613)    | 3.267<br>(25.411)     | 17.083<br>(26.361)   |
| Number of partners<br>(1 = More than 2)                             | -17.785<br>(34.794)  | -14.795<br>(22.394)   | -13.737<br>(16.511)   | -13.390<br>(1.149)    | -11.751<br>(26.333)  |
| R&D<br>(1 = R&D activity)   | 3.450***<br>(0.633)  | 5.718***<br>(1.17)    | 5.420***<br>(1.114)   | 3.944***<br>(1.149)   | 6.630***<br>(1.484)  |
| National<br>(1 = Domestic or domestic & foreign)                    |                      | -11.958***<br>(1.743) | -11.515***<br>(1.669) | -10.382***<br>(1.606) | -9.606***<br>(1.471) |
| Reciprocity<br>(1 = Disadvantage situation)                         |                      |                       | -1.702***<br>(0.597)  | -2.224***<br>(0.704)  | -2.176***<br>(0.715) |
| Financial returns produced by firm's<br>alliance relationships (s2) |                      |                       |                       | -2.704**<br>(1.274)   |                      |
| Interaction Opportunism & Future Value                              |                      |                       |                       |                       | -5.731***<br>(1.453) |
| Size (number of employees)<br>(1 = 200 or more)                     | 3.262***<br>(0.624)  | 2.144***<br>(0.696)   |                       |                       |                      |
| Firm age<br>(1 = Less or 10 years old)                              | -2.692***<br>(0.703) | -3.015<br>(0.783)     | -4.550***<br>(0.905)  | -2.609**<br>(1.295)   | -0.781<br>(1.367)    |
| Sector (reference = high technology)                                |                      |                       |                       |                       |                      |
| 1. Natural sources  | -4.648**<br>(2.031)  |                       |                       |                       |                      |
| 2. Services   | -14.145<br>(25.287)  |                       |                       |                       |                      |
| 3. Basic Manufacturing  | -9.326***<br>(1.393) |                       |                       |                       |                      |
| -2 Log. Likelihood  | 213.839              | 130.056               | 133.278               | 126.734               | 115.301              |
| Chi square  | 303.702***           | 387.485***            | 384.263***            | 390.807***            | 402.241***           |
| Cox & Snell R <sup>2</sup>  | 0.496                | 0.583                 | 0.58                  | 0.586                 | 0.597                |
| Nagelkerke R <sup>2</sup>   | 0.72                 | 0.846                 | 0.842                 | 0.851                 | 0.866                |
| Percentage correct classification                                   |                      |                       |                       |                       |                      |
| Overall   | 85.1                 | 92.3                  | 92.3                  | 92.6                  | 92.3                 |
| Separated Ownership   | 98.3                 | 99.2                  | 97.5                  | 98.3                  | 97.5                 |
| Joint Ownership   | 80.2                 | 89.8                  | 90.4                  | 90.4                  | 90.4                 |

Standard error in parenthesis.

\*Significance < 0.1; \*\* Significance < 0.05; \*\*\*Significance < 0.01.

**Table 4. Satisfaction comparison**

|                  | N   | Mean   | Std. Deviation | 95% C. I. for Mean |             | F     | Sig   |
|------------------|-----|--------|----------------|--------------------|-------------|-------|-------|
|                  |     |        |                | Lower Bound        | Upper Bound |       |       |
| Single Ownership | 120 | 0.036  | 0.633          | -0.078             | 0.150       | 1.729 | 0.189 |
| Joint Ownership  | 323 | -0.110 | 1.155          | -0.237             | 0.016       |       |       |
| Total            | 443 | -0.071 | 1.04           | -0.168             | 0.026       |       |       |

**DEVELOPMENT AND MAINTENANCE OF BOARD STRUCTURES AND  
PRACTICES IN SMALL TO MEDIUM SIZED FAMILY BUSINESSES: AN  
EXPLORATORY STUDY**

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**ABSTRACT**

This paper reports on an exploratory study of how Australian small to medium sized family businesses are approaching one key aspect of effective governance, namely the establishment and maintenance of functioning boards of directors. The research sample consists of a convenience sample of nine family business cases to represent a range of experiences with board formation and operation, and those with non-independent (family) directors and others which included non-family (independent) membership. From the study, it is suggested that advantages of established boards in the family business include: enhanced performance and compliance; providing reassurance to shareholders that there is an objective and professional

approach to the business and their assets; and augmenting management expertise by appointing people with complementary skills – usually, non-family non-executive directors. Disadvantages of formalised boards include: that they act as defacto management committees and more as mediating bodies to minimise tensions between family members; that owner/managers perceive that they will lose control of the business and flexibility of approach; and that the board function is considered a waste of time and money, especially where people – usually family members – are appointed without appropriate director's skills. In cases without established functioning boards, interviewees did not perceive that there were gaps in meeting their corporate responsibilities in terms of accountability to shareholders, setting strategic direction, monitoring of results or setting policy although interviews demonstrated that this perception may be incorrect.

# **DEVELOPMENT AND MAINTENANCE OF BOARD STRUCTURES AND PRACTICES IN SMALL TO MEDIUM SIZED FAMILY BUSINESSES: AN EXPLORATORY STUDY**

## **INTRODUCTION**

As long ago as 1948, Mace (cited in Castaldi and Wortman, 1984), claimed that the advice of members of boards was effective in widening the perspectives of managers of smaller firms and that outside directors with complementary experience and backgrounds could be helpful in complementing management's business capabilities. Few would argue against establishing board structures, systems and processes that facilitate outcomes such as effective and efficient work practices, harmony in work relationships, compliance and effective risk management, and the pursuit of shared objectives and values. Effective governance structures and practices, including boards of directors, can contribute to these outcomes, particularly in the small to medium enterprise (SME) sector (Zahra & Pearce, 1989; Lorsch, 1995).

In the legal corporate framework a board is the body charged with the responsibility for managing the company, which may include overseeing management where such responsibility has been delegated to a CEO or equivalent. However, corporate governance requirements for publicly listed companies are demanding and, partly as a result of recent corporate excesses, are undergoing reform in most developed economies. Governance requirements for the unlisted and smaller companies can be less stringent in some aspects. For example, the criteria for a directorship of an unlisted private company in Australia, are no

more than (i) to be over 18 years and (ii) not to have been declared a bankrupt, insane or have a criminal record.

It is becoming increasingly evident that many private companies, in striving to respond to a range of stakeholder interests and achieve success in a dynamic marketplace, will operate 'almost' as public companies and take on many of the more stringent protocols of corporate governance. Size, characteristics and structures of boards have been found to be important influences on the performance of large firms but the examination of their roles in SMEs has been less extensive and to date has not yielded such specific findings (Bennett & Robson, 2004).

While *formal* governance arrangements including the strategic planning, accountability, supervisory and monitoring responsibilities of boards of directors have received considerable attention in the research literature, *informal* governance mechanisms, including social interactions, family institutions, and shared visions, have received less attention (Mustakallio, Autio & Zahra, 2002, p 219). These informal mechanisms are particularly important for family owned small to medium enterprises.

Family members often play both managing and governing roles in the family business which, if not properly undertaken, may contribute to some blurring of governance responsibilities and relationships (Tagiuri & Davis, 1996). The extent to which the family and the business require separate but linked governance structures will depend on the effectiveness with which the family members are able to communicate with the business's governing body (such as a board). The family may consider it has adequate opportunity to communicate with the board both formally and informally through corporate and social forums. However, some

businesses – often, but not always, those with larger family shareholder numbers – find a separate family forum an effective interface between the family and the business.

Small to medium enterprises, most of which are family owned businesses, will benefit from effective governance practices and structures, particularly as they grow and as more family members become involved in the ownership and, in many cases, in the day to day management of the business. The unlisted family owned SME may choose to elect a board simply to comply with the law – in some cases, a single director board – however, those which elect a functioning board of directors may be rewarded with a smooth functioning company that excels in conformance and performance. A functioning board will facilitate the interests of both the ‘family’ and the ‘business’ ensuring that each is objectively considered and integrated into effective decision making.

This paper reports on an exploratory study of why some Australian family owned small to medium sized enterprises (SME) establish boards of directors and others do not, and if boards have been set up, whether the owners consider them to be valuable to their business.

## **BACKGROUND TO THE STUDY**

Family businesses are estimated to account for 80% of the number of worldwide business (Gersick et al, 1997). In Australia they are the largest employer group with about 3 million of the 5.5 million workforce, equating to over 50% of the private sector workforce (Smyrniotis et al 1997). While there is no single agreed definition of a family business, there is broad agreement that a business owned and managed by a family unit or their descendents is a family business (Chua et al, 1999). Accordingly, these figures are an indication of the

dominance of family owned businesses in world economies. As researchers become more attracted to undertaking empirical research in the family business arena, which has traditionally been perceived as being difficult to access (Litz, 1995), there is also an increasing interest in research about family business governance. Dyer (1986) highlighted the need for effective boards in family businesses and Ward (2001), deemed that the fundamental responsibility of successful ownership is effective governance. Hence, whether a family business is publicly listed or not, the complexities of the overlap between the family, ownership and the business inherent in the 'family business' entity, will be managed more effectively with a structured approach to governance issues, including the formation of a board of directors.

Drawing on agency theory, it is suggested that for the SME sized family business, the board may have a more important role than for larger businesses due to the wider information gap often prevalent between the owner/manager and the business stakeholders (Johannisson & Huse, 2000). Also, the board can be particularly useful in facilitating generational transitions in the family business: a time when the distribution of power needs clarifying and problem solving for the different generational groups is emotionally charged (Dyer, 1986).

An effective family business board is seen as one in which the advantages of family ownership can be balanced with the development of independent and professional governance practices:

“The (family business) board is elected by the shareholders and legally represents them in directing (the business). It typically comprises top management, family members, and, in the best cases, experienced business people from outside the

company. Ideally, a board will have a majority of independent, outside directors and will elect its own chairperson.” (Ward, 1988, p8).

Also according to Ward, for such boards to be effective in the family owned business, shareholders need to be prepared and educated for ownership roles and responsibilities. There is a need for mentoring and counselling those who may not have prior experience of governance issues, including the family member CEO, senior family and non-family management, family employees and other family shareholders not involved in the day to day management of the business (Ward, 2001).

The concept that a board should ideally include independent non-family directors has received considerable support recently. For example, Johannisson and Huse (2000), argue that the family business will be better served by incorporating external (non-family) members as they will create awareness of a wider range of managerial issues than would the family-only board members. Johannisson and Huse (2000) take this further by exploring the challenges of the *family owned* SME to attract and select the ‘right’ outside appointee/s for the board. In their view the emotions and politics of the family business may cause some degree of irrationality which may adversely influence the nature of board member selection in these businesses. They surmised that traditional defensive family businesses may be hesitant to invite external members onto a board whereas genuinely entrepreneurial firms may consider access to managerial competencies as just another resource to exploit when growth is aggressively promoted. The cases studied by Johannisson and Huse suggest that in practice the CEO, often a family member, made the final selection of independent directors and that decades of personal relations and ‘personal chemistry’ played an important role in the selection rather than the track record of the candidate. Berry and Perren (2001) support

this practice in finding that the appointment of non-executive directors should be made through sources trusted by the owner/managers. In their survey of over 5000 UK SMEs, they also found that non-executive directors were more likely to be appointed when the firm reached 50 employees.

Corbetta and Salvato (2004) take a contingency perspective and warn that boards in the family business will not lead to increased performance under all conditions because of the contingent situation created by family involvement. In their view:

“Family firms that explicitly take the extent and the quality of such involvement into consideration will develop boards of directors through which they will reap rewards by improving its effectiveness in providing both control and accountability, and resources which are vital to the firm’s prospects for success and survival.” (Corbetta & Salvato, 2004, p6)

Texts and treaties about the roles of boards of directors and their contribution to the governance of organisations abound. In one such publication Hilmer and Tricker (1994) summarise the work of boards as having four components: formulating strategy, setting policies, supervising executive management and providing accountability. Figure 1 (Hilmer & Tricker, 1994, p 287) depicts these responsibilities across four dimensions, internal/external (to differentiate between a focus on internal operations and on the external influences from the environment in which the firm exists) and long term/short term. This arrangement also enables the board’s contribution to the company’s performance through strategy formulation and policy making to be grouped on the right hand side, and its responsibility to ensure conformance to required results and maintenance of accountability to

the shareholders and other interested parties, to be grouped on the left hand side. While these dimensions have not been specifically developed for the SME sized business nor for the family owned business, they provide a useful framework for this study though which to explore how board functions are conceptualised in the family owned SME.

Cutting across all four dimensions is the board's responsibility for the selection of the chief executive and planning for his or her successor. The latter function is of particular interest in the family business which may or may not desire to have a family member in the position of chief executive. The challenges of appointing on merit, if this is the case, become complex.

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Figure 1 about here

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Boards of directors of family businesses are governance bodies that will both monitor management on behalf of shareholders and provide various resources to the business. (Corbetta and Salvato, 2004). Other roles performed by boards include ensuring legal and ethical conduct by the business and its employees (Lorsch 1995, Conger et al. 1998), and bringing ideas and perspectives of people from within the business and from outside it to contribute to more effective and responsive decision making (Gabrielsson & Winlund 2000). According to Gabrielsson and Winlund (2000, p314), "the main function of the board is considered to be its control role... (as it) is seen as a formal body for stakeholders or principals to control managerial behaviour". The board's involvement in the ratification and monitoring of decisions can make a significant difference to the development of the business. The board also acts as a service provider by giving valuable advice and networking opportunities for the management team through its accumulated knowledge and skills. These comments are directed at SMEs generally. However, in the family owned SME where

management and ownership often overlap, the monitoring body should ideally include independent directors and the board's service role can be invaluable in complementing scarce management resources.

In their research about boards in SMEs in the UK, Bennett and Robson (2004) highlight that the value provided by boards of directors in SMEs is difficult to identify and will depend on managerial needs and trading conditions often unique to each firm. They did not find any one board structure or system that could be offered as being more linked to better performance than another.

Fiegener et al's (2000) research about boards in small private firms in the USA proposed that CEOs of small private firms who have larger ownership stakes will tend to have smaller boards with more non-independent members in order to preserve their decision autonomy. While this proposition was generally supported by the research, they also found that in some cases, where there was more complex family/business overlap and greater potential for conflict between family and business needs, the CEO tended to expand the board numbers to accommodate greater family involvement in governance of the business. This was also the case when there was an imminent transition to the next generation of family management.

In summary, while there seems to be general agreement that functioning boards of directors will be helpful in some ways to small to medium sized family business, there is no single recommended composition, or agreement as to how boards will influence performance (including conformance) of the business. The focus of this study was therefore to explore why some family owned SMEs have established boards while others have not and whether

the boards added value to their business's operations. Where boards were not formalised, the objective was to explore how the usual governance responsibilities were undertaken.

## **RESEARCH DESIGN**

The study was necessarily qualitative as the focus was on why (or why not), family businesses established and maintained functioning boards of directors and, if so, how did this occur. A series of case studies were developed in which the emphasis was on the family business participant's attitudes to board formation and their perception of the importance of board function in the business. The study was based on one-to-one interviews with family and non-family executive and non-executive directors in family businesses. Family directors - executive or non-executive - are referred to as non-independent directors, while non-family directors are referred to as independent directors. A semi-structured interview guide was prepared to ensure interviews were on the one hand consistent, and on the other were flexible enough to probe specific aspects in the different cases. The following research questions were explored through the one-to-one interviews:

1. What are the current informal/formal board mechanisms in these family businesses?
2. Where a board of directors has been established, how is it structured?
  - a. What stimulated its formation and how does it currently operate?
  - b. Is the board considered to add value to the performance of the business?
  - c. What are the barriers to effective board function?
3. Where a formal board is not constituted, why is this so and how are governance requirements met in the family business?

Interviews were transcribed and qualitative software was used to organise data. Consistency of analysis was ensured by co-authors evaluating interviewee responses and comparing interpretations.

### **Research sample**

Data was collected through in-depth one-to-one interviews of ten family business directors across nine small to medium sized Australian family business cases (ie businesses with up to 200 employees) ranging from the first to the fifth generation of ownership and management (see Table 1). While family business cannot be viewed as an homogenous sector, for the cases in this study the family ownership stake was almost 100% providing the potential for strong family influence in the governance and the management of the business. In each case, there were family members in management positions and, in all but two cases, there were two generations involved in the business.

The ten interviewees across the nine cases included nine family members: eight family member CEOs/MDs, all of whom were non-independent directors, one non-independent non-executive director, and one independent director/chairman.

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Table One about here

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The following cameos outline the current board situation of the participating cases. Company names and details have been changed to protect confidentiality.

**Andersons** is a fifth generation family business owned by the fourth and fifth generations, and managed by a fifth generation cousin consortium. The board is active, includes non-executive directors from the family and from outside the family. The motivation for an active board stems from the third generation when the number of shareholders grew. The former fourth generation Chairman was instrumental in encouraging the board to include outside independent directors as he wanted some support for projects he thought would meet with resistance. Since then, independent directors have become an established part of the structured board which has non-independent directors nominated from four arms of the original founding family. The board includes non-independent executive and non-executive directors and independent directors with the non-independent directors being in the majority. The board is chaired by a non-independent director; it holds monthly meetings, focusing on reviewing sales results, marketing programs, employee issues, and bad debts. Any proposals for capital expenditure above \$50,000 require board consideration, along with any 'significant' proposed financial commitments.

**Boyds** is a fourth generation family business owned by a sibling partnership and managed by a third generation member, with fourth generation members working in the business. The board has only non-independent directors and is considered of nominal value to the business. It was constituted by the second generation owner who bequeathed the business to his five children. They are all still alive and attend board meetings, although in the view of the current CEO, none are very productive or have anything of value to add to board deliberations. The CEO would like to encourage

these now elderly directors to nominate qualified and knowledgeable representatives so the board may make a worthwhile contribution to the family business operations.

**Carmodys** is a third generation family business owned and managed by a second generation sibling partnership with third generation members working in the business. There is an active board with independent directors and an independent chairman. The board was formed by the owner /founder when the business was in its early stages and has been run almost as if it were a public company from its inception, paying attention to corporate governance requirements 'except for all the sub committees' (Interview transcript). Board membership includes non-independent sibling managers and independent directors and an independent chairman. There are equal numbers of non-independent and independent directors at present. Recently, the board considered its balance and agreed that it lacked an IT focus and headhunted a female board member to also partially redress the male dominance. That appointment was not successful as the appointee took too long to appreciate the particular business and industry environment to be able to make a meaningful contribution to the board's deliberations.

**Dawsons**, a fourth generation family business owned by a third generation former CEO and a sibling partnership, with the siblings managing the business. There is no active board as the third generation 'Chairman' fears loss of control with a formalised board and particularly doubts that any independent directors will understand their business sufficiently to make a contribution that would be worth the money it would cost to recruit 'him' (sic). He would rather meet around the kitchen table with his son and daughter. The sibling partnership is keen to establish a board in due course. In

their view, they are able to undertake the monitoring and supervisory roles of the board but miss out on the strategic focus and discipline that might be offered by a board.

**Howsons** is a second generation family business owned by a sibling partnership and managed by one of the second generation owners. There is an active board with non-independent and independent directors and an independent chairman. While this board is 'ideally' constituted according to the literature, it has some significant communication issues to address. The non-independent non-executive directors consider that the non-independent executive director (and CEO) is choosing the board members to suit his needs and they are not happy about the recent recruitment of the 'independent' chairman who in their view is a personal appointee of the CEO and not suitably qualified for the position.

**Kleemans** is a third generation family business owned by one second generation director together with a third generation sibling partnership, and is managed by a third generation member. The board was formed by the third generation CEO when his sibling resigned from the business and took much business knowledge with him. To avoid similar gaps in experience and competency, the third generation CEO formed a board with an independent chairman and he commented that the arrangement was working very well: "Before we had a board we relied heavily on our external accountant to advise us to 'comply with what we had to comply with'".

**Pauls** is a fourth generation family business owned by a third generation cousin consortium, managed by joint MD's from the third generation and including the

fourth generation in the management team. There is a board with non-independent directors and an independent chairman. The board acts more like a management team. “Certainly it does deal with the basic requirements of compliance and review of financials but even that, to a degree, I believe is compromised. I think our attention to risk management, to the organisational structure, to personnel, is all compromised . . .” (Non-independent non-executive director interviewee transcript)

**Smart**, a first generation family business, is owned and managed by a controlling owner with a board having an independent chairman. The board was formed when legal advisors suggested that to comply with various corporate regulations, a committee be formed for this relatively new business. The owner founder chose to form a board with an independent chairman who had (a) previous corporate experience and (b) an enquiring mind.

**Taylor's** is a second generation family business owned and managed by a controlling owner and employing a second generation family member. There is no active board. While the CEO is cognisant of the advantages of a board of directors, and considers directors could augment the range of expertise available to him in running the business, he is a sole owner/director so sees no immediate need.

Of the nine cases, seven had active boards of directors and all except one of these included independent non-executive directors. In all but one case, an independent director acted as chairman of the board. Two cases did not have formally constituted boards, one because it was owned and managed by an owner/founder/sole director, and the other because the third generation part owner refused to contemplate an actively functioning board. However,

performance of the boards varied and the perception of their value ranged from excellent to very poor.

## **IDENTIFIED CHALLENGES**

From an analysis and evaluation of the interview transcripts, several themes emerged which portray the key challenges experienced in the family business cases:

Motivations for formally establishing an active board

Perceived advantages in having a board

Perceived disadvantages in establishing a board

Board membership issues

Barriers to effective board operations

### **1 Motivations for Establishing Active Boards**

While the need for boards of directors to undertake responsibilities such as those articulated by Hilmer and Tricker (see Figure 1) was generally recognised and appreciated by interviewees, in this study several reasons for the board's existence *other than* carrying out those functions were identified. Reasons included: to reassure shareholders and other stakeholders (e.g. future buyers) that the business was solid; to cope with a particular crisis (including external crises and internal issues relating to family dynamics); and to help alleviate risks associated with the business that come with succession considerations, particularly if that succession might involve a family member.

## **2 Perceived Advantages of Boards**

Once boards were established, there were several perceived advantages identified for the family business including forcing the owner-manager to take time out of the day-to-day operations, enabling family owners to take a bird's-eye-view of the business, providing comfort or peace of mind for owner-managers that all aspects of the business are being actively addressed (“overcoming the nagging feeling that some things are being missed” Interviewee transcript), and facilitating better decisions because “more heads” are thinking about and discussing the business. Effective family business boards were also perceived as promoting a more professional relationship between family owner-managers and non-family management. A specific function was their delivery of objective appraisals of remuneration levels for family executives and thus avoiding another potential source of conflict between family members where relations may be already strained.

## **3 Perceived Disadvantages of Family Business Boards**

Reasons given for not setting up boards, or expressed disadvantages in their operation included that they are costly in time and money, that they would create additional work, that family owner/managers (and simultaneously, non-independent directors) were fearful of being judged naïve or ignorant – either by the other directors or by shareholders, that family owner/managers feared of becoming bogged down in bureaucracy and losing the ability to respond quickly.

Some expressed uncertainty about how to attract suitable (and willing) directors, were fearful of making a poor selection and not knowing what capabilities to look for or how to confirm

those capabilities. Fear was also expressed that independent directors might misuse sensitive company information.

#### **4 Issues of Board Membership**

All interviewees supported the inclusion of independent directors to ensure an external perspective is brought into the family business. However, these family business cases also commented on other roles of such appointees, which were necessitated because of the 'familiness' of the business. Independent directors were seen to be effective in minimising tensions between family members, as in the family business many family members were appointed directors almost solely because of their (or their close relatives') shareholding and they often lacked the qualifications needed to be effective as directors.

Independent directors were also advantageous in filling gaps in expertise and to encourage other board members to push the boundaries. However, they were often recruited because the family knew them, trusted them and could therefore agree upon the appointment. In no case was a rigorous, objective selection process articulated. Most often the appointees had been known to the family members for some time and they were comfortable with them as people and with their apparent potential to add to the board's expertise. Not having objective selection processes in place for the selection of directors from the beginning may be a weakness for family businesses, which leads them into stalemates over decisions on suitable board members and fuels any existing mistrust between family board members, in particular.

It was agreed in each case that independent directors, particularly those from outside the industry, add value by asking questions and forcing reflection on what might normally be

taken for granted. However, several interviewees suggested that care should be taken in recruitment to ensure that appointees from outside the industry would not take too much time to 'come up to speed' with the needs of the family business and the industry in which it operates.

## **5 Barriers to Effective Family Business Board Operations**

Boards in family businesses are sometimes set up for the wrong reasons, such as to provide representation for family groups or to fix management problems. In other situations, the role of a board is not respected and is viewed by some as an expense the company could do without.

While most family businesses prefer to structure their boards to give appropriate recognition to branches of the family, they need to fill those branch appointee board positions with appropriately qualified directors. Such appointees may be family or non family – and therefore non independent or independent – however, once appointed to the board, they are expected to act in the interests of the whole family business rather than to act in the interests of one branch of the family.

Family-only boards sometimes have operated for many years without paying attention to skill requirements with the result that those boards have acted more as management boards, mediating between family managers in the business. When an independent chairman is appointed to redress such a situation, much is expected of him or her to mediate between non-independent directors from different branches of the family, who do not necessarily have high

levels of trust between them. Such mediation is often beyond the scope of an independent chairman's role and will detract from effective board deliberations.

In only one case was appropriate training as a director an expectation, rather than a formal requirement, for ongoing board involvement. In another case a shareholders' agreement was being drafted to formalise such an expectation.

## **DISCUSSION AND IMPLICATIONS**

Overall, those businesses without functioning boards (two cases) or those with ineffective boards (three cases) could not be deemed to be satisfying the strategic role of governance nor adequately ensuring that the management team was monitoring the compliance of the company with laws and regulations. Two boards delegated decisions to the CEO/MD for employee matters, and appear to have, in effect, delegated much of their powers to the CEO/MD to run the business on a day-to-day basis. In such cases the governance responsibilities of the board cannot be assessed as being adequately discharged. These boards did not monitor general success measures (other than financial results). The boards had set little in the way of formal board policy, and have generally limited their monitoring role to that of financial results. Another board was acting as a defacto management committee and has had made little inroad to strategic issues.

In the less effective boards, compliance monitoring was not a focus of the board – instead there was reliance on external professional advisers (accounting, legal, OH&S) to ensure the companies operated appropriately in these areas, and was otherwise dealt with by management. Strategic planning for these firms was done in broad terms at the level of the

management teams, involving the CEO/MDs. There was a lack of formal board policy, but the CEO/MDs interviewed did not see this as a problem in the running of the businesses. These boards, as they operated, were not seen as covering the true governance roles other than financial oversight and considering specific expenditure proposals.

In the remaining four cases the functioning boards were perceived as being of value and each CEO/MD stated that they would indeed keep the boards going if they were given the choice. In three of these cases, there was a perceived lack of expertise (one in IT, one financial and one legal) which the CEO/MDs wanted to redress. However each of these boards were perceived as valuable in challenging executive management to think about their issues and decisions, and being good at identifying and asking unexpected questions. From time to time the boards had helped a great deal in deciding what to do on the bigger issues, including where these have related to family issues. In short, these boards have been functioning in each of the governance roles: setting direction, making policy and overseeing performance, with much of the decision making and implementation appropriately having been delegated to the CEO/MDs and executive team.

From the Hilmer and Tricker (1994) model of board roles, it could be argued that boards usually commence by identifying the key stakeholders of the organization, and where relevant, their relative order of importance. Having done that, the board's job is then to be clear about what these stakeholders define as success of the organization – how it is measured; what are the various aspects; which are the more important. In these family business cases, it was clear that family stakeholders were seen to be pivotal in the board's interactions, not always for the right reasons. The stated motivation for setting up boards revolved around family dynamics or the potential for dysfunctionality in some cases.

Membership comments focused on both the need to include a range of family appointees or the need to get non-family appointees to counteract the family dominance.

In this study there was less evidence of the board's role in setting standards and implementing strategies. The family business boards might well pay more attention to creating a framework for the management of the organization to undertake such roles, providing guidance and constraints on management. This would ensure an effective policy framework which would help clarify the relationship between board and management, which so often overlap in the family business. The family business boards would then periodically assess the progress of management against these plans and strategies, to identify where interventions (but not interference) need to occur, to best deliver the desired results.

## CONCLUSION

Overall, from this study, it appears that family owned SMEs that have set up functioning boards with appropriate board practices, appropriate appointees as independent directors, and have been serious about making the board function as a board, have found that those boards make a valuable contribution to the business. The experiences of these family businesses do not however suggest any one best way to constitute the board; various models have been shown to work, depending on the context. Setting up a board for the wrong reasons and without directors who are qualified to act as such, has generally led to unsatisfactory results.

While further research is needed before these findings can be generalised, this study suggests that *the way a board operates* and how it *ensures the competence of its members* should be important foci for advisors and trainers in the corporate governance field. Further research

might also explore how best to encourage more family owned SMEs to establish an effective board for the right reasons and to believe that the board will be a worthwhile investment rather than a wasted expense. Research could usefully identify the conditions under which boards could additionally add value to the family owned SME such as where trust is low between family members, the number of shareholders has increased with generational transfer, and/or information sharing is rare.

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|                 |   |  |
|-----------------|---|--|
| <b>External</b> | <p><i>Accountability</i></p> <p>Reporting to shareholders</p> <p>Ensuring statutes - regulatory compliance</p> <p>Reviewing audit reports</p>                     | <p><i>Strategic thinking</i></p> <p>Reviewing and initiating strategic analysis</p> <p>Formulating strategy</p> <p>Setting corporate direction</p>     |
| <b>Internal</b> | <p><i>Supervision</i></p> <p>Reviewing key executive performance</p> <p>Reviewing business results</p> <p>Monitoring budgetary control and corrective actions</p> | <p><i>Corporate policy</i></p> <p>Approving budgets</p> <p>Determining compensation policy for senior executives</p> <p>Creating corporate culture</p> |
|                 | <b>Short term</b>   | <b>Long term</b>   |

*Figure 1: Range of Board Functions (Source: Adapted from Hilmer and Tricker, 1994)*

**Table One: Profile of cases and interviewees**

| <i>Case</i>      | <i>Type of Business</i>                | <i>Generation of ownership/ Generations working in the business</i> | <i>Employee size (F/TE)</i> | <i>Interviewees</i> |                           |  |
|------------------|--|---|-----------------------------|---------------------|---------------------------|--|
|                  |  |   |                             | <i>Role</i>         | <i>Family/ non-family</i> | <i>Functioning Board [*indicates non-ex director included in membership]</i> |
| <i>Andersons</i> | Food and Beverage Production/Retailing | 4 & 5<br>5  | 110                         | CEO                 | F                         | Yes*   |
| <i>Boys</i>      | Printing                               | 2 & 3<br>3 & 4  | 140                         | CEO                 | F                         | Yes  |
| <i>Carmodys</i>  | Retailing and Distribution             | 2<br>2 & 3  | 500                         | MD                  | F                         | Yes*   |
| <i>Dawsons</i>   | Food Production and Retailing          | 3 & 4<br>4  | 120                         | CEO                 | F                         | No   |
| <i>Howsons</i>   | Financial Services                     | 2<br>2  | 170                         | MD                  | F                         | Yes*   |
| <i>Kleemans</i>  | Sales and Distribution (white goods)   | 2 & 3<br>3  | 45                          | CEO                 | F                         | Yes*   |
| <i>Pauls</i>     | Food & Beverage Production/Retailing   | 3&4<br>3&4  | 50                          | Non Ex Director     | F                         | Yes*   |
| <i>Smart</i>     | Media                                  | 1<br>1  | 4                           | MD                  | F                         | Yes*   |
| <i>Smart</i>     | Media                                  | 1<br>1  | 4                           | Chairman            | NF                        | Yes*   |
| <i>Taylor's</i>  | PR and Marketing                       | 1<br>1 & 2  | 12                          | MD                  | F                         | No   |

*THE INTRAPRENEURIAL REVOLUTION:  
NOW IS THE TIME FOR ACTION*

*by*

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## ***Introduction***

In order to survive economic downturns, disasters such as 9/11, and other unexpected crises, larger sized companies must develop an intrapreneurial process within their companies.

Intense competition, within the United States and globally, have put the pressure on traditional companies to diversify, increase productivity, and develop new lines of businesses and new products. Basically, the traditional culture is restrictive: follow instructions, no mistakes or failures, do not take initiative, stay within your own sandbox, and protect your rear end. An intrapreneurial culture supports entrepreneurial spirit with emphasis on creating, experimenting, taking responsibility and ownership.

However, without the CEO's commitment, a company will fail in attempts to be more intrapreneurial. It takes a leader in top management that understands the importance of an entrepreneurial spirit to the company's bottom line. As Hisrich and Peters have described in their book, Entrepreneurship, an intrapreneurial leader should have the following characteristics: understands the environment, visionary and flexible, creates management options, encourages teamwork and open discussion, builds a coalition of supports, and persists. Actually, intrapreneurship, as a term, is not new. About twenty years ago Norman Macrae, in an Economist article, stated that corporations, in trying alternative ways of doing things in competition within themselves, had resulted in a confederation of intrapreneurs. A break-through occurred in 1992 when The American Heritage Dictionary of the English Language added the word intrapreneur to its dictionary: "A person within a large corporation who takes direct responsibility for turning an idea into a profitable finished product through assertive risk-taking and innovation". Ian Hamilton-Fazy, in a 1984 Financial Times article developed the term intrapreneurialism "What has become known as intrapreneurialism, where people within the corporation acquire more adventurous small business outlooks." In 1985 Gifford Pinchott<sup>1</sup> coined the term *intrapreneurship* to describe entrepreneurial activity within the firm where individuals (intrapreneurs) champion new ideas from conception to complete profitable implementation.

## ***Now is the Time for Action***

The economic downturn in US and the world has necessitated cost cutting in many firms, and layoffs for many employees, which has indirectly precipitated the growth of entrepreneurial ventures. The rapid evolution of knowledge and technology has promoted the growth of high-tech startups. The increase in double income families has also supported entrepreneurship where one member can take up risky ventures with the support of a spouse. The US venture capital market has also fostered the growth of many

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<sup>1</sup> Gifford Pinchott, *Intrapreneuring* (New York: Harper & Row, 1985).

entrepreneurs from among the cash-strapped but passionate and motivated idea-rich individuals. This emphasis of entrepreneurship in the US has led corporations to encourage entrepreneurial activities within the company. Although most people look at entrepreneurship as an upstart against well-established bureaucratic policies, which cannot coexist peacefully, many researchers have also noted the growth of entrepreneurial ventures within the framework of an existing enterprise. This is what many researchers refer to as '*corporate entrepreneurship*' or '*intrapreneurship*'. Many companies like 3M, IBM, CISCO, ORACLE, Hewlett Packard, AT&T, GE have adopted entrepreneurship within their firms to explore new lines of businesses and boosted profitability through innovative processes. We believe that large corporations should not let go of this opportunity to become more intrapreneurial. A policy could be established, similar to 3M, which allows employees to work on their own creative ideas for at least 15% of their work time. This percentage could be higher or lower depending on the corporation's overall mission. Also, a corporation could develop intraprise competing teams to focus on a specific corporate goal or a needed improvement to an in-house process. Intrapreneurship involves creation of semiautonomous teams within an organization for leveraging the external and internal innovative developments, screening and assessing those new venture opportunities and nurturing the new ventures. Therefore intrapreneurship is incubative in nature and requires top-managerial-level commitment in order to survive and flourish. If an organization's structure and atmosphere does not encourage innovation, then intrapreneuring will probably not happen.

Over the past few years there has been a growing trend among corporations to adopt intrapreneurship (corporate entrepreneurship), as a strategy to leverage the innovative talent of employees, simultaneously enhancing competitiveness, augmenting profit margins and improving employee morale and retention. Although this formula seems very simple on paper, in reality it is difficult to implement, as it asks for radical changes in organizational framework and risk propensity. This desire towards corporate entrepreneurship has increased mainly for the following reasons:

1. The downturn in the world economy and stiff competition from rivals and small businesses. Dynamic innovation is now looked upon as a way to beat the competition, and thrive in uncertain market conditions.
2. Intrapreneurship is perceived as a way to avoid stagnation and decline.
3. The turnover of talented but frustrated and disenchanted employees due to the bureaucratic structure of an organization, and subsequent loss of intellectual know-how and potential loss of a promising business venture. This turnover is further intensified due to the rise in number, of venture capitalists, who are willing to take risks and invest in innovative projects as well as entrepreneurship's newly acquired appeal as a promising career.

One new business unit acquired space in its corporate headquarters. The key manager said, "By far the most profound lesson is how quickly you can create something good when you don't have the constraints of a legacy company and that comes from all angles: financial constraints, administrative constraints, and the 'that's how we've always done

it' constraints." Later this business unit or intrapreneurial enterprise (intraprise) became the mainstay of the corporation. One intrapreneur turned the leftovers of an internal abrasive-processing plant into a lucrative wire-saw business. Some intraprise projects could aim at improving certain current corporate processes from within, others could develop ideas into businesses, which sell, to the outside marketplace.

Some companies think they are operating as intrapreneurial corporations by merely dumping an idea into one of the corporation's venture divisions. The potential business becomes isolated and unable to use the resources of the mother company. Normally this results in failure. Most of the companies that set up like this in the 1980s and 1990s failed. We have analyzed and enumerated the traits of an entrepreneur and suggested ways to adopt intrapreneurship and reap its rewards.

Corporations need to take action to become more intrapreneurial because their good employees may get frustrated and leave. "The venture capital industry is producing 35 percent return on investment by taking frustrated R&D people and their rejected ideas out of large companies, and financing the commercialization of those ideas," states Gifford Pinchot, an intrapreneur expert. Therefore entrepreneurial attitudes and actions are necessary for firms of all sizes to prosper and flourish in the face of extreme competition.

### ***Traits of an 'Intrapreneur' and teamwork:***

It takes an entrepreneurial fire in the belly to start a business – and achieve success – and this fire is not readily available.<sup>2</sup> Although there is no definite way to find out if a person has the knack to be an entrepreneur, we do notice certain emotional and family traits in common among successful entrepreneurs. One of these attributes is that an entrepreneur essentially does not like to work for someone; he prefers to be his/her own boss. People who are successful at establishing their own company generally have had parents who worked for themselves, hence they had someone to look up to. Quite often these successful entrepreneurs have histories of being fired from their job due to unsatisfactory performance. Basically an entrepreneur is a person who can be effectively managed and motivated only by himself. He is generally very confident of his abilities and a risk taker, who does not worry too much about job security. Hence these types of people are often very indifferent about their personal finances. Thus they require some 'safety nets' to be able to experiment with their ideas and work towards their dream projects. Very often they have spouses who have secure source of income, so they are able to take risks as they have family support. There are, however exceptions to this rule.

A taste of early success sometimes leads people to retire early and then energetic and motivated people take upon entrepreneurial ventures to bring back some excitement and challenge in their lives. Sometimes fear of stagnation motivates people to try out lucrative new ideas with potential for business success. Overall, entrepreneurs are self-driven and

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<sup>2</sup> 7 signs of an entrepreneur, Money Matters / Joseph Anthony, <http://www.bcentral.com/articles/anthony/187.asp>

extremely energetic. Having said that, it is also important to note that entrepreneurs also have a willingness to seek help from others, especially in areas where they do not have expertise. Finding friends, consultants, employees and family members with expertise in such areas, and enlisting their support, is an indicator of future entrepreneurial success. An intrapreneur is someone who is directed by the need for achievement and realization of his/her dreams, rather than a need for control over subjects and people. Intrapreneur's are not motivated by greed for material possessions or wealth. They consider the success of their mission as their reward. An 'intrapreneurial' company is the best possible environment for these individuals to thrive and remain engaged in what they are good at – relentless pursuit of innovation and creativity.

Gifford Pinchot mentions in his book that an employee may use 10% of her time to pursue ideas she believes may be useful to the organization. While this rule may suffice for all employees in general, we feel that there is a need to create intrapreneurial teams within an organization, the purpose of which will be to come up with new ways of doing things and creating innovative products and services. There should be dedicated teams for intraprisers and the team members can be any employees. This teamwork will be in addition to the normal duties of the employees. The team's effectiveness can be monitored using Pinchot's Team Expectations Checklist (see Appendix A). The benefit of the company is that it does not create overhead in order to start free intraprisers, and the benefit for the employees is that they get to pursue their dreams at the company's expense and if successful they also have a share of the profits. This creates the necessary win-win situation where an intraprise can thrive and drive the growth of large companies. Most importantly, the company gets to leverage the combined brainpower of all of its employees, by creating a channel to direct their creative juices. The ideas that were lying dormant within the minds of the employees can now get a fresh breath of air and be reviewed by peers and colleagues, before they can be approved for funding. This sounds like a haven for innovation and entrepreneurship, which in turn will be a haven for well being of all the involved members. This is the entrepreneurial revolution that will drive corporate America out of this economic downturn.

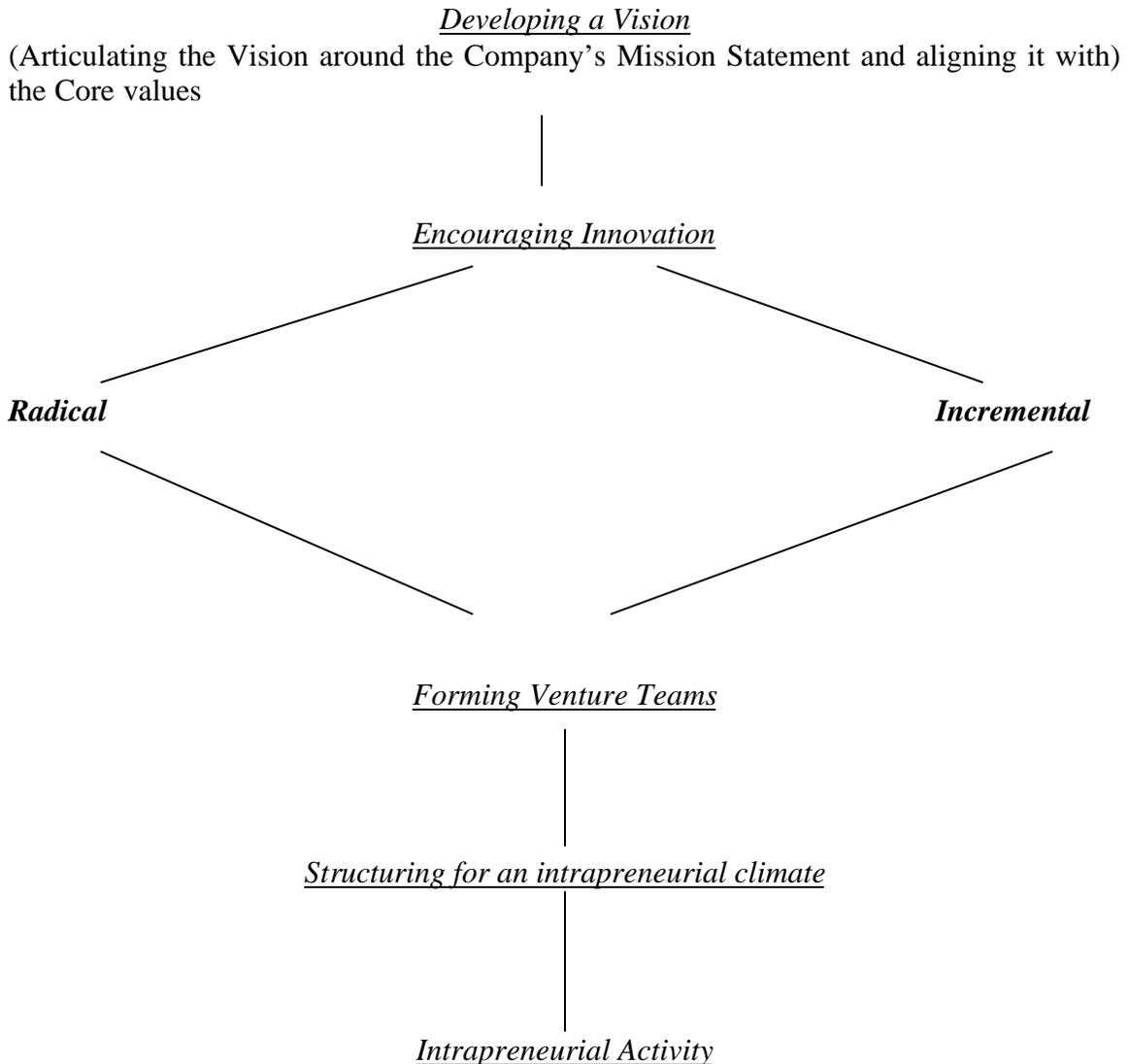
Nurturing intraprisers within a corporation can lead to corporate cost reductions, competitive advantages, new features and strategic thrusts, and new profit centers within the corporation. An intraprise can keep a corporation's standard brand from growing obsolete. For example, an intraprise could develop cellophane tape to the marketplace for the first time. Sometimes the initial purpose of an invention ends up being secondary. Scotch Tape was developed to improve the insulation for refrigerated railroad cars.

### ***Analyzing Intrapreneurship***

Intrapreneurship or 'Corporate Entrepreneurship' is a broad concept which consists of generation, development and subsequent implementation of innovative ideas and behaviors within an organization. This innovation can be a product, a new process of achieving some target, a new service or system related to the organization's business model. Basically intrapreneurship is the collection of formal and informal activities

aimed at creating new business opportunities within an established organization, by product, process, service or market developments. All these activities may take place at any level of the organization e.g. corporate, business division, functional, or project level, with the ultimate objective of improving firm performance and creating a competitive advantage over market rivals. Intrapreneurship is a process by which an individual or a group of employees, in association with an existing organization creates a new organization or instigates change or innovation within an organization. Therefore strategic renewal (major structural or organizational changes within a firm), innovation (introduction of a new product, service or process in the market), and corporate venturing (corporate entrepreneurial efforts that lead to the creation of new business organizations within the larger corporate umbrella organization), are essential parts of the intrapreneurship process. Figure 1 illustrates the process of intrapreneurship within an organization.

Flowchart showing key steps in developing an intrapreneurial Strategy



Source: Adapted from Harry S. Dent Jr., "Growth through New Product Development", Small Business Reports (November 1990)

Figure1

The first step in intrapreneurial planning starts with sharing the vision of innovation that the CEO or principal of a firm wishes to achieve. Since corporate entrepreneurship is a collective effort, every individual should know and understand the shared vision. This is critical to the success of the ultimate objective of their mission and action plans. Developing the shared vision requires identification of specific areas and objectives and formulating strategies and action plans to achieve the goals.

The next step is active encouragement of entrepreneurship, to leverage the combined innovative ideas and talents of employees. Innovation can be chaotic and unplanned as well as systematic, depending on the nature of innovation. Radical innovation is somewhat chaotic representing unprecedented breakthroughs like personal computers, post-it notes, ballpoint pens, overnight mail delivery, etc. These innovations are a result of determined vision and vigorous experimentation that cannot always be managed or systematized. However there is another type of incremental innovation where a product or process gradually evolves into a newer or better product addressing the needs of a larger market, e.g. frozen yogurt, microwave popcorn, two minute noodles etc. Sometimes incremental innovation takes over after radical innovation has initiated a breakthrough. However, it requires vision, support and nurturing to keep innovation alive. Such support must come from the top management. Every intrapreneurial activity requires a champion – a person with the vision and ability to share it. Managerial commitment is the key to intrapreneurship, however, it also requires a high degree of risk propensity. The intrapreneur manager should not only have tolerance towards failure, but also be able to learn from mistakes. Often it has been found that a failed idea led to the evolution of a new concept, which led to a very successful product. Our advice to managers is: When you lose, don't lose the lesson.

This is how 3M's entrepreneurial philosophy was born. Innovation is a numbers game, the more ideas you have, the better your chances of successful innovation. In other words, to achieve success, a company must be strong enough to tolerate failure. This progressive attitude towards intrapreneurship has paid off well for 3M. They have created world famous innovations like post-it notes, translucent dental braces, synthetic ligaments for knee surgery, antistatic videotape and many others. Altogether they have a catalogue of 60,000 products that have contributed to excess of \$10 billion in revenue.<sup>3</sup>

3M follows the following set of principles to encourage intrapreneurship:

Never kill a project: If an idea cannot be used in any of 3M's divisions, an employee can devote 15% of his time towards proving that it is workable. As many as 90 innovation grants of \$50,000 are awarded every year.

Tolerate failure: By encouraging risk taking and experimentation, a company has more chances of creating a successful product. 3M, defines its goals as 25% of a division's

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<sup>3</sup> Russel Mitchell, "Masters of Innovation" Business week 10 April 1989

revenue must come from innovative ventures introduced in the past 5 years. This figure may be as high as 30%.

Keep small divisions: Too many cooks spoil the broth, so is the case with entrepreneurial teams. The team manager must know each person by name and when a division becomes too big (exceeding annual revenues of \$300 million), it is split up into two.

Motivate the champions:

Acknowledge the efforts of innovators by declaring awards and giving cash grants to accomplish their projects. Promotions and salaries should be tied to the progress of the innovative product. The champion gets the chance to head his/her own product division one day.

Stay close to the customer: Seek regular feedback and work on fine tuning the product to match customer expectations. Invite customers to brainstorm about new product ideas.

Share the wealth: When a new product or technology is developed, it belongs to everyone, so share the wealth obtained from a successful technology, with the team, by providing stock options or cash awards.

### ***Venture Teams:***

Venture teams are becoming increasingly popular in many corporations because of their huge potential to initiate radical innovation and start new business lines. Managers who introduced venture teams often describe this approach as revolutionary transformation of their business strategy. The teams are generally composed of high performers who are self-directed and self-managed. Thus entrepreneurship is not a top-down approach, or the sole responsibility of the CEO, rather it is diffused throughout the organization, with particular emphasis on the venture teams. Former US Labor Secretary Robert B. Reich has referred to this effort by using the term 'collective entrepreneurship', where individual skills are integrated into a group and their collective capacity to innovate becomes more than the sum of the parts.<sup>4</sup> Over a period of time the group members learn about each others strengths and find out ways to cooperate and help each other in working through difficult problems and approaches towards making a product. The best part of Venture Teams is that people are extremely motivated and willing to take advantage of each others strengths to reach a common goal. This brings in synergy which leads to successful innovation. Each member tries to improve the process and smooth the evolution of the project. The combined results of all these miniature innovations propels the organization forward and results in a profitable income statement. In short, intrapreneurship gives the opportunity to utilize the innovative talents of individuals but with a sense of teamwork.

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<sup>4</sup> Robert B. Reich, "The Team as Hero", Harvard Business Review (May-June 1987)

Signode Enterprises formed a corporate development group to pursue markets outside its core business, but within the framework of its corporate strengths. Before launching this initiative, Signode's top managers identified the firm's global business strengths and broad areas with potential for new product lines. The goal of each new business opportunity suggested by a venture team was to generate \$50 million in business within five years. Additionally each opportunity had to exploit on one of Signode's strengths, e.g. its industrial customer base and marketing expertise, systems sales and service capabilities, productivity and distribution know-how, or any one of the various technological capabilities. The criteria were based on business to business selling, because Signode did not wish to deal directly with retailers or consumers. The basic technology employed for the new business had to exist and it should also have a strong likelihood of achieving major market share within a niche. Finally the initial investment in the new opportunity had to be less than \$30 million. Based on these rules of engagement, Signode began its experimentation with V-Teams. It took 3 months to select the first team members and each of the six teams had the following traits in common: high risk taking ability, creativity, and the ability to deal with ambiguity. Every team was staffed with multidisciplinary volunteers who worked full time to develop new customer product packaging ideas. The teams were composed of individuals from diverse backgrounds like design engineering, marketing, product development, and they set up a venture shop in a different rented location near the company headquarters. Although all the teams did not come up with marketable ventures, the efforts paid off hugely for Signode. One team developed a business plan to manufacture plastic trays for frozen foods that could be heated in both traditional and microwave ovens. Later, this proposal resulted in business in excess of \$50 million per year! Apart from this tangible benefit, there were many intangible successes – the Venture Team approach rekindled enthusiasm among the employees and improved morale throughout the firm. Most importantly, with the V-Team strategy working well Signode was now in a position to chart out its own destiny instead of chasing competitors. This innovative approach allowed Signode to invent its own future rather than wait for things to happen.<sup>5</sup> Figure 2 explains the individual (people) and organizational factors that influence intrapreneurship within an organization.

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<sup>5</sup> Strategic Entrepreneurial Growth, Donald F. Kuratko, Harold P. Welsch, pp 359

The Joint Function of Individual and Organizational Factors for Internal Ventures

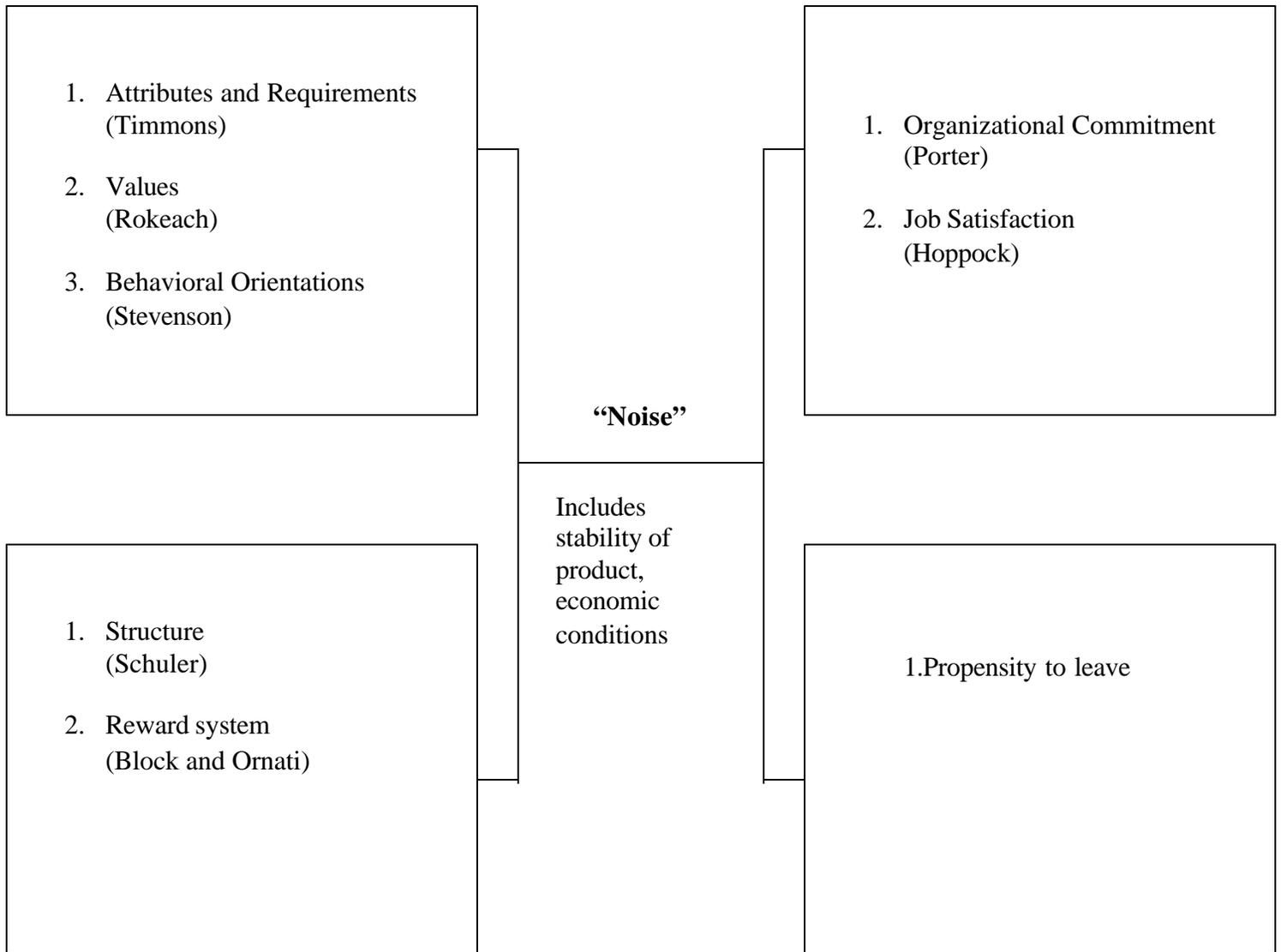


Figure 2:

Source: Adapted from Deborah V. Brazeal, “Organizing for Internally Developed Corporate Ventures” *Journal of Business Venturing* 8 1993

### ***Creating an Intrapreneurial Climate within an organization:***

In order to ensure entrepreneurial growth one of the most critical elements is the structure of a firm, which encourages the birth of new ideas and allows innovation to flourish. This concept when coupled with the other strategies of innovation can enhance the potential for employees to become venture developers. In fact companies should nurture their employees as a source of innovative ideas and business plans to realize future economic gains. This requires information sharing within the company and a transparent decision making process where good ideas are rewarded but failures are not punished. Instead employees are encouraged to learn from their failures and improve their odds of achieving success in future. Such an attitude will help innovative minded people to realize their full potential. Figure 3 shows an interactive model of intrapreneurship.

An Interactive Model of Corporate Entrepreneuring

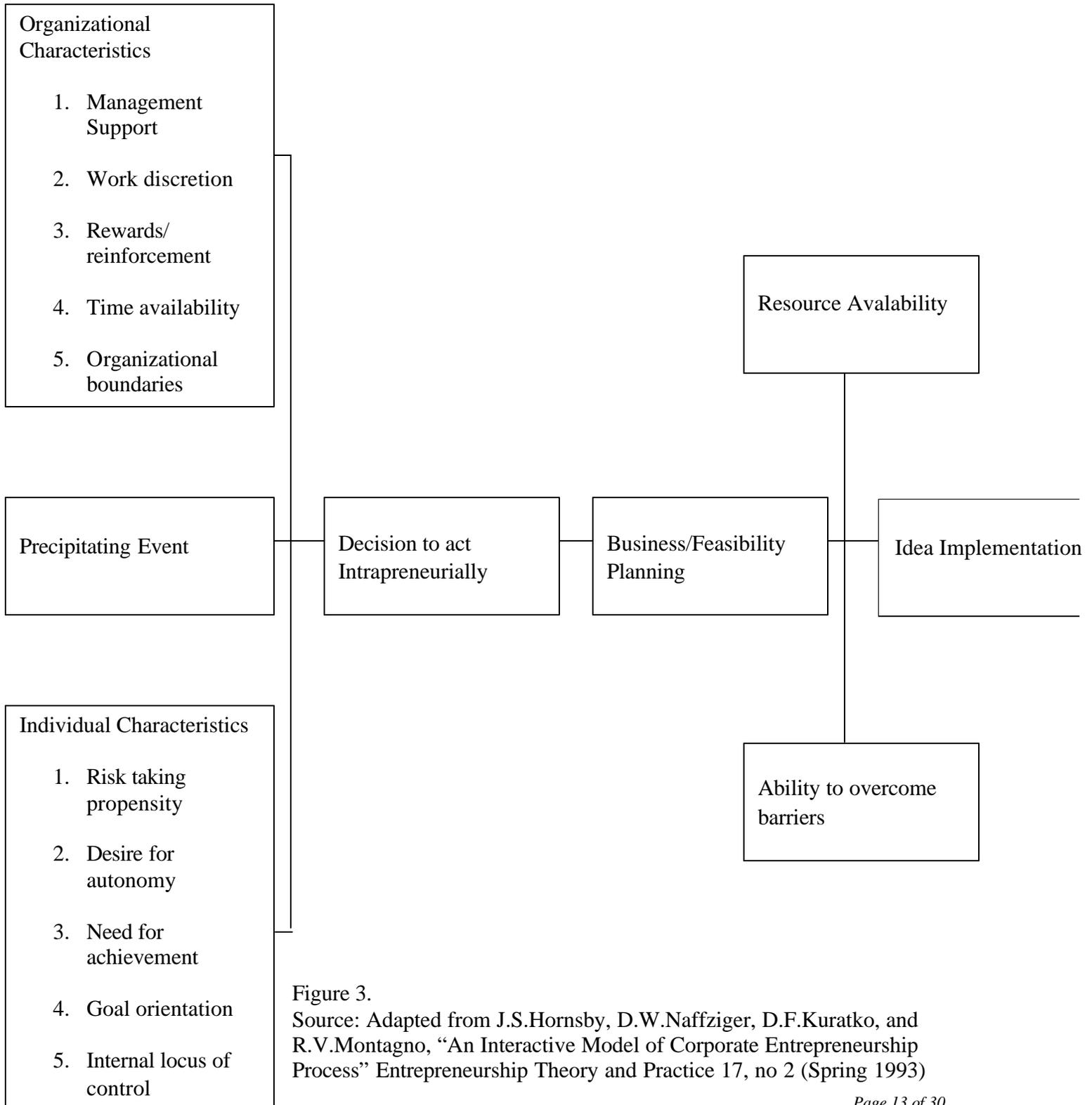


Figure 3.  
 Source: Adapted from J.S.Hornsby, D.W.Naffziger, D.F.Kuratko, and R.V.Montagno, "An Interactive Model of Corporate Entrepreneurship Process" *Entrepreneurship Theory and Practice* 17, no 2 (Spring 1993)

### ***Intraprise training:***

Training programs have been used by companies to develop key structures for creating a work atmosphere conducive for intrapreneurship. The objective of the training program is to train participants to be able to support intrapreneurship within their own work area. An intrapreneurship training program should consist of the following sub modules:

Introduction: Consists of a review of management and organizational behavior concepts related to entrepreneurship and a discussion of a few good intrapreneurship cases, to build up the interest of the audience.

Personal Creativity: This consists of many personal creativity exercises to help participants develop a personal creativity enrichment program. The objective is to define and stimulate personal creativity.

#### Intrapreneuring:

A Review of current literature on intrapreneurship as well as in depth analysis of several organizations intrapreneurial practices.

#### Assessment of current culture:

This is interactive in nature where a survey is administered to the training group for generating discussion about the current facilitators and barriers to organizational change.

Business Planning: Trainees are taught the process of developing a business plan and each specific element of a business plan is explained and illustrated. An example of an entire business plan is stated and illustrated.

Action Planning: This session requires participants to form groups and prepare action plans designed to bring about change in their individual work teams.

To validate the effectiveness of the training program, a corporate entrepreneurship assessment instrument (CEAI) questionnaire should be developed to measure key entrepreneurial climate factors. The responses to this questionnaire when statistically analyzed should identify factors, which are important for supporting entrepreneurship within the firm, e.g. management support for intrapreneurship, risk propensity, failure tolerance, rewards, resource availability, etc. These results indicate that firms intending to encourage intrapreneurship should focus on a certain underlying set of internal environmental factors: these are consistently stressed in leading management journals related to intrapreneurship. After a review of these elements it becomes apparent that a change in corporate structure and attitude is necessary to adopt intrapreneurship. In the process, people, corporate mission, and existing needs all undergo a change. This shows an organization can introduce intrapreneurship by relinquishing traditional controls and beating back bureaucracy.

The authors feel that intrapreneurship training, within the organization, will separate companies from their competitors. These candidate intrapreneur's are employees who have wonderful ideas, but need training to understand ways to start-up. This is a way to launch intrapreneur teams, i.e. via intrapreneurship workshops or seminars. A typical workshop could include: idea creation and nurturing the idea, researching the specific target market, competitor analysis, ways to develop funding support, selling tips, organizing an 'I' team and business planning. Most likely, by the time the workshop sessions are completed, teams will have formed.

The intraprise leader should develop an intraprise Business Plan that supports the Corporate Strategy. The plan should consist of the following: executive summary; the product, service, or process improvement; corporate fit; the marketing and sales plan; operations plan; summary of risks; targets/milestones; financials; managerial team.

It is very important that the idea fits with the company's strategic direction. Thus, the intraprise leader needs to respond to the following questions:

- Is there a reason to believe your company could be very good at the business?
- Does it fit the company culture?
- Can you imagine who might sponsor it?
- Does it look profitable (high margin – low investment)?
- Will it lead to larger markets and growth?

The intrapreneur leader could be more effective and efficient by following the intrapreneur's ten commandments (see Appendix B).

### ***Sample of Intrapreneuring organizations:***

Some organizations that utilize some form of intrapreneurship are listed below: The idea behind listing these is to generate curiosity and instigate creativity among readers – which, we hope will drive intrapreneurship among the intelligentsia. Also, it helps us to understand the one of the reasons behind the sustained successes of these large organizations and provides a pointer to managers for ensuring the same in their organizations.

Dupont – Establishes a '*Seed*' fund by which seed money is managed by committees for encouraging and supporting intrapreneurial ventures within the organization.

Fleischmann's – Sets up intrapreneurial new product teams to develop and commercialize new products.

General Electric – Emphasizes communicating openly and candidly. This helps in bringing out the ‘hidden’ talents of its employees and encourages generation of new ideas through a company wide ‘brainstorming’.

GTSI – Parts of the organization are divided into self-contained teams.

Head Ski Co. – Does whatever it takes to bring an idea into reality

Hewlett Packard – Believes in developing second-generation products well before the first generation enters the market.

Honda – Exploits its core competencies in many different businesses.

Motorola – sets tenfold improvements (10X), which seem to be impossible targets, yet the company achieves about 75% of its 10X goals.

Texas Instruments – Divides up seed money throughout the company. Emphasizes dedicated intrapreneurship.

3M – Project system using self-forming teams. 3M has 60,000 products and the company generates so many new products that 30% of their sales are new within the last five years. 3M is an example of intrapreneurship at its best.

CISCO<sup>6</sup> – Every 6 months or so, they have ‘best practices’ meetings where staff from various locations meet and discuss the best practices of their offices located all over the country. Thus the company leverages the strengths of their employees’ creativity by creating a common forum for exchange of ideas. If an employee has found a ‘cool way of doing a particular process’ he transfers this knowledge to his ‘virtual team’ and gets credit for his idea. The ‘Virtual Team’ of the related technology group, then discusses this idea in regular ‘place ware’ sessions or through teleconferences and if the idea is sound, it is sent to the product manager for approval. The managers always encourage active participation of all employees in the ‘place ware’ sessions of their Virtual teams, which helps in bringing out all the creative ideas hidden in the minds of employees.

The World Bank (IBRD<sup>7</sup>) --

The World Bank has decided to cut back on its bureaucratic procedures and encourage creativity and innovation within its operations. The ‘Development Marketplace’ is a novel way by which the World Bank patronizes ‘intrapreneurship’.

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<sup>6</sup> Telephone Interview with an employee of CISCO, 8<sup>th</sup> December 2002.

<sup>7</sup> International Bank for Reconstruction and Development

The Development Marketplace is a program that promotes innovative development ideas through initial seed funding. It attempts to link social entrepreneurs with poverty fighting ideas to partners with resources to help implement their vision. Since 1997, the Development Marketplace has awarded more than US\$14 million to over 180 groundbreaking projects through Global Competitions and Country Innovations Days.

"The Development Marketplace is a real opportunity to come together, with no bureaucracy, with no preconditions, and no preconceptions about each other, just about ideas and trying to see how we can help people. It is, in fact, the very best of development: people-based, partnership-based, with development impact."

-James D Wolfensohn  
President, World Bank

### ***The 80/20 Principle:***

Think of what could happen to a corporation if the corporation applied the 80/20 Principle to its intraprisers. The 80/20 Principle asserts that 80% of results come from 20% of effort. Furthermore, 20% of products usually account for about 80% of dollar sales volume. So intraprisers would drive down the largely irrelevant four-fifths of the effort. This will increase the productivity of the corporation. The corporate strategic plan has to include the process of developing intraprisers or entrepreneurial organizations within the corporation. Gifford and Elizabeth Pinchot have ten basic principles for creating an entrepreneurial organization:

- 1) Give users of internal services a choice of more than one internal vendor.
- 2) Give employees the security of something akin to ownership rights in the internal intraprisers they create, as well as the larger corporation.
- 3) Demand and engender truth and honesty, marketplace feedback and marketplace discipline, to support widespread decision-making.
- 4) Give intrapreneurial teams responsibility for their own bottom line even if they are subsidized – as a profit center rather than a cost center.
- 5) Allow many options and diversity in personnel, in jobs, in innovation efforts, alliances, and exchanges.
- 6) Provide extensive training and education, and safety nets, so employees can develop and take risks as their organization develops.
- 7) Create an internal “bank account” for every internal enterprise.
- 8) Streamline systems for registering internal enterprises so they have standing in the corporation.
- 9) Establish a system for registering agreements and contracts between internal enterprises, so that people can give their word and trust the system.

- 10) Establish a justice system for adjudicating disputes between internal enterprises and between employees and enterprises.

***SAIC Case Study:***

The authors interviewed David M. Binns, Vice President of Beyster Institute in person at his office in Washington DC on June 2, 2004. The following is a summary of our findings.

SAIC (Science Applications International Corporation), a 6.7 billion dollar company founded in 1969, is the second largest employee owned company in US (the first being Publix- a grocery chain in the southern part of US). Beyster Institute is a non-profit organization affiliated with SAIC. They have a program called Beyster Institute Entrepreneurial Employee Ownership (BIEEO) to promote the idea of entrepreneurship among the employees of SAIC. They are responsible for fostering an entrepreneurial culture within SAIC. They are also actively involved in research, publications, workshops to train and educate SAIC employees with the latest trends and knowledge of the business world, e.g. corporate governance issues, Sarbanes Oxley rules and its implications for SAIC and similar other educational ventures. Thus their relationship with SAIC is informal and very valuable to SAIC.

Beyster works to educate the employees of SAIC on various business issues and helps promote an entrepreneurial culture which is the cornerstone of SAIC's business. We can understand the structure of SAIC through the following Figure 4, which will help us to appreciate the various factors that influence an entrepreneurial company and help it thrive.

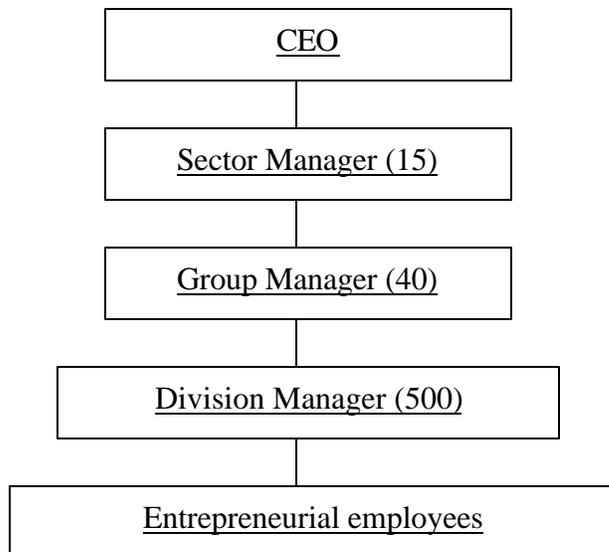


Figure 4:

The CEO has 15 managers directly reporting to him – from the various sectors (e.g. aerospace and intelligence, engineering and environmental, technology solutions, outsourcing, medical applications, etc.). Each sector oversees a number of groups each headed by a group manager, and each group is further subdivided into a number of divisions headed by a division manager. The division manager is solely responsible for profitability and bringing in new business. He has hire and fire authority over his employees. The division manager is incentivised by a 50-50 share in the profits. SAIC earns 6% of the total revenue generated from a project and 3% of this is returned to the division, for distribution among employees. This money can also be reinvested into the business of that division.

These division managers employ people who are entrepreneurial by nature and are constantly looking for new opportunities and keep themselves updated with the latest developments in their respective fields of interest. Thus the divisions of SAIC have transformed into competency centers that can compete with the best in the industry. By generating new business leads the division managers get promoted within the organization. There is no separate business development force – the scientists themselves are responsible for developing new business and maintaining customer relationships. The employees earn ownership of a project by doing high quality work – thus each division has become an individual profit center. This has also created some unnecessary internal competition within divisions, however the top management keeps dissensions under control by carefully underlining the rules of engagement and demarking each division's area of operation.

We believe that the freedom to choose their subject of interest and pursue the work they cherish, SAIC has created a truly entrepreneurial culture that is reaping huge dividends to its shareholders.

### ***The Future (Now –2015)***

The authors feel successful companies in the next decade will structure themselves so that the line structure is small but has internal suppliers (those who will provide input) to accomplish projects. We envision a number of line elements, each being a virtual profit center and each providing leadership for projects under its own mission and umbrella of responsibility. In other words from now through 2015, we shall see the 'intraprise' system winning out over the boring, typical and traditional line and staff organization.

This free intraprise system allows for flexibility and the capability to change or adjust to market demands. This next decade will require many organizations to meet the homeland security requirements. This is a complex maze of rapid change, which means an organization must bring order to chaos. The organizations that promote intrapreneurship will be on the leading edge to meet this vastly different market place. Those, heavy in bureaucracy will fade away and be on the rear of the competitive edge.

In our survey, Dendy Young, CEO of GTSI in Chantilly, VA, said,

“We divide many parts of our organization into self-contained teams that have P&L metrics. We grow by growing the teams and by adding new teams.”

Today’s business climate is impacted by layoffs, job freezes, companies renegeing on signed job contracts, the economic slowdown, 9/11, and changing lifestyle desires. Yet the corporations that have changed from traditional to intrapreneurial have overcome those impacts. Most people who are allowed to be free to innovate will not leave. They want to couple their dreams with action. So now is the time for corporations to join the intrapreneurial revolution in order to retain good employees and gain all the beneficial outcomes of intraprises.

In summary, the companies of this decade that structure an internal marketplace that allows intraprises to achieve corporate goals will survive. It’s a win-win-win situation. Employees win by being permitted to do something different and better, thus increasing their morale. The company wins by using intraprises to stimulate and capitalize on employees thereby gaining in overall productivity. The customer wins by getting a product or service that is needed in the marketplace.

Overall the major elements of an entrepreneurial strategy point to a change in the existing corporate status quo that’s leads to a newer, leaner and more flexible organization. It should be noted that such a strategy couldn’t be implemented at once. It must proceed through all the preceding steps as mentioned earlier in the paper. The following figure 5 shows the dimensions of entrepreneurial activity.

## The Intrapreneuring-Venturing Continuum

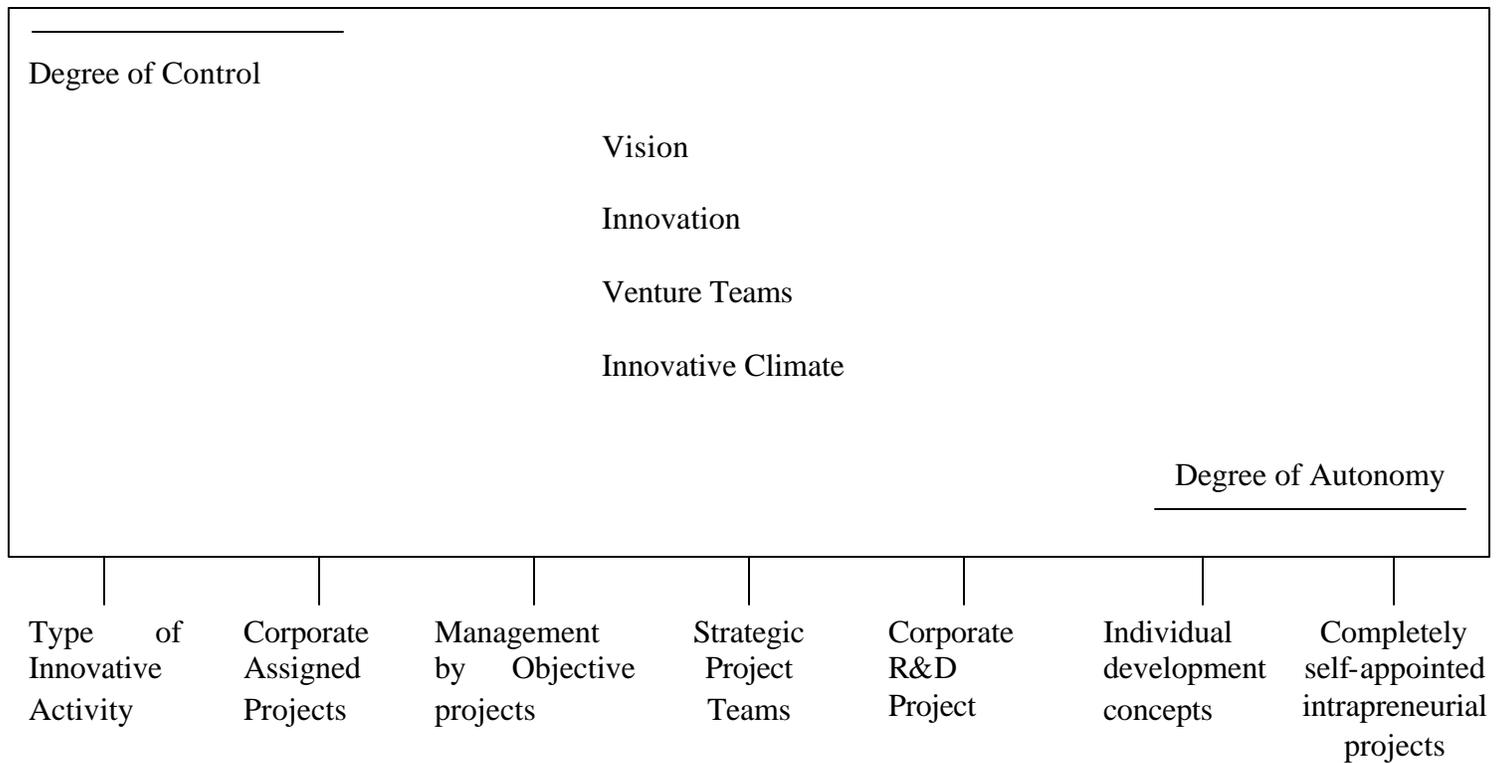


Figure 5:

Source: Adapted from Donald F. Kuratko & Harold P. Welsch, *Strategic Entrepreneurial growth*, second edition, 2003

Innovation plays a crucial role in the long-term survival of a company. The foundation of all innovation is creative ideas, and it is individuals and groups who generate, promote, discuss, modify and realize ideas. Although innovation is a complex and iterative process, the concept of innovation can be conceived as a composition of two major components. The first is creativity, which refers to the generation of novel and useful ideas in any domain and the second is implementation of the ideas within the work role, work group or total organization. Such innovative initiatives have bright outcomes like enhanced individual and group performance, employee morale, effective adjustment to change and unusual situations, higher quality of interpersonal relationships and cooperation, beneficial attitudes towards job, group and organization, psychological well-being etc.

There may however, be some negative effects of innovative behavior such as escalatory conflict and less satisfactory relationships with resisting colleagues, destructive hierarchical conflict with supervisors or subordinates who want to prevent innovative

change, work overload resulting from innovative effort going heavily beyond regular in-role work behaviors, unhealthy stress reactions at the individual and group level due to the insecurity and uncertainty surrounding innovation, etc. The Figure 6 tabulates the positive and negative outcomes of following an intrapreneurial strategy in an organization.

Having said that, we still feel intrapreneurship is by far the surest way to remain ahead of the competition and maintain a sustainable advantage over rivals.

Intrapreneurship is a risk, but it has to start somewhere – even if it starts small and moves slowly in small steps, under corporate control. Once initiated, there is a fair chance that people will become more comfortable with the idea and confidence will build up, results will occur, and gradually the corporation will become entrepreneurial. Very soon corporate assigned projects will evolve into more autonomous ventures and involve the innovative abilities of all team members. These key steps of vision development, mission articulation, encouragement of innovation, formation of venture teams and action plan, and emergence of an innovative climate need to take place each in its own turn, in order for intrapreneurship to happen. This gradual development approach is a realistic one which business managers and strategists should be aware of.

## INTRAPRENEURSHIP

| POSITIVE  | NEGATIVE   |
|---|--|
| <p>DYNAMIC INNOVATION IS THE KEY TO LONG-TERM SUCCESS OF A COMPANY.</p> <p>ENHANCED INDIVIDUAL OR GROUP PERFORMANCE.</p> <p>EFFECTIVE ADJUSTMENT TO CHANGE IN THE MARKETS AND UNUSUAL BUSINESS ENVIRONMENT.</p> <p>HIGHER QUALITY OF INTERPERSONAL RELATIONSHIPS AND COOPERATION AMONG COLLEAGUES.</p> <p>BENEFICIAL ATTITUDES TOWARDS JOB.</p> <p>GROUP AND ORGANIZATIONAL PSYCHOLOGICAL WELL-BEING.</p> | <p>POSSIBLE ESCALATORY CONFLICT AND LESS SATISFACTORY RELATIONSHIPS AMONG EMPLOYEES.</p> <p>POSSIBLE DRAIN ON COMPANY RESOURCES (TIME, LABOUR, CAPITAL), IF NOT MANAGED PROPERLY.</p> <p>WORK OVERLOAD RESULTING FROM INNOVATIVE EFFORT GOING HEAVILY BEYOND NORMAL WORK SCHEDULES.</p> <p>UNHEALTHY STRESS REACTIONS, BITTER HIERARCHICAL CONFLICTS BETWEEN STAFF DUE TO INSECURITY AND UNCERTAINTY SURROUNDING INNOVATION.</p> |

Figure 6:

Appendix A:

THE TEAM EFFECTIVENESS CHECKLIST

Take a reading on team effectiveness every week or so by having each team member rate the team's performance on the factors below. Use the following grades:

A: This is a major strength    B: We are doing quite well on this  
 C: So-so needs improvement    D: weakness in this area is serious

Date:            Date:            Date:            Date:            Date:

|  |  |  |  |  |  |
|--|--|--|--|--|--|
| Clearly defined outcomes                                       |  |  |  |  |  |
| Continuity of relationship                                     |  |  |  |  |  |
| Inspiring common purposes                                      |  |  |  |  |  |
| Measurable goals and deadlines                                 |  |  |  |  |  |
| Agreement on how and when                                      |  |  |  |  |  |
| A common fate (all go up and down together)                    |  |  |  |  |  |
| Competent and committed team members                           |  |  |  |  |  |
| Good communication, quick feedback, open information           |  |  |  |  |  |
| A strong network with other teams, intraprises and entraprises |  |  |  |  |  |
| Mutual support   |  |  |  |  |  |

Appendix B:

The Intrapreneur's Ten Commandments:

1. Remember it is easier to seek forgiveness than to ask for permission.
2. Do any job needed to make your project work, regardless of your job description.
3. Come to work each day willing to be fired.
4. Recruit a strong team.
5. Ask for advice before resources.
6. Forget pride of authorship, spread credit widely.
7. When you bend the rules, keep the best interests of the company and its customers in mind.
8. Honor your sponsors.
9. Underpromise and overdeliver.
10. Be true to your goals, but realistic about ways to achieve them.

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THE LOST ENTREPRENEURIAL TRAIT FOR SUCCESS: THE VIRTUE OF  
HUMILITY

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## THE LOST ENTREPRENEURIAL TRAIT FOR SUCCESS: THE VIRTUE OF HUMILITY

Charles N. Toftoy and Rena A. Jabbour

Humility...has this ever been recognized as being a part of an entrepreneur's required traits? Our research shows that humility is a lost business ethical virtue. Therefore, the authors' strove to develop this unique paper, the first in the business ethics field that treats humility as a trait for success. We cover the following topical areas: the definition of humility, the misconceptions of humility, how to detect the counterfeit versions of humility, as well as research studies that prove the value of being humble. The level 5 leader is explained along with ways to become a humble leader. It is suggested that people can better themselves by improving twelve personal qualities, which includes humility.

We have provided ways to become more humble to make the new you move your company from good to incredible. The lost entrepreneurial trait of humility is one that should be a requirement for any of today's leaders. This virtue of humility allows for society to discover dignity. Others are placed before selfish thrusts. Humility allows you patience and self-control, while aiding you to overcome traumatic experiences that you may have experienced in your life. It requires one to fully transform himself/herself to develop humility. Grasping the virtue of humility is a goal that everyone should hope to achieve by the end of their life cycle. When the leader of an organization practices humility, the entire organization benefits; furthermore, it leads to the betterment of oneself.

**The Lost Entrepreneurial Trait for  
Success: The Virtue of Humility**

*Arrogance, pretentiousness, and the desire for attention are qualities that exist in some of our society's entrepreneurs. The success that you have been granted is a result of several traits such as your determination and the clear vision you have for your company. But, have you ever wondered if a lost trait exists that could shoot your company from good to incredible?*

**HUMILITY: THE LOST TRAIT FOR SUCCESS!**

According to Webster's Dictionary, humility is the state or quality of being humble of mind or spirit; it is the absence of pride or self-assertion. It will allow you to show a consciousness of your shortcomings. It is the most powerful virtue of all that is needed within every entrepreneur hoping to be successful. The virtue of humility has been described as "perceiving one's place in the world not according to one's own accomplishments but according to the intrinsic value of all individuals" (UO Stratics, 2003). Humility is not necessarily a quality you consider as being a required "entrepreneurial trait". Our goal is to help you refresh yourself and instill the virtue of humility that may help you to move your company further than it has already gone. Therefore, the purpose of this paper is to open up this lost entrepreneurial trait, humility, so that you can gain depth as a person and business leader.

A truly humble individual demonstrates a compelling modesty and feels somewhat intimidated with public praise. Such an individual acts with strong determination and motivates others, principally on inspired standards for the business. She/he cares about others first, and therefore attempts to delegate more responsibility to her/his employees and successors. She/he leads with motivation, inspiration, and ambition not for himself, but for the business as a whole.

This method of instruction, allows for the growth and success of your company to be shared by all the employees that have aided in the process. Taking such a path helps employees feel that they are not working to make only you successful, but rather the whole organization. The most significant characteristic of humility is the ability for you to assume responsibility of shortcomings, rather than blaming them on such external factors as other under performing employees or even sheer bad luck; “He looks in the mirror, not out the window”.

This virtue of humility allows for society to discover dignity. Others will now be placed before your personal selfish thrusts. It allows for patience and self-control, while aiding you to overcome traumatic experiences that you may have experienced in your life. To develop this trait of humility, you are required to fully transform yourself. Grasping the virtue of humility is a goal that everyone should hope to achieve by the end of their life cycle. We believe that when the leader of an organization practices humility, the entire organization benefits. Furthermore, it leads to the betterment of oneself. Our society perceives humility as a sacrifice, however this myth is often proved false: More is gained by humility than is sacrificed! “Humility is strong-not bold; quiet-not speechless; sure-not arrogant” (Estelle Smith, 2003).

### **HUMILITY IS NOT...**

Modern-day society tends to view humility with skepticism, fearing that it annihilates the entrepreneur. It is viewed as being embedded in the past, which cannot be used in the present society. Individuals seem to believe that there is not enough room for humility in our competitive and progressive civilization. This view can be seen throughout our society including academia. Have you ever heard of a class being taught about humility? Has the trait ever been recognized as being a part of an

entrepreneur's required traits? No. Instead, individuals take pride in believing that they are self-sufficient in knowledge and experts in all walks of life. You may find humility to be a needless trait and do not appreciate selflessness as among the finer facets of leadership.

From the time we are young, society teaches us to put ourselves first, making us believe that loving ourselves and taking pride in our talents scores over everything and everyone else. Generally, we will continue to feel this way until we encounter an event that makes us feel less capable than we thought we were and that will result in discontentment. As a result, this causes us to feel insignificant in a vast universe and thereby disables us from understanding how to deal with our shortcomings. It is at this point in time that we will be more receptive to humility; we may now realize the importance of this trait, and are better willing to forgo an arrogant, selfish, and egoistic behavior.

It is believed that people are inherently modest by birth. The irony is that this quality needs to be nurtured in order to develop and refine humility. This cannot be accomplished through self-revelation; it develops when an individual feels there is nowhere else to turn. This is a difficult proposition especially because individuals are inclined toward self-pride and admiration.

### **THE MODERN DAY COUNTERFEITS**

Never be fooled by those who you may think are humble. There are some that may pretend to encompass this virtue of humility that is only superficial, not truly within them. You should be aware that there are people who may attempt to fool you with traits that may appear to make them humble, when truly they are acting it out in an insincere way. The following scenarios provide examples of the modern-day counterfeits of humility.

**Satisfied with appearances**

This individual wants to superficially appear humble, whereas his inner-self is overflowing with pride and self-sufficiency. He is satisfied by putting on a humble front in hopes that the appearance of it will fool others. This purpose is usually one of self-gain.

**Protesting its unworthiness**

This individual consistently repeats to himself and others the unworthiness they experience. He believes that by saying how he does not deserve certain things in life, he will appear to be humble, however “true” humility makes no implication of being humble. A “real” humble person bears ridicule from others, and does not get irritated when others disrespect him.

**Afraid to Admit Talents**

This individual denies all talents and accomplishments in hope of appearing modest. If one is being told that he is a good writer, and the reply is “I am a scribbler”, that does not mean he is humble. Humility is truth. If someone is praised, a humble person will thankfully appreciate the ability to be successful based on other people’s assistance.

**Terrified of making mistakes**

Spurious humility is horrified at the possibility of making mistakes. When this is the case, the individual feels that he can no longer be the example for others. He does not look upon the amount of insight one can gain from making mistakes. Especially in the business world, as it may apply to small businesses, several mistakes must be made to learn how the world works. The fearless attempt to involve oneself in a trial and error period allows them to further themselves in understanding the needs of

consumers in the business world. Woodrow Wilson said, “A fault which humbles a person is of more use to him or her than a good action which puffs him or her up.”

### **WHAT HUMILITY CAN DO FOR YOU!**

There are several offshoots of humility, particularly peace of mind and dedication. Peace of mind allows for you to experience happiness leading you to treat others with kindness and consideration. Consideration and kindness are very important traits to run a particular business, and allow you to relate to your employees and understand the hardships they may face. Instead of scolding their feelings, you must use consideration and understand their experiences. An example of this is as follows:

*A woman receives a phone call that her husband has been in an accident, and is now in the hospital. The nurse told her exactly how to get to the room where her husband was, only to find out that when the wife attempted to find the room, it did not exist. The nurse had failed to let her know exactly what wing the room was in. After running around in circles looking for her husband, the lost woman ran into a doctor who was willing and able to help her on her search. Instead of scolding her for her inability to find the room on her own, he mentions to her how many months it took for him to finally understand the hospital layout himself.*

The example mentioned above shows how important it is to relate to one's feelings and downfalls. These qualities will help you to be cognizant and accepting of your mistakes. This realization, as a result, will allow you to better yourself as, both, the leader of your company and as a person.

In addition to piece of mind, qualities of dedication and encouragement must be recognized. These are two qualities that every individual in the business world should

experience. Dedication and encouragement allow for improvement within a business organization, for innovations to be made within a company whether it may be in the structure, the strategy, or the products of the firm.

Peace of mind and dedication allow for employees to confide and feel able to confront you, as their superior, with ideas they may have. It is a misconception that a manager has all the answers; surely, you depend on others in the organization to provide new ideas for improvement and growth for the company. Employees are the closest ones to consumers and they must be the ones to relay information to you and the remaining executives in the company. Through peace of mind, you will have ability to relate to your employees, and with dedication and encouragement, new innovations arise within the organization.

Humility, the trait that the authors' feel is an outstanding personal virtue, is and should continue to be a mandatory qualification for any individual assuming a leadership position. As an entrepreneur, you are subject to many learning experiences, however to amplify that experience, you should grasp the meaning and pure existence of humility. Humility is a requirement for learning; it gives you the opportunity to discover. Humility gives you the opportunity to listen. It is imperative to keep focus on every event that is occurring within your business, and realize the actions that must be done to strengthen the company's positioning in the market.

The success of a firm is related to the well being of the leader. Your energy, your vision, and your beliefs as a CEO are represented in the company's business ethic. The business environment should be one of comfort and understanding for both the employees and the consumers. The lack of humility will turn a comfortable and honest working zone into something in the likeness of Enron, Arthur Anderson, and WorldCom. The selfishness that has occurred within these firms makes the entire

community question the intentions of every company in the market. It is up to you to show how much responsibility you and your organization has to your clients, the most important individuals to the success of your company.

The advantages that humility can offer you are not to be taken lightly. You gain better employees that are eager to work for you due to the understanding you have. As a result of this, the employees become happier people because they are credited for each task they partake in. An example is set for these employees, which will be transferred to their clients. Since the clients will be receiving products /services they are in need of from an individual they enjoy to be surrounded with, the consumer walks away happy, and society is suddenly made aware of how magnificent your company is. Clients swarm into your firm, sales increase, and higher profits are made...the advantages follow through on every line of the business!

### **HUMILITY CAN IMPROVER YOUR BUSINESS...WE'LL PROVE IT!**

A five-year research project searched for the answer to what makes a company from merely good to truly great. The result of this project concluded that the most powerfully transformative executives possess a paradoxical mixture of personal humility and professional will. Under this study, a "Level 5" hierarchy was created to distinguish between the different types of leadership styles. (See Figure 1)

The figure shows that the Level 5 leader sits on top of the hierarchy of capabilities. This person is a necessary factor for transforming a small business into a great business. The research implies that it is not necessary to move sequentially through each of the different levels, however the Level 5 leader requires the capabilities of all the lower levels, plus the special characteristic of humility.

## **The Project**

The research project began in 1996 to determine how a good company can become a great company. To answer this question, companies that had shifted from good performance to great performance, and sustained it, were recognized. It was then necessary to identify the comparative companies that had failed to make a sustained shift. By doing this, it was possible to pinpoint the qualities that successful companies encompass versus those of unsuccessful ones.

Twenty-two research associates worked together to collect both qualitative and quantitative analyses data to test the hypothesis. As part of the qualitative analysis, 6,000 articles were collected, 87 interviews with top executives were conducted, and analyses were made of internal strategy documents. On the quantitative side of the research, financial metrics, an examination of executive compensation and observations of company stocks were made.

After the research had been conducted, there were a total of 11 companies that qualified as a company that experienced a good to great transformation. The data that resulted in this study was not what was expected from observers. Companies were researched over a 15-year period. It was recognized that no matter what state the company was in, whether in crisis or steady state, offering services and products, and no matter how big the transition was, each of the successful organizations had a Level 5 leader at the time of the transition. It was at this particular moment that the idea of a Level 5 leader was in contradiction to conventional wisdom and management theory of the modern-day society.

### **Level 5 leader profile:**

-Humility in conjunction with professional will leads to a successful transformation from a good to great company.

-The Level 5 leaders have ambition not for themselves but for their company and the executives.

-The Level 5 leaders want to set up the company for success in future generations, focusing on how the company will be perceived rather than how the company leader will be remembered.

-A Level 5 leader is always one to credit others for successes within the company, and if no person or event can be credited directly, then the leader will look upon good luck for the company's accomplishment. This type of leader will never blame anyone or anything (including bad luck) for any failures within the company.

### **CONVINCED? LEARN HOW TO BECOME THE “HUMBLE LEADER”**

There is a belief that individuals carry a seed within themselves that is in dire need of nurturing. You, like many others may either ignore it or do not realize that you have the capability of becoming a Level 5 leader. Under circumstances such as self-reflection, mentoring, significant life experiences, as well as other factors, your “seed” can slowly become nurtured. The following steps will help you to encompass the qualities of a humble leader:

#### **Assume any responsibility that you may bestow upon your employees!**

Whether you are dealing with the best leader in your company, or the janitor, you must always portray yourself as being on the same level as each employee. A truly humble individual will never look down upon the specific divisions of responsibilities. Make sure to focus on the importance of the employee's contribution, not what their specific contributions are.

#### **Put yourself in their shoes!**

Remember the Golden Rule: “Do unto others as you would have them do to you.” It should be one of your primary focuses in managing a firm. If you find yourself

unhappy with specific ways people may treat you, then you should never do that to one of your employees. Realize the actions that were of importance to you when working under another individual and relay those same actions to your employees. You should be cautious, however, not to fully implement your ideas at all times due to the differences in opinion people may have. Provide the employees with what you may find to make them happy, but also leave room for adjustments if employees are not content with your suggestions. The understanding of another person's feelings is the focus of this step.

### **Admit Mistakes!**

Not one person is born flawless, and no one can ever become flawless. The mistake that many leaders make is the idea that they know everything, and no one but themselves is right. Generally, a leader places himself on a pedestal. However to acquire humility, you should admit your shortcomings and mistakes. This will allow your employees to feel more comfortable working for a person that is only "human" and not a superpower. By doing this, you will subject employees into a more comfortable work environment, thereby developing close employee relationships. The employees will no longer be fearful of making mistakes, but appreciate the learning experience they have gained. You should use your their personal faults as springboards to higher things.

### **Give credit to those who have led to your success**

Placing full recognition upon the accomplishment of a leader has been a mistake in the business world for ages. You should continuously recognize that each employee has led to the success of your firm, and therefore led to the positive impression set of you, as the leader. A good, humble leader will consistently recognize the hard work and efforts of their employees, and recognize them in times of success. Idealistically,

the success of a firm is dependant upon many people, not just you. Regardless of how great a leader you may be, if the employees are not willing to work with you, the intentions will become inconsistent and blurry. As a result, the success of a firm is the outcome of a large workforce aiming to provide the best product or service. “Heroic Leaders give credit to all the people behind their success.” (Murphy, Emmett C., 1995)

### **Be an original**

Never try to be a carbon copy of what you think business professionals are supposed to be. By being your original self, you are exposing your company to behaviors that are new and exciting. Following in any predecessors’ footsteps will restrict you and may lead you into a path quite far from that of humility. As a unique leader with a unique vision, you be able to express yourself in an artful, creative, and innovative way. Consequently, your employees will be led to believe how important it is to have innovative ideas of their own. “If you can’t be creative at work, it may be time to move on” (Koonce, Richard).

### **Don’t take yourself too seriously!**

There is nothing that can ruin a person more than success. Success leads some individuals into egoistical behaviors that make it uncomfortable for others to be around. Regardless of how profitable your business is, or how important you are to the future, you should still not take yourself too seriously! Switch that egoism into humility and allow yourself to be more successful.

### **Listen Up!**

You may have assumed that as a leader you should direct your employees by telling them what to do, and how to do it, but be aware that this offers no opportunity for feedback from your employees. Behaving in this manner represents a selfish trait and

would be considered intolerable from a humble person's perspective; you should listen to others. Surprisingly, listening to others may give you more knowledge of topics that you may have ignored or overlooked. Your employees are the front-line people of your company, and you must be dependant on them to learn what is good for your clients. You may believe to have the best idea in mind, but not being so close to the purchasers may give you a blurry vision of what consumers may expect. Listen. Recognize the emotions of others and attune yourself to their needs and wants. Listening may assist you to better understand your employees, thus leading to the future success of your company.

**Take the harder right, than the easier wrong!**

Situations that have arisen over the past few years are examples of leaders taking an easier path that then leads to their wrongdoing. As mentioned earlier, many financial companies felt the pressures of outside forces to take the easier wrong and thus disclosed inaccurate, yet appealing financial statements instead of dealing with the harder right of disclosing statements that would make the shareholders unhappy. Sometimes it is easier to choose the wrong belief so that we do not have to struggle with trying to reach the right belief. Humility helps you make a decision; once it is acquired the harder right will always be chosen over the easier wrong.

**Have a role model**

Always look up to a higher authority than yourself. This higher standard will help instill a sense of humility, open-mindedness to new learning experiences. "Being oriented toward a higher power is more than just being aware of it-you have to love by the best light and knowledge you receive and be obedient to the higher law".

(Sherman Covey, 1996)

## THE NEW YOU !

Traditionally, entrepreneurs are expected to have certain personal qualities that will lead them to future success. Various papers, textbooks, and articles will always mention the ideal “base-line” characteristics an individual must have, thus portraying the ability they will have to maintain responsibilities that an entrepreneur will deem necessary. The authors’ believe that humility should be included in this list of entrepreneurial traits as one of the most important traits to help you experience and understand the true meaning of success. Today’s entrepreneurs should have an equal balance between each of these characteristics so that they may better serve their employees, their clients, and themselves.

The authors’ have developed the following traits based on many years of experience in the real business world. By assisting over 2,100 small to medium enterprises, from high-tech to low-tech, and having face to face contact with successful entrepreneurs including Ernst & Young Entrepreneurs of the Year awardees, it has been made possible to distinguish what traits you must encompass to be a successful entrepreneur. (See Figure 2)

**-Passion-** this is the most important entrepreneurial trait for success. After meeting over two thousand entrepreneurs, the authors’ conclude that the successful ones have passion. Some entrepreneurs show visible signs of self-assertiveness, are aggressive, and are powerful in appearance. Others are quite and soft-spoken yet remain silently forceful. The most striking quality of these entrepreneurs is the depth they have. By having depth, a sense of emotional drive is detected, and shows the spirit they have to accomplish something. They love what they do and find a way to make a profit through their business while simultaneously providing a contribution to society.

**-Enthusiasm-** this is the second most important trait. This inner sense of encouragement gives you the capability of inspiring all of those around you. When your employees see that you are eager to carry out their vision, they will attempt to follow in your footsteps.

**-Trustworthy-** you must be able to build loyalty with everyone surrounding you. This trait will show that you are dependable, reliable, and worthy of confidence. Bob Reiss, President of R&R, Inc. (a family game company) is a good example of a trustworthy entrepreneur. He took good care of everybody and made his employees feel good. Trustworthiness is a definite key to success that allows you to admit your mistakes and move on.

**-Creativity-** Your creativity and originality are what inspire others around you to be excited about a product and service. Generally, entrepreneurs that have this quality regularly participate in the research and development of products. A good example of a creative entrepreneur is Josh Frey, President of Granny's Goodies (a gift care specialist company). He studies everything in order to allow the company to move forward. The creative entrepreneur is one that likes to create a positioning for his company's venture.

**-Persistence-** The entrepreneur must be persistent! We all know that things are not always easy, and therefore must rely on persistence to become resolved. You, as an entrepreneur, should be indefatigable and refuse to give up when the situation becomes very tough. You should not be afraid to fail, and if you do, use that failure as a learning tool.

**-Responsibility-** You must have a strong sense of responsibility. By being responsible, you can feel a sense of achievement. The accountability that you have designates an emotional and liable attachment to your business, and therefore will be

taken more seriously. David C. McClelland, a Harvard psychologist, conducted a study, which concluded that entrepreneurs, on average, have a higher need for achievement than others of the general population. Prior to establishing your own firm, you are able to recognize the problems in starting a business, but believe that you can overcome those problems. The responsible entrepreneur is one that stays away from uncertain high risk, and usually likes to outsource everything.

**-Flexibility-** you must have the flexibility to adapt to changes in the market. This will allow for a long-life within the organization. You should be looked upon as a “Plastic Man” so there is enough mental toughness to rebound from adversity. (Charles Toftoy, 2000)

**-Self-confidence-**You must be confident in your actions and beliefs so that others may recognize them as being credible. This sets the tone for everyone else in your company. Your self-confidence will allow you to believe in your own strengths and apply a practical approach to accomplish nearly all tasks, including the overcoming of obstacles. Entrepreneurs perform best when they are confronted with nearly impossible tasks; they do not assume anything and seek out criticism in order to make improvements. Since they have such a high curiosity level, they are believers in continuous learning.

**-Perceptibility-**You must have an awareness and insight about people so that you will be able to hire and retain good employees within your organization. You can serve as a filter for the company in this position. Having the ability to perceive between right and wrong allows a proper direction to be set for your company.

**-Communicator-**You must be able to express yourself clearly and effectively. You should be able to convey your vision to the rest of the organization. Having this characteristic allows you to listen to others’ feedback to better improve the company.

The communicator method, allows for a face-to-face approach to be made to communicate with your employees while telephone, email, letters, and memos are only secondary means of communication.

**-Seller-**You must be artful in selling. You should believe in what you and your company are promoting and be able to promote the value of the product. Stephen Forte, President of Travelers Telecom, is an example of an entrepreneur who believes in his cause. The entrepreneur never accepts “no” but rather comes back with an alternate strategy or tactic.

**Humility-**Being affable, modest and gracious helps you to develop a mutual trust with others. This will allow others to easily approach you. Everyone is important regardless of what their occupation may be; you may learn a lot from others since they may be more knowledgeable in their own field. Humility also helps in controlling anger and ego, two characteristics that may lead to unwanted problems and mistakes.

We, the authors feel that you can become the “new you” by improving yourself through the traits mentioned. Self-examine yourself to understand which traits you may have as an entrepreneur, and consider the benefits that they offer you and your business. By being cognizant of these traits we have provided, you should become a better person, and a more successful entrepreneur.

### **Summary**

The practice of strategic humility is one that leads heroic individuals to the driving out of co-dependency within themselves and their organizations. Confrontation of the destructive habits of selfishness, pride, and the blaming of other is imperative. Characteristics as such, become the root of the problems that may cause the inability

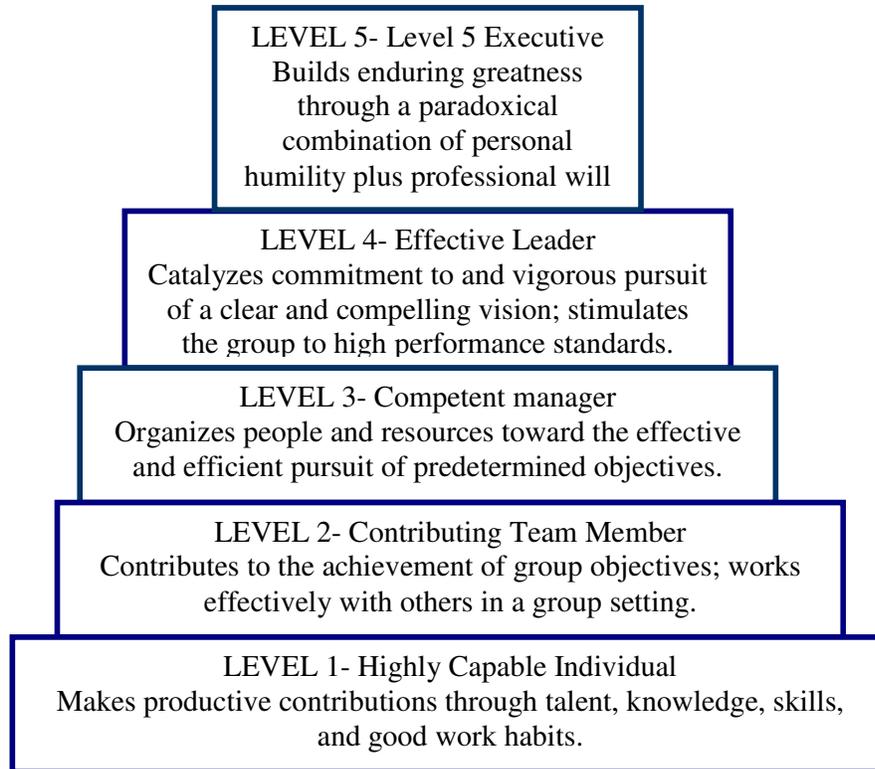
to make serious commitments, unwillingness to learn from others, and unwillingness to accept personal responsibility for any type of company failures.

The ideal leader is driven by a deep belief they have, and attempt to succeed regardless of the obstacles and possibilities of failure. When tough times arise, the leader turns to others with hope and optimism in finding solutions and ideas. It is understood that full responsibility will be assumed when a mistake has occurred due to the belief that personal achievement requires the competency that only personal accountability can teach. Humility allows a leader to feel self-fulfillment when they serve others and move beyond their personal ambition.

You may feel that much of this paper is ordinary common sense, but we believe that there is not much coverage on this issue. We want you to refresh yourself and present the lost virtue of humility, and how equally important it is to all other entrepreneurial traits. We have offered you with the definition of humility, the misconceptions of humility, how to detect the counterfeit versions of humility, as well as research studies that prove the value of being humble. We have offered you with ways to become more humble to make the new you move your company from good to great. The lost entrepreneurial trait of humility is one that should be a requirement for any of today's leaders. The gratitude that individuals feel for humble people is irreplaceable, and will portray an image of a company that no other person will be able to imitate. As leaders of our societal marketplaces, we should take the initiative to become and implement authority figures that are driven solely not by the selfish purposes of superficial profiting, but rather self-gain and fulfillment of providing a remedy to needs of the society. In the likeness of Abraham Lincoln, who signified the pure meaning of humility, we can walk into the betterment of our society, our company, our leadership, and our truly humane well being. It may be that John (Jay) McCloy said it best, "Humility leads to strength and not to weakness. It is the highest form of self-respect to admit mistakes and to make amends for them".

## TYPES OF LEADERS

Figure 1



*Source: Harvard Business Review, January 2001*

## ENTREPRENEURIAL TRAITS

Figure 2



*Source: Charles N. Toftoy, GWU, Monograph, 2001*

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# **Entrepreneurial Motivation in a Multicultural Society: The Effects of Ethnicity and Entrepreneurial Self-Efficacy.**

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In addressing entrepreneurial behavior in a multicultural country and how it is influenced by individual and environmental factors; self-efficacy beliefs and cultural values were predicted as producing the most salient affects on entrepreneurial intentions. The structural equivalence of the instruments used was established and primary data was collected from samples representing distinctive ethnic cultures in one national environment. The results indicate it would be inaccurate to describe South Africans as having high entrepreneurial intentions as a result of cultural values; even though SA cultural values tend to reflect the inevitable consequences of Westernization and modernization. What did matter however was the effect of self-efficacy, which continued to be statistically significant throughout our analysis; this means that the personal context and not the social-cultural framework is pivotal to increasing entrepreneurship. Despite social interventions designed to encourage entrepreneurship via centralized planning and coordination on a national basis, the success of entrepreneurs seems to depend more on the personal motivation and will to succeed. With knowledge on entrepreneurship evolving in SA, particularly where much is left unexplained, studying the impact of culture on entrepreneurship in a multicultural society under a political correct climate is often construed as officious and arrogant. Although the sophistic argument exists that all must be celebrated and no judgments or analysis is permitted, the point is to rescue cultural relativism from speculations and impressions and to establish it on more solid empirical ground as this study has done. Findings have relevance for entrepreneurs and policy makers seeking a competitive advantage for their products/countries, particularly when encouraging entrepreneurial mindset among multicultural populace.

## **Introduction**

South Africa is not only a culturally heterogeneous society, but because of its colonial and apartheid history different cultural values were hypothesized to influence proclivity towards entrepreneurship among major ethnic groups. According to GEM 2003, SA has the lowest total entrepreneurship activity (TEA) rate of any developing country (Orford, Wood, Fischer, Herrington & Segal, 2003), which means that entrepreneurial activity on a range of measures is extremely low in SA. This is significant in a country where entrepreneurial ventures account for one third of total employment. Moreover experts believe that entrepreneurial activity is affected by attitudes to discriminated groups and by cultural practices which hinder entrepreneurship in SA (Orford *et al.*, 2003). Uganda, which has the highest TEA of all countries surveyed in the GEM, suggests that low entrepreneurial activity is not an African phenomenon.

Conceptual arguments for the link between culture and entrepreneurship have existed for decades (Schumpeter, 1947; Weber, 1958; McClelland, 1961), with more recent empirical research (Hayton, George, & Zahra, 2002; Marino, Strandholm, Steensma,

& Weaver, 2002) suggesting mixed findings. Some studies suggest entrepreneurs share a common set of values regardless of culture (McGrath, Macmillan, & Scheinberg, 1992), while other studies support the notion that culture will affect entrepreneurship (Busenitz & Lau, 1996; Shane, 1994). Studies in Africa conclude that psychological variables (Frese, 2000), and race and ethnicity (Ramachandran & Shah, 1999) are important predictors of entrepreneurial activity.

Many individuals in transitional economies may have the desire to pursue entrepreneurial ventures but are not engaging not because they do not have knowledge and skills but because they are lacking in self-belief. However this general label, self-belief provides little point of reference for hypothesis testing, and for the purposes of paper was operationalized through the self-efficacy construct and related to culture and entrepreneurial intentions. By acknowledging the legacy of apartheid education it becomes apparent that damage was done to self-esteem, motivation, and creativity of individuals, with many schools and universities continuing in present day to inculcate a mindset that undermines entrepreneurship. Building entrepreneurial capacity requires inculcating a can do attitude as well as more people developing self-belief towards entrepreneurial aspirations and skills (Driver, Wood, Segal, & Herrington, 2001).

Economically disadvantaged communities often suffer from deficits in self-efficacy. Rabow, Barkman, and Kessler (1983) show that victims of poverty visibly reflect the symptoms of learned helplessness, which resonates with SA socio-cultural conditions and reinforces the vital role of self-efficacy in empowerment and capacity building.

Although there can be wide variety of contextual as well as individual factors that influence the entrepreneurs choice, the role of entrepreneurial self-efficacy has been emphasized as key antecedent (Boyd & Vozikis, 1994; Krueger & Brazeal, 1994; Chen, Greene & Crick, 1998; Markman et al., 2002). Unlike personality traits self-efficacy can be developed through training and modeling. Efficacy judgments are task specific and regulate behavior by determining task choices, effort and persistence. Self-efficacy also facilitates learning and task performance particularly early in the learning process (Stevens & Gist, 1997) and can also change as result of learning, experience and feedback (Gist & Mitchell, 1992).

Although Bandura (1986) reasoned that self-efficacy influence is partially socially constructed and that such construction may differ as a function of national culture, little direct evidence exists that may connect cultural values to self-efficacy. This controversy by whether historical and societal processes are responsible for creating distinct communities, that may render individual meanings as trivial, or what makes humans similar, is important for this study, since trying to study entrepreneurial motivation without insight into culture/ethnicity is an idle pursuit.

Self-conceptions embody both personal and collective affects although their relative emphasis may vary depending on the cultural values of their environment (Bandura, 1997). Efficacy beliefs have a similar multi-faceted character. Personal efficacy can serve varied purposes many of which subordinate self-interest to the benefits of others, e.g., Nelson Mandela provides a prominent example of self-sacrifice in the exercise of powerful personal efficacy. Cross-cultural research, (Earley, 1994; Erez & Earley, 1993), attests to the general functional value of efficacy beliefs; with cultural embeddeness shaping the way in which efficacy beliefs are developed.

A variety of studies lend support to the argument that cultural values influence entrepreneurial behavior. Much of the study of ethnic entrepreneurs is based on issues of culture, with a growing body of literature supporting the argument that national culture influences a variety of economic/ management behavior (Hofstede, 2001) and entrepreneurship (McGrath *et al.*, 1992).

Hofstede (1980) treats values as part of culture. Hofstede's statistical handling of IBM data at country level produced four empirical dimensions of national culture. The four are labeled as; power distance (which is related to the different solutions to the basic problem of human inequality); uncertainty avoidance (which is related to the level of stress in a society in the face of an unknown future); individualism vs. collectivism (which is related to the integration of individuals into primary groups); and masculinity vs. femininity (which is related to the division of emotional roles between men and women). A fifth dimension, as a result of focusing on Asian values, is long term vs. short-term orientation (which is related to the choice of focus for people's efforts, the future or the present) is also included (Hofstede, 2001, p. 29).

Several studies suggest that entrepreneurship is more compatible with certain cultures. Although empirical evidence is required to substantiate such generalizations, which are based on specific configurations of cultural dimensions, several African evaluations exist, for instance see Kinunda-Rutashobya (1999); Themba *et al.* (1999); and also Kiggundu (2002) for an illustrative summary about entrepreneurship and culture in Africa. Morris, Davis & Allen (1994) found that a balanced level of individualism-collectivism led to greater entrepreneurship in their multi-country sample, which included SA. Their study revealed that entrepreneurship declines the more collectivism or higher levels of individualism are emphasized. Such findings mean that entrepreneurial activity peaks at moderate levels of individualism, with extreme individualism promoting competition, and absence of team identification, all lowering levels of entrepreneurship.

In accordance with the aforementioned research, hypotheses are formulated with the following configuration of cultural values based on Hofstede's dimensions.

*Hypothesis 1:* Moderate individualism and collectivism and higher self-efficacy increases entrepreneurial intentions.

*Hypothesis 2:* Lower uncertainty avoidance and higher self-efficacy increases entrepreneurial intentions.

*Hypothesis 3:* Higher masculinity and higher self-efficacy increases entrepreneurial intentions.

*Hypothesis 4:* Lower power distance and higher self-efficacy increases entrepreneurial intentions.

*Hypothesis 5:* Higher long-term orientation and higher self-efficacy increases entrepreneurial intentions.

The article proceeds to describe the research methodology including sampling, and data analysis. We test the hypothesis and detail the results. The last part of the article provides substance in the form of conclusions, implications and imperatives for further research.

## METHODOLOGY

Highly relevant to this paper is that sub-cultures may form within a societal group, based on a distinct history or geographically based experiences that have influenced the values of the group (e.g., apartheid policy). Hence the justification for using ethnic groups, as a unit of analysis, at this sub-cultural level, is based on Hofstede's exhortations, as well as the precedent set by the GEM studies which describes entrepreneurial activity according to racial classifications (Foxcroft *et al.*, 2002). The basic assertion is that different racial/ethnic groups exist in SA. Because of SA's colonial and apartheid history there is a high degree of correlation between race, location, education, self-awareness, and gender elements of disadvantage (Klasen, 2002). This racial indicator is important and therefore accounted for in this study. Bornman (1999) regards ethnicity as a mode of social differentiation based primarily on perception, kinship, a common cultural focus, and an awareness of historical destiny. Although biogenetic heritage can play a role, definitions of ethnicity normally emphasize language, religion, and other cultural practices. In contrast, definitions of race emphasize phenotypical or external physical characteristics (e.g., skin color).

Although we are aware that ethnic / racial categorizations, as a primary definition of groups of people implies dogmatism, this is not intended as such, but is used strictly as a methodological convenience, in the context of social differences, for purposes of this study (using political correct or evasive euphemisms such as 'Zulu speaker' is also avoided). An attempt was made to capture as many ethnic groups as possible (even though SA represents a complex multicultural society), but a cruder version of Asian, Black, and Caucasian South Africans was used due to practicalities of sampling.

While the relationship between self-efficacy and entrepreneurial intentions has been extensively documented (e.g., Krueger, Reilly, & Carsrud, 2000; Krueger & Brazeal, 1994), this study seeks to extend this relationship by the introduction of cultural values. Using cultural values and self-efficacy beliefs to predict entrepreneurial intentions seems to be a more robust approach than using personality traits: values and beliefs are more proximal to behavior and intentions than the distal personality traits. Hence when the relations between the independent variables (IV) - self-efficacy and cultural values, and dependent variable (DV) - entrepreneurial intentions, are tested, the unexplained variance should be less and the correlations stronger.

### Instruments

The following instruments were subjected to item and factor analysis to establish structural equivalence: (1) Entrepreneurial intentions were assessed on a cumulative approach based on Ajzen's (1991) and Shapero's (1982) models as compared by (Krueger *et al.*, 2000). Previous estimates of internal consistency for the items in this model vary between .69 to .83). Our measure reflects this theory driven approach and comprises of items used in both models; these are: intentions, attitudes, expected utilities, and normative beliefs and motives (important for ethnic groups where only cultural differences are hypothesized in social norms). Global and specific perceived feasibility, which is empirically linked to self-efficacy, are measured separately with the self-efficacy measure (next section). In total 11 items were measured along a 5-

point Likert-type scale (1 = very high, 5 = very low). Principal component analysis (PCA) demonstrated a unifactorial solution with an eigenvalue of 9.28, which explained 87.3 % of the variance, with an overall alpha of .93.

(2) The items for the self-efficacy instrument are incorporated from Chen *et al.*'s (1998) entrepreneurial self-efficacy (ESE) scale as well as the revised general efficacy scale (GSE) (Chen *et al.*, 2001). More specifically the ESE sub-scales (slightly modified) will consist of roles /tasks, with respondents indicating degree of certainty (strength) in performing these roles/tasks on a 5-point Likert-type scale, as well as their magnitudes (yes /no). Self-efficacy magnitude (not measured previously by the existing ESE and GSE measures) and strength as separate non-combined measures appear to have generally weaker predictive validities and correlations than self-efficacy composites have (Lee & Bobko, 1994). In other words a composite measure of self-efficacy, which includes magnitude and strength, and measures general and specific levels of self-efficacy is used for this study. The initial results of PCA indicated that several of the original scale items did not load satisfactorily on any factors in the generated factor solutions. Items with maximum factor loadings less than .30 were omitted as well as items that loaded significantly on more than one factor. With these omissions further analysis yielded the following accepted 4-factor solution: Factor 1 (GSE); Factor 2 (ESE MARKETING); Factor 3 ESE (INNOVATION); Factor 4 ESE (FINANCE) with eigenvalues of 6.41; 2.21; 1.03; 1.04; that explained 44.8%; 17.7%; 16.6%; 15.6% of the variance, with Cronbach alphas of .91, .81, .89, .89 respectively

(3) The latest Value Survey Module (VSM 94) (Hofstede, 2001) which is considered the best-validated and most efficient instrument for arriving at an empirical replication of the five dimensions of culture was used. According to Hofstede the VSM 94 is relevant to respondents without employers, such as entrepreneurs, students, and housewives. Hofstede is adamant that what can be measured are only differences in the statistical distributions of scores for groups, sufficiently large (20-50 per group), and sufficiently matched, (i.e. similar in all respects except nationality). Hofstede's VSM 94 instrument was designed for comparing mean scores of two or more countries / regions / ethnic groups. Global correlations across all individuals and within society correlations are not the same as between society correlations. Confusion between within system and between system correlations is known as ecological fallacy (Hofstede, 2001). However it remains important to remember that Hofstede's indexes yield statistically significant differences when males vs. females are contrasted or when entrepreneurs vs. non-entrepreneurs are compared. Davidsson and Wiklund's (1997) analysis of cultural dimensions on the individual level also reveals a reasonably strong relationship between values and beliefs on the one hand, and entrepreneurial intentions on the other. VSM 94 consists of 20-content questions and 6-socio-demographic questions. Only 8 of the original 13 items from which IBM scores were based remain. The additional long term vs. short-term orientation dimension is included for the first time in the VSM 94. Computational formulas were followed as prescribed that allow comparisons of culturally determined value dimensions between people from two or more ethnic groups. In VSM 94 all 20-content questions have a 5-point structure (i.e., range from 1 = of the utmost importance to 5 = of very little to no importance). Initial PCA component analysis yielded 2, 3, and 4-factor solutions. Items were scattered among factors with loadings below .30 in some instances. After repeated analysis a 6-factor solution was obtained with 4-factors corresponding to four of the indexes. The Cronbach alphas for each cultural index was .79, .77, .69, and .49 respectively. Factor 5 and 6 had mixed items,

which were consequently collapsed into one factor representing uncertainty avoidance (UAI). Other replications using VSM 94 have also failed to support the five subscales as derived by Hofstede. Spector, Cooper and Sparks (2001) using 23 nations at the country level of analysis also found suspect internal consistencies in the VSM 94. Such findings together with the results we obtained prevent the unambiguous interpretation of the internal consistency of the VSM 94 instrument.

## **Sampling**

Primary data was collected across different ethnic groups (n=150), from a M.B.A. student population at a higher education institution. The objective was to use the students on a M.B.A. program and not the general population. The samples are relatively matched in all respects except ethnicity, in order to allow comparison between ethnic groups. Such sample comparability should minimize method bias (van de Vijver & Leung, 2001) such as response styles, and further represent distinctive ethnic cultures in one national environment. The control for socio-demographics is relevant to the hypotheses formulated since as predicted values generally differ between socio-demographic groups. The final sample consisted of 150 students of whom 69 % were men, 50 % are in the 30 to 40 year age group, 60 % have 16 years or more of formal education, 35 % work as academically trained professionals, and belong to one of the three major ethnic groups; Black (n = 50), Indian (n = 50), and Caucasian (n = 50) South Africans.

## **RESULTS**

### **Descriptives**

Table 1 shows the means, standard deviations and Pearson's correlations of the variables under study (N = 150). Entrepreneurial intention (entint) with a mean of 2.52 is a midpoint average of the 5-point rating scale, with a relatively low standard deviation of .73. In order from highest to the lowest mean score, the cultural dimensions are ranked as: IDV, UAI, LTO, MAS, and PDI. It must be noted that substantial standard deviation in all of the scores is evident. The mean scores for the self-efficacy factors are; GSE, followed by ESE marketing (mkt), ESE finance (fin), and ESE innovation (inn). The Pearson correlation coefficients are reported with the statistically significant exact probabilities (*p* values) asterisked. Correlations range from .00 to .85. The level of correlations is generally low even though in some instances they are statistically significant. The significant correlations are between entrepreneurial intentions and self-efficacy sub-scales. For the self-efficacy scores several relatively high intercorrelations between these variables are evident; this was expected since the individual self-efficacy composite measures add up to total self-efficacy composite.

[Table 1 about here](#)

### **ANOVA and multiple regressions**

Analysis of variance (ANOVA) was used to test the significance of differences in scores of the factors. The effects were interpreted as follows: (a) GSE is statistically

significant,  $F = 3.40$ ,  $p < 0.05$ . (b) ESE Inn is statistically significant,  $F = 3.21$ ,  $p < 0.05$ . (c) PDI is statistically significant,  $F = 3.19$ ,  $p < 0.05$ . (d) MAS is statistically significant,  $F = 4.64$ ,  $p < 0.01$ . (e) LTO is statistically significant,  $F = 6.14$ ,  $p < 0.00$ . However to determine which specific groups differ on which variables a post hoc test, Duncan's multiple range test (a more refined test than the omnibus F test) was conducted to complement ANOVA. Using this procedure significant differences were detected between the groups for the GSE, ESE Inn, ESE Fin, PDI, UAI, MAS, and LTO factors. Contrastingly for ESE Mkt, IDV and ENTIINT there are no significant differences between the groups. This is important for further analysis in that specifically no differences on the DV (ENTINT) are detected. This could be interpreted that urban (metropolitan) respondents represent a common entrepreneurial classification. The differences in entrepreneurial intentions by race are generally small between urban respondents.

Using a regression model, where all the factors were entered, a squared multiple correlation of 0.15 was obtained, indicating 15.83 % of the variation in the DV is attributable to variation across the levels of the 9-variables in this model. This is rather weak since 84% remains unexplained variance.

Examining the parameter estimates in this model - apart from GSE and ESE Mkt, other variables are not statistically significant. This means that the higher the GSE and ESE Mkt the higher will be entrepreneurial intentions. No cultural predictors exercised influence on entrepreneurial intentions. The next procedure involved entering the total self-efficacy composite variable (tsc), instead of the separate factors, since an overall measure might be more robust. The result was a deflated  $R^2 = 0.113$ . Stepwise regression entailed entering the statistically significant variables; ESE Mkt was entered first ( $R^2 = 0.08$ ) and then GSE ( $R^2 = 0.13$ ). The stepwise regression results indicate that few patterns of relationship between the variables can be established.

In summary, although findings are modest in correlations and regressions, they are not trivial. In relation to each of the hypothesis, no support was found for the effect of any of the cultural values on entrepreneurial intentions: further no interaction between cultural dimensions and self-efficacy was revealed by findings. However on the other hand results indicate there was a modest but statistically significant ( $p < 0.05$ ) effect of self-efficacy on entrepreneurial intentions, partial support was found, in particular that GSE and ESE Mkt effect entrepreneurial intentions. A possible interpretation of these findings, which reinforces a pattern of similar results, is that beliefs are more salient than values in determining individual cross-cultural behaviors (Leung, Bond, & Schwartz, 1995). Notwithstanding possible instrument inadequacies, our findings suggest that self-efficacy beliefs possibly eliminated the effect of cultural values, when these two factors were examined together in an entrepreneurial context.

## DISCUSSION

Broadly speaking it seems cultural values are not associated with, and do not predict entrepreneurial intentions in SA. There is a paradox here since certain configurations of cultural dimensions as measured across the ethnic groups (high IDV, low PDI) are generally indicative of an entrepreneurial culture. Low PDI can be interpreted that

equality is now highly valued in SA with more egalitarian views prevailing across ethnic groups. The high score obtained by all the groups on IDV is clearly the inevitable consequence of Westernization and modernization (Allik & Realo, 2004); so why is there no association with entrepreneurship? Some plausible explanations may be found in SA's historical roots, which may have inhibit an entrepreneurial mindset to develop. It could also be that entrepreneurship is not necessarily seen as a legitimate or desirable occupation (due to the traditional strong culture of wage labor in SA combined with affirmative action policies). Negative attitudes towards failure (Driver *et al.*, 2001) and a low risk-taking mentality could also be contributing factors. The general lack of entrepreneurial activity in SA seems to be further exacerbated by a low entrepreneurship status, and a general lack of entrepreneurial role models. As a matter of fact it has been suggested that entrepreneurship is a self-reinforcing process (Bygrave & Minniti, 2000). Entrepreneurship leads to more entrepreneurship and is a dynamic process in which social habits (entrepreneurial memory) are as important as legal and economic factors. Thus entrepreneurs act, as catalysts of economic activity, and the entrepreneurial history of a community is important. Indeed the different experiences of groups lying outside the dominant entrepreneurial culture of the US must be further investigated, especially in view of the notion that not every culture fits every dimension of culture in a precise way.

Conversely what our results do indicate is South Africans are in fact relatively motivated (high self-efficacy beliefs) to be entrepreneurs. This means that institutional obstacles and lack of support structures, that actually deliver results, may prejudice existing motivations and intentions to be entrepreneurial. Financial support is cited (GEM SA 2003) as the biggest obstacle to potential entrepreneurs and specifically a lack of financial administration skills among emerging entrepreneurs. So it seems despite social interventions designed to encourage entrepreneurship via centralized planning and coordination on a national basis, which are generally characterized by a lot of activity and little action, the success of entrepreneurs remains dependent on personal motivation, and will to succeed, as our results demonstrate.

The results have relevance for government and policy makers who are encouraging an entrepreneurial mindset among South Africans. Social interventions designed to encourage entrepreneurship need to take into account the culture values of the target population, since motivational differences across cultures can be salient. Inculcating self-efficacy among potential entrepreneurs requires more than teaching competencies, prospective entrepreneurs must internalize the competencies by experiencing mastery of skills. Not only can educators and policy makers help increase perceptions of feasibility for prospective entrepreneurs but also for community by increasing collective self-efficacy by emphasizing successful entrepreneurial role models. It would not be presumptuous to say that SA needs to empower individuals to have the potential to be entrepreneurs and to do this entail fostering empowerment amongst individuals (especially for sectors of population such as women and previously disadvantaged groups who could be perceived as lacking entrepreneurial traditions) by increasing perceptions of self-efficacy. For global entrepreneurs venturing into a developing market, the most useful aspects of understanding cultural differences and motivations are that it allows entrepreneurs to predict how ethnic groups may behave, consequently providing valuable clues about potential consumers and business partners.

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**TABLE 1**  
**Means, Standard Deviations, and Pearson Correlations for Variables**

|                   | <b>M</b> | <b>SD</b> | <b>1</b>    | <b>2</b>    | <b>3</b>    | <b>4</b>    | <b>5</b>    | <b>6</b>    | <b>7</b>    | <b>8</b>    | <b>9</b>    | <b>10</b>   | <b>11</b>   |
|-------------------|----------|-----------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 1. ENTINT         | 2.52     | .73       | <b>1.00</b> | .07         | .06         | .00         | .06         | .01         | .29**       | .28**       | .28**       | .11         | .16*        |
| 2. PDI            | -2.30    | 45.33     | .07         | <b>1.00</b> | -.00        | -.00        | -.25*       | -.18*       | .09         | .01         | .16*        | .08         | .02         |
| 3. UAI            | 46.36    | 69.91     | .06         | -.00        | <b>1.00</b> | -.11        | -.01        | -.12        | -.03        | .00         | -.00        | -.09        | -.00        |
| 4. IDV            | 82.46    | 46.93     | .00         | -.00        | -.11        | <b>1.00</b> | .01         | .11         | -.29**      | -.30**      | -.03        | -.11        | -.27**      |
| 5. MAS            | 30.46    | 92.91     | .06         | -.25*       | -.01        | .01         | <b>1.00</b> | .20*        | .08         | .08         | -.00        | .09         | .05         |
| 6. LTO            | 45.20    | 22.51     | .01         | -.18*       | -.12        | .11         | .20*        | <b>1.00</b> | -.18*       | -.14        | -.14        | -.01        | -.09        |
| 7. TSC            | 36.16    | 8.90      | .29**       | .09         | -.03        | -.29**      | .08         | -.18*       | <b>1.00</b> | .85***      | .54***      | .58***      | .73***      |
| 8. GSE (Sc1)      | 15.04    | 4.90      | .28***      | .01         | .00         | -.30***     | .08         | -.14        | .85***      | <b>1.00</b> | .23*        | .31***      | .55***      |
| 9. ESE Mkt (Sc2)  | 6.84     | 2.21      | .28***      | .16*        | -.00        | -.03        | -.00        | -.14        | .54***      | .23*        | <b>1.00</b> | .14         | .33***      |
| 10. ESE Inn (Sc3) | 3.94     | 1.84      | .11         | .08         | -.09        | -.11        | .09         | -.01        | .58***      | .31***      | .14         | <b>1.00</b> | .40***      |
| 11. ESE Fin (Sc4) | 4.17     | 1.64      | .16*        | .02         | -.00        | -.27        | .05         | -.09        | .73***      | .55***      | .33***      | .40***      | <b>1.00</b> |

\*p < 0.05, p < 0.01\*\*, p < 0.001\*\*\*

**Role Model Influences on Entrepreneurial Intentions:  
A Comparison Between USA and Mexico**

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March 2005

## **Role Model Influences on Entrepreneurial Intentions: A Comparison Between USA and Mexico**

### **Abstract**

Most research and popular writing includes entrepreneurial role models as an important factor in the decision to start a business. Few, if any, studies compare the influence of business owner role models between two different countries. Further, studies cite the importance of role models for potential entrepreneurs but ignore how the role model process actually works. This study looks at activities that role models might engage in and compares their influence on respondents the US and Mexico. This is the first study that examines differences in role model influence between two countries. Ten of the variables are significantly different between respondents in the two countries. Nine of the differences were rated as being significantly more influential among Mexican students than US students while only one variable was rated as being significantly less influential. Results of the study, especially as related to the specific influence of role models on career intentions, may be relevant in designing entrepreneurship programs. The results may also be appropriate in courses that discuss entrepreneurship in different countries (e.g. international entrepreneurship). The results may also be relevant in family businesses where eventual continuity of family ownership through succession is desired.

## **Role Model Influences on Entrepreneurial Intentions: A Comparison Between USA and Mexico**

### **Introduction**

Most work in both the popular and academic press about the decision to start a business includes background or antecedent factors underlying the entrepreneurial decision. Included among those antecedent factors is the influence of role models on the potential entrepreneur's thought process. Studies have shown that 35%-70% of US entrepreneurs had entrepreneurial role models (Scherer, Adams, Carley, & Wiebe, 1989). Informal discussions with entrepreneurs and surveys of students in university entrepreneurship courses generally support this contention. Sharing wisdom and practical knowledge and include their children in the business at an early age. An affinity for and valuable knowledge about entrepreneurship is acquired through a person's interactions with role models. The purpose of this paper is to compare the influence of role models on entrepreneurial intentions between US and Mexican students. Specifically we look at the relative influence of role models on students.

### **Previous Literature**

Recent research regarding the decision to start a business has focused on entrepreneurial intentions. Built largely around the "Theory of Planned Behavior" (Ajzen, 1991) and the model of the "entrepreneurial event" (Shapiro, 1982), a number of researchers have shown that intentions are a predictor of behavior. Further research focused on the antecedents to those intentions. (Krueger, Reilly, and Carsrud, 2000).

### **Intentions**

Krueger et al (2000) asserted that intentions better predict entrepreneurship than personality traits (internal) and situations (external) and that "a strong intention to start a business should result in an eventual attempt, even if immediate circumstances . . . may dictate a long delay". As part of his development of intentions based models, he concluded that role models could affect entrepreneurial intentions if they changed attitudes and beliefs about a person's self-efficacy – their perceived ability to be successful in a new venture.

In a related study, Krueger (2000) used the intentions model to predict opportunity recognition. In this model, he posited that intentions were a function of perceived desirability of an act and perceived feasibility of the act. He asserted that perceptions related to desirability are learned and that perceived feasibility is a key to intentions. Noel

(2000) found that since entrepreneurial intentions were stronger among students with entrepreneurship majors, then entrepreneurship majors should have higher intentions to start a business within two to five years.

Douglas and Shepherd (2002) studied business alumni of an Australian university to determine factors influencing intentions to start a business. Their findings suggest that risk, need for independence, and income potential are important factors affecting career decisions, and that risk and independence are especially important for those intending entrepreneurial careers. They found that income is not a determining factor leading toward the intention to start a business.

Goals, motivations, and intentions are intertwined in predicting the entrepreneurial decision. Kuratko, Hornsby, and Naffziger (1997) suggested that individuals starting businesses have personally relevant goal sets to which they aspire. Extrinsic goals that concentrate on wealth and personal income and intrinsic goals, such as recognition, challenge, autonomy, family security, and excitement were important for sustaining entrepreneurship.

### **Career Planning**

Scott and Twomey (1988) proposed that parental role models and experience (work or hobbies) led to the perception of oneself as an entrepreneur. This self-perception, when added to a triggering factor and a business idea, would lead to an entrepreneurial career preference. They found that students whose parents owned their own business showed a significantly higher preference for self-employment and lower preference for a career in a large business or working in a small business.

Lent et al (1994) found that career-related decisions reflect a process in which beliefs, attitudes, and intentions evolve as we cognitively process our knowledge, beliefs, and experiences. Role models are important in this cognitive process, as association with the role model provides positive experiences for the individual.

Dyer (1994) developed a model of entrepreneurial career that included antecedents that influenced career choice, career socialization, career orientation, and career progression. Antecedents to career choice included individual factors (entrepreneurial traits), social factors (family relationships and role models), and economic factors. Dyer asserted that children of entrepreneurs are more likely to view business ownership as being more acceptable than working for someone else.

Baucus and Human (1994) studied Fortune 500 firm retirees who started their own business and found that networking, their view of departure (voluntary vs. involuntary), and prior employment experience positively affected the entrepreneurial process. Carroll and Mosakowski (1987) asserted that children with self-employed parents likely

work in the family firm at an early age. That experience, coupled with the likelihood of inheriting the firm, led the individuals to move from a helping situation to full ownership and management.

Scherer, Adams, Carley, and Wiebe (1989) and Schere, Adams, and Wiebe (1989) used social learning theory to investigate the link between parental role model and the development of a preference for an entrepreneurial career. They noted that no previous study had shown whether an entrepreneurial role model resulted in individual to pursue an entrepreneurial career. They contended that individuals will likely express a preference for an occupation if they have seen role models have positive experiences with that profession. As a result, individuals will pursue training in that field, have expectations about entering that profession, and evaluate their own skills (self-efficacy) necessary to perform in that field. They concluded that performance of the role model was not as important as the very existence of the role model.

## **Methodology**

### **Questionnaire**

A questionnaire was developed and pre-tested during the spring semester, 2003. Students at two Midwestern universities and one Mexican university were surveyed regarding role model influence on career decisions. A total of 213 valid responses were received from the US students and 87 were received from the Mexican students.

The students were asked to indicate and rate the overall influence on career-thinking using a 1-5 Likert scale (1 = influence a lot and 5 = no influence) of their most significant role model during their formative years. Respondents were then asked to rate the influence of 18 student-role model interactions on career intentions using a 1-5 Likert scale (1=strong negative influence and 5=strong positive influence). These twenty activities were based on both a review of previous literature and knowledge of role model relationships. The respondents were also asked to rank the extent to which they wanted to own their own business within ten years of graduation using a 1-7 Likert scale (1=strongly do not want to own a business and 7=strongly want to own a business). Additionally, the questionnaire asked if their role model was a business owner.

### **Analysis**

The data were initially summarized using univariate statistics (means and frequencies) to provide a better understanding of the respondents and characteristics of the data. The initial summary statistics included those relating to demographic information and the mean ratings of the relevant variables. ANOVA was used to compare the mean

ratings of the influence variable on career intentions between US and Mexican respondents. Statistical significance found by from ANOVA suggests that the amount of variation between groups is significantly different than the amount of variation within the group and that differences between the groups exist.

## **Results**

### **Respondent Characteristics**

US respondents consisted of 65.9% males and 34.1% female students. Approximately 42.5% of the Mexican respondents were male and 57.5% were female. The majority of the US respondents (96.3%) were undergraduate students (25.9% - freshman, 3.7% - sophomores, 14.8% - juniors, and 51.9% - seniors). Only 3.7% of the respondents were graduate students. All respondents from Mexico were undergraduate students.

### **Most Significant Role Model**

Table 1 shows the most significant role models for US and Mexican students. The father was the most significant role model for students in both countries. The percentage of respondents who indicated that father was their most significant role model was also very similar (US students = 61.90%) and Mexican students = 62.07%). Relatively small differences in the significant role model are evident between the respondents from the two countries.

The next most significant group of role models are more concentrated among Mexican students than US students. Another relative (11.49%), mother (10.34%), and teacher (9.20%) are ranked similarly by Mexican students while a much smaller percentage ranked sibling (3.45%), other non-relative (2.30%), and friend (1.15%) as the most significant role model. US students' most significant role models are evenly distributed among mother (7.14%) other relative (7.14%), friend (7.14%), teacher (7.14%), and other non-relative (7.14%). A very low percentage of both US and Mexican students indicated that a sibling was their most significant role model.

### **Role Model's Influence on Career Thinking**

Table 2a shows the mean ratings of the extent to which US and Mexican role models influenced the respondents' career thinking. The mean rating among US students (5.66) is significantly greater (1%) than the mean rating (5.26) among Mexican students. The result implies that role models have significantly greater influence on career thinking of US students than the Mexican students.

The data was also evaluated relative to whether the role model owned a business. Table 2b shows that having an entrepreneurial role model that owned a business had a significantly more positive influence on respondents' career

thinking among US students. However, Table 3 also indicates that business ownership resulted in no statistical difference between the rankings of the extent to which the role model influenced Mexican students' career thinking.

### **Interest in Starting Own Business**

Table 3a compares the degree of interest in starting a business within 10 years of graduation among US and Mexican students. The table indicates that Mexican students are significantly more interested (1%) in starting their own business (mean = 6.46) than US students (mean = 4.85).

The respondents' degree of interest in starting a business within 10 years of graduation was also evaluated relative to whether the role model owned a business. Table 3b shows that having a role model that owned a business significantly increased US and Mexican students' ranking of interest in wanting to start a business after graduation.

### **Mean Rating of Influence Variables**

Table 4 shows the US and Mexican respondents' mean rating of the model influence variables. Almost all of the US respondents' mean ratings are between 3.0 and 3.90. The only exception is comfortable lifestyle (mean = 4.20). The next three highest rated influence variables are discussed job with you (mean = 3.83), included you (mean = 3.68), and management details (mean = 3.61). The three lowest rated influence variables are another job then join (mean = 3.12), away from home (mean = 3.18), and assumed would follow (mean = 3.18). No mean ratings are below 3.10.

Almost all of the Mexican respondents' mean ratings are also between 3.0 and 3.9. The two exceptions are comfortable lifestyle (mean = 4.48) and included you (4.10). The next three highest rated influence variables are adv and disadv of job (mean = 3.98), discuss with family (mean = 3.92), and management details (mean = 3.86). Three lowest rated influence variables are, brought work home (3.03), away from home (mean = 3.07), and paid for minor work (mean = 3.10).

A comparison of the mean ratings between the respondents in the two countries shows several general patterns. The two highest rated influence variables are the same for respondents in both countries. The three lowest rated influence variables are different, but still rated low for respondents in both countries. US respondents rated 7 of the 18 variables as having more influence than Mexican respondents while the other 11 variables were rated by Mexican respondents as having more influence.

The ANOVA examined difference between US and Mexican students' mean ratings of variables. Ten of the differences in mean ratings are different at a 5% level of significance. Mexican respondents rated nine of the mean ratings higher than US respondents (discussed with family, included you in that discussion, attended professional meetings, comfortable lifestyle, ad and disadvantage of job, assumed you would follow, management details, encouraged joining, another job then join). US respondents rated only one variable (paid minor for work) as being more influential than Mexican respondents. Interestingly, the two highest rated variables among Mexican respondents are also rated significantly more influential than US respondents. The only variable rated significantly lower among Mexican than US respondents (paid minor for work) was also the lowest rated variable by Mexican respondents.

### **Discussion**

The results of this study demonstrate that role models influence career intentions for both US and Mexican respondents. This finding is consistent with a number of previous studies (Krueger et al 2000; Azjen, 1991; Shapero, 1982). The results provide evidence on the relative importance of specific types of interaction between role models and students. Role model activities that actively included the respondent were had more influence on respondents. Those activities that were more passive from the perspective of the student respondent were generally less influential. Thus, being gone from home, bringing work home at night, assuming that the respondents would follow in their footsteps, and even encouraging the respondent to join their business or organization were of less importance than the activities that included substantial interaction between the respondent and the business or organization. This finding was relatively consistent among students from both countries.

The combined influence of relatives, especially parents, on career intentions is greater in Mexico than the US. The respondents' father was the most significant role model for US and Mexican respondents. Mothers and other relatives were also more frequently the most significant role model among Mexican than US students. This finding is consistent with a widely held belief that the structure and influence of families is greater in Mexico than the US and that US children tend to be more independent of parental influence than Mexican children.

The results also showed that role models who owned a business had a significantly greater influence on the career intentions of US than Mexican respondents than role models that did not own a business. This result may also be consistent with the greater influence of role models external to families in the US than in Mexico, especially since

findings indicated that the influence of Mexican role models who owned a business was not significantly different than those who did not own a business.

Mexican students were also found to have a significant greater interest than US in owning a business within 10 years of graduation. This finding may be explained by the university culture context in which students are immersed. US students, especially business students, are commonly exposed to a curriculum that is consistently influenced by large company issues. Mexican students receive much more encouragement to consider business ownership in both their family setting and university curriculum.

Finally, the results also showed that specific role model variables generally had a greater influence on Mexican than US students. This result is consistent with the stronger influence of family relationships among Mexican students than US students. US students may be more evaluative of role model interaction and, as a consequence, independent thinking than Mexican students. Mexican students may exhibit more influence by family interactions, especially when family members are also role models, and accepting of role model influences than US students.

### **Summary and Conclusions**

This study examined differences in role model influences between a sample of 213 US and 87 Mexican students. Respondents were asked to report the influence of their most significant role model from an overall viewpoint and with regard to specific role model activities. ANOVA was used to identify trends as well as differences in role model influence by country.

The results showed that the respondents' father was the most significant role model for US and Mexican respondents. Role models were found to have a greater influence on career thinking among US than Mexican respondents. Role models who owned a business had a significantly greater influence on the career intentions of US respondents than role models that did not own a business. Whether or not Mexican role models owned a business had no significant difference among Mexican students. Mexican students were also found to have a significant greater interest than US in owning a business within 10 years of graduation. Interestingly, both groups of students indicated less interest in owning a business if the role model was a business owner. Finally, the results also showed that specific role model variables generally had a greater influence on Mexican than US students.

The results may be of interest to instructors who teach entrepreneurship classes, business owners, and consultants. Perhaps more important, the results provide insight into differences in role model influences among two

countries whose economic and social structure have been becoming more integrated. Understanding the influence of role models should be of interest to entrepreneurship programs in colleges and universities. Entrepreneurship programs and workshops may consider including business owners as part of their curriculum. The results suggest that greater interaction between the business owners and student/program/workshop participants may lead to greater entrepreneurship orientation of the participant. Another option might be entrepreneurship internships. If universities offer internships with entrepreneurs, this may strongly affect a student's interest in becoming an entrepreneur. Instructors may find the results especially relevant when discussing factors influencing the decision to launch a business, issues related to family business, and role model influence on aspiring entrepreneurs. Business owners, especially family businesses, can use the results to better understand what influences generational succession decisions. Consultants can use the information by providing information on how to positively influence entrepreneurial intentions. All of these areas may be especially relevant when working with young adults who are exploring or developing career options. A better understanding of these issues, especially relative to differences between the US and Mexico, can provide insight into social and economic country dynamics.

The limitations of this study provide opportunities for future research. The study was conducted during only one time period. Future students might examine the influence of role models over time. The samples were also relatively small and geographically limited. Future studies could be expanded in size and geographic location. Future studies could also expand the sample to other countries. A multi-country sample could establish a data base of information over time that could provide insight into cultural differences, role model influence, and career intentions.

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| <b>Table 1</b><br><b>Most Significant Role Model of Respondents (Percents)</b> |   |   |
|--|---|---|
| <b>Role Model</b>  | <b>Percentage of Respondents:<br/>US Sample<br/>(n=317)</b> | <b>Percentage of Respondents:<br/>Mexican Sample<br/>(n=85)</b> |
| Father   | 61.90   | 62.07   |
| Mother   | 7.14  | 10.34   |
| Sibling  | 1.19  | 3.45  |
| Other Relative   | 7.14  | 11.49   |
| Friend   | 7.14  | 1.15  |
| Teacher  | 7.14  | 9.20  |
| Other Non-Relative   | 7.14  | 2.30  |

| <b>Table 2a</b>   |      |       |
|---|------|-------|
| <b>Extent Of Role Model On Influence On Career Thinking</b> |      |       |
| (1 = no influence and 7 = to a great extent)                |      |       |
| Sample  | n    | Mean  |
| Combined  | 402  | 5.57  |
| US  | 317  | 5.66  |
| Mexican   | 5.26 | 5.26* |

\* Significantly at 1% (F-Statistic=8.875)

| <b>Table 2b</b>  |                           |                   |
|--|---------------------------|-------------------|
| <b>Role Model Influence On Career Thinking Relative to Whether Role Model Owned Business: US and Mexican Respondents</b> |                           |                   |
| (1 = no influence and 7 = to a great extent)   |                           |                   |
|  | Role Model Owned Business | Mean              |
| US Students  | Yes (n=122)               | 5.83              |
|  | No (n=195)                | 5.55 <sup>1</sup> |
| Mexican Students   | Yes (n=56)                | 5.31              |
|  | No (n=29)                 | 5.17 <sup>2</sup> |

<sup>1</sup> Significant at 5% (F=5.065)  
<sup>2</sup> Not significant

| <b>Table 3a</b>   |                    |               |                   |
|---|--------------------|---------------|-------------------|
| <b>Rating Of Interest In Business Ownership Within Ten Years After Graduation</b> |                    |               |                   |
| (1 = no interest and 7 = to a great extent)                                       |                    |               |                   |
|   | Overall<br>(n=398) | US<br>(n=313) | Mexican<br>(n=85) |
| Mean  | 5.19               | 4.85          | 6.46*             |

\* Significantly different at 1% (F=68.958)

| <b>Table 3b</b>   |                              |                   |
|---|------------------------------|-------------------|
| <b>Interest In Business Ownership Within Ten Years After Graduation Relative To Whether Role Model Owned Business</b> |                              |                   |
| (1 = no interest and 7 = to a great extent)   |                              |                   |
|   | Role Model<br>Owned Business | Mean              |
| US Students   | Yes (n=121)                  | 5.40              |
|   | No (n=192)                   | 4.49 <sup>1</sup> |
| Mexican Students  | Yes (n=57)                   | 6.61              |
|   | No (n=28)                    | 6.14 <sup>2</sup> |

<sup>1</sup> Significant at 1% (F=22.362)  
<sup>2</sup> Significant at 5% (F=4.497)

| Variable   | Country | N   | Mean | F      | Sig. |
|--|---------|-----|------|--------|------|
| A. Long hours owned                              | US      | 320 | 3.51 | .222   | .638 |
|  | Mexico  | 87  | 3.44 |        |      |
| C. Away from home                                | US      | 320 | 3.18 | .854   | .356 |
|  | Mexico  | 87  | 3.07 |        |      |
| D. Brought work home                             | US      | 320 | 3.21 | 2.195  | .139 |
|  | Mexico  | 86  | 3.03 |        |      |
| E. Discuss with family                           | US      | 320 | 3.58 | 6.006  | .015 |
|  | Mexico  | 87  | 3.92 |        |      |
| F. Included you                                  | US      | 320 | 3.68 | 10.326 | .001 |
|  | Mexico  | 87  | 4.10 |        |      |
| G. Encouraged reading                            | US      | 320 | 3.39 | .987   | .321 |
|  | Mexico  | 87  | 3.52 |        |      |
| H. At bus before 10 yrs                          | US      | 320 | 3.48 | .301   | .584 |
|  | Mexico  | 87  | 3.41 |        |      |
| I. Paid for minor work                           | US      | 320 | 3.40 | 6.234  | .013 |
|  | Mexico  | 87  | 3.10 |        |      |
| J. Hired in high school                          | US      | 320 | 3.44 | 2.486  | .116 |
|  | Mexico  | 87  | 3.24 |        |      |
| K. Know colleagues                               | US      | 320 | 3.49 | .316   | .574 |
|  | Mexico  | 87  | 3.56 |        |      |
| L. Prof meetings                                 | US      | 320 | 3.19 | 6.096  | .014 |
|  | Mexico  | 87  | 3.46 |        |      |
| M. Comfort lifestyle                             | US      | 320 | 4.20 | 5.368  | .021 |
|  | Mexico  | 87  | 4.48 |        |      |
| N. Discussed job                                 | US      | 320 | 3.83 | .485   | .486 |
|  | Mexico  | 87  | 3.74 |        |      |
| O. Discussed Advantages and Disadvantages of Job | US      | 320 | 3.61 | 7.581  | .006 |
|  | Mexico  | 87  | 3.98 |        |      |
| P. Assumed would follow-                         | US      | 320 | 3.18 | 6.380  | .012 |
|  | Mexico  | 87  | 3.46 |        |      |
| Q. Management details                            | US      | 320 | 3.61 | 4.040  | .045 |
|  | Mexico  | 87  | 3.86 |        |      |
| R. Encouraged joining                            | US      | 320 | 3.22 | 8.522  | .004 |
|  | Mexico  | 87  | 3.53 |        |      |
| S. Another job then join                         | US      | 320 | 3.12 | 4.455  | .035 |
|  | Mexico  | 87  | 3.32 |        |      |

## **A STRATEGIC APPROACH FOR THE SUCCESSION PROCESS OF THE FAMILY FIRM AND THE ROLE OF SOCIAL CAPITAL**

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This paper explores relationship between family firm incumbent owners and the chosen successor. In particular, the decisions made by the incumbent to invest in the successor's social capital and the commitment of the successor to the firm are the main focus. Game theory is used to investigate these issues to achieve optimal outcomes for the parties concerned including the firm. The main findings of this study are that commitment of the successor is important to the firm and the incumbent realising a return from the investment for the firm.

## INTRODUCTION

The transition of a family business from one generation to the next is often a complex process influenced by the dynamics of many different relationships. One of the most important and influential relationships to the outcome of succession is that between the incumbent and the chosen successor. The transition of ownership and/or control from the incumbent to the successor has been attributed with whether the succession is successful and the resultant performance of the firm. Many researchers have suggested that communication between the two parties minimises the level of turbulence resultant of the transition. Furthermore it has been suggested that the communication will provide harmonious continuity of leadership style, strategic direction and the sharing of values.

This view does not consider the fact that each party possesses its own social capital which it brings to the position of owner/controller of the firm. Furthermore the decision of the incumbent to share his/her social capital with the chosen successor and how much is shared will have consequences on the outcomes of the succession and ultimately the performance of the firm post transition.

With the increased levels of education and external training received by successors prior to the succession process many have ample opportunity to develop their own social capital independent of the incumbent and the family firm. The successor brings this social capital with them to the position. Where the values associated with the social capital differ with the values held by the incumbent the potential for enhancing the strategic direction of the firm can result or alternatively conflict with the incumbent may occur. The enhancement is dependent on whether the successor and incumbent can combine their social capital or whether the incumbent is resistant to accepting the social capital of the successor or resistant to sharing their social capital with the successor.

This paper aims to investigate the probable outcomes resultant of the decisions of the incumbent and successors to share or withhold their social capital. Specifically, game theory will be employed to investigate the various strategies that may be adopted by both parties and the potential outcomes resultant of the positions taken.

The relationship between the incumbent and successor is a central theme throughout the family business succession planning literature. The quality of the relationship between these two parties has been highlighted as an important factor that contributes toward the succession process (Fox et al 1996). Cooperation between the two parties has been viewed as being imperative for the succession process to be managed and for negotiations to occur. Furthermore the quality of the relationship has ramifications for the relationships with other key stakeholders in the business, including staff members, important suppliers and customers.

Fox et al (1996) identified several key factors that may become the source of disagreement or alternative views held by the incumbent and successor. These factors include: the leadership style, existing relationships with key staff, relationships with suppliers, feelings about the future direction, ownership and management of the business. Each of these areas can provide differences that lead to alternative strategies adopted by each party toward their relationship with the other. Miller et al. (2003)

identified three common relationship patterns - conservative, rebellious and wavering – in a survey of faltering family businesses.

In this paper we present a *bargaining* game that consists of two players (the incumbent and successor) who are involved in two stages of the game. In the first stage the incumbent invests in developing social capital and human capital in preparing the chosen successor. The development of social capital may be the result of sharing access to the incumbent's social networks with the successor or allowing the successor to develop his/her own. The investment in human capital can be manifested through formal training/education or allowing the successor to gain experience outside the firm. In the second stage, the incumbent makes an offer to the successor to own/manage the firm. The successor has two options – accept or reject the offer. The incumbent can only realise the output of the investment if the successor accepts the offer. Alternatively the successor rejects the offer and chooses to pursue options external to the firm. The main issue in this game is for the incumbent to determine how much he/she should invest in the successor to develop the full potential but without providing too much potential (opportunity) outside of the business.

## BACKGROUND

Wong, McReynolds and Wong (1992) have examined Chinese businesses in Chinatown of the San Francisco Bay area, where 90% of the businesses are family firms. According to them the development and operation of these Chinese firms are the result of a complex interactive process involving ethnic resources-such as traditional values, kinship relations and information networks. These family firms are the prime example of the *jiating*. The term *jiating* is a Chinese concept refers to an economic family unit "consisting of members related to each other by blood, marriage, or adoption and having a common budget and common property" (Lang, 1968, p. 13). These Chinese firms serve primarily Chinese-speaking clients and their hiring preferences are (i) family members (ii) kin (iii) members of the same lineage or clan (iv) Chinese who speak the same dialect. However, family members are mostly favoured because of the assumption that they will be loyal, dependable and trustworthy. More importantly, they are also economical. Hence, Wong et. al. (1992) argue:

*They were quite willing to hire outsiders if family members were unable to participate. Their constraints were economic rather than family related.*

These Chinese family firms are relatively short-lived, rarely extending beyond one generation. One of the reasons is that younger generations, who born and educated in U.S., have more opportunity for social and economic mobility than their parents. Moreover, these young generations often feel alienated from the traditional Chinese management style of their elders and may not even speak in Chinese. As Wong et . al. (1992) have explained:

*.....They have brisk business. A man and his daughter run the firm. The family business has been supporting the education of other children. Now the children are grown up and have found employment in American establishments. They have no intention of returning to family business.*

*Many Chinese family businesses are too difficult to run for young generations. They have to work long hours but receive little reward. The immigrant business is good for those who have no higher education and other opportunities.*

From the above, we have found the following observations:

**Observation 1:** The family business has been supporting the education of children.

**Observation 2:** Once the children are properly educated, they might get higher return from the outside option, hence, they have less incentive to join family business where they have to work long hours but receive little reward.

**Observation 3:** The family business is good for those who have no higher education and other opportunities.

These observations motivate us to develop the following model. The model incorporates the fact that by making transfer payment to successors (i.e. son or daughter), an incumbent (i.e. parents who own the family business) brings potential risk towards the succession process of family business. Indeed, this transfer payment opens up an opportunity to the successor of getting higher return from outside options, which might create disincentive for him to join the family business.

## STRUCTURE OF THE GAME

We consider a two-period game with two players: an incumbent and a successor. In the first period an incumbent makes a transfer payment ( $t$ ), to a successor and the successor gets skilled with that transfer payment. In the second period (also the last period), the return from investment (transfer  $t$ ) to the family firm is realised, this return mainly depends on two things: the level of skill of successor and the benefit generated from social capital, ( $N$ ). Once the return for the family business is realised, the incumbent makes an offer to the successor as a the share of the family business on return of the successor into the firm. The successor can either accept or reject that offer depending on both his inside and outside options.

Note that the more transfer payment a successor gets, the more skilled he becomes, which also increases his outside options. This also brings uncertainty in the succession process. The more transfer payment an incumbent makes, the higher the level of skill of a successor, which may also increase the return of family business. However, the higher level of skill increases the successor's bargaining power by increasing his outside options and this may lead a successor to reject the offer. Based on this trade off the incumbent decides how much transfer payment he has to make to the successor. There also exists the cost of making transfer payment to the successor. The more transfer payment an incumbent makes, the less social capital he can develop for himself – this is due to the resource constraint. We assume that social capital is costly and contains a marginal cost ( $c$ ), which is constant. Furthermore, we assume that if the successor rejects an offer made by the incumbent then this incident leads to an unsuccessful succession process.

In this situation we find that incumbent has always an incentive to have a successful succession process as this will increase the return for the family business, and

subsequently the share for each player (Lemma 1). Besides, when the successor is not committed to join family business, the incumbent can make the transfer payment to the successor in such a way that a successor will always accept that offer (Proposition 1). However, this outcome is suboptimal as in this scenario the family business will realise less return than when the successor is committed to join the family business. Figure 1 shows us the extensive form of the game:

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TAKE IN FIGURE 1 HERE

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### MODEL

There are two players: incumbent (i) and a successor (s). At period 0, player i makes a transfer payment (t) to a player s. Player s will acquire skill with that transfer payment. The return from the skill level (h) which itself depends on t, therefore, one can write h(t). We assume that  $h'(t) > 0$  and  $h''(t) < 0$  i.e. the return function is subject to law of diminishing return. Furthermore, the function h(t) takes the equational form:  $h(t) = t^{1/2}$ . The total return of family business is as follows:

$$\begin{aligned} \max \{t\} R &= [h(t) \cdot d_s + N] \text{ subject to } t + cN = r \\ \text{or,} \quad \max \{t\} R &= [t^{1/2} \cdot d_s + (r-t)/c] \end{aligned} \quad (1)$$

Where, N = social capital, r = resource endowment which is fixed, c = marginal cost of social capital which is constant,  $d_s$  = decision of a player s. We assume that  $d_s$  takes binary values i.e.  $d_s = 1$  if player s joins family business firm, otherwise  $d_s = 0$ . If we differentiate the equation (1) with respect t then from the first order condition we get:

$$t^* = 1/4 \cdot c^2 \cdot d_s^2 \quad (2)$$

Putting the value of  $t^*$  in equation (1) we will get the following :

$$R^* = 1/4 \cdot c \cdot d_s^2 + r/c \quad (3)$$

We are now able to develop the following lemma.

**Lemma 1:** The family return will be higher if a skilled successor will join the family business.

**Proof:** The proof follows from the equation (3). If a successor joins the family business then  $d_s = 1$  and  $R^* = 1/4 \cdot c + r/c$  and if he does not join the family business then  $d_s = 0$  and  $R^* = r/c \equiv R^{**}$ . Clearly,  $R^* > R^{**}$ .

Implication of lemma 1 is straight forward. It means that if a successor joins the family business after acquiring skill with the help of transfer payment  $t$ , the return of family business will be higher. Therefore, a rational incumbent always has an incentive to make his successor to join the family business. Since the higher level of transfer payment increases outside options of a successor, thereby his bargaining power will increase, an incumbent has to make an offer such that uncommitted successor will accept that and join family business. In order to analyse that first we need to find out the disagreement point of each player i.e. what return each player will get if the agreement is not reached. Let assume that being a leader or Chief of a family business, a player get utility  $g^*$ . Hence, the disagreement point for each player will be as follows:

- Disagreement point of an Incumbent ( $D_i$ ):  $D_i = r/c + g^*$  i.e. if the agreement between an incumbent and a successor is not reached then the incumbent will get  $r/c$  as  $d_s = 0$  (follows from equation (3)) and his inside option  $g^*$  i.e. utility of being a Chief executive. Note that we assume that an incumbent has no outside option. This assumption is not too restrictive for our model.
- Disagreement point of a successor ( $D_s$ ): A successor has an outside option. For simplicity we assume that perfect competition prevails in skill labour market and the market wage for skill labour is  $w$ . Whether the successor will realise this market wage or not, depends on his level of skill which in turns depends on how much transfer payment  $t$  he gets from an incumbent. If the probability of realising market wage is  $\phi(t) \in [0,1]$ , then the return of his outside option will be  $\phi(t)w = t w$  minus  $g^*$  as he has to give up the utility of being a chief (if accepts an offer made by an incumbent). The function  $\phi(t)=t$  captures the fact that the more transfer payment ( $t$ ) a successor will get, he will realise higher level of wage which means his return of his outside option goes up. Therefore, one can write as follows:  $D_s = \phi(t)w - g^* = t w - g^*$ .

Having discussed these disagreement points, now we consider two cases:

**Case 1:** A Successor is not committed to join family business

If a successor is not committed, then an incumbent has to make the following offers (follows from Nash Bargaining Solution (NBS)):

$$X_s = D_s + \frac{1}{2} [R^* - D_i - D_s] = \frac{1}{2} [1/4c + tw - 2g^*]$$

$$X_i = D_i + \frac{1}{2} [R^* - D_s - D_i] = \frac{1}{2} [1/4c + 2r/c + 2g^* - tw] \quad (4)$$

Where,  $X_i$  and  $X_s$  are the shares of the return of family business of an incumbent and a successor respectively. The equation (4) follows from equation (3) and putting the values of  $D_i$  and  $D_s$ .

If the incumbent wants his successor to join his family business then he has to make sure that the following condition is satisfied:

$$X_s \geq tw - g^*$$

$$\Rightarrow \frac{1}{2} [1/4c + tw - 2g^*] \geq tw - g^*$$

$$\Rightarrow t^{**} \equiv 1/4 \cdot c/w \geq t \quad (5)$$

The equation (5) helps us to develop the following proposition:

**Proposition 1:** If the successor is not committed then the incumbent will make transfer payment ( $t$ ) to a successor such that  $t \leq t^{**}$ . By making such transfer payment an incumbent can keep successor in family business. In this scenario an incumbent and a successor will get the following respective shares:

$$X_s = 1/4c - g^* \text{ and } X_i = r/c + g^*$$

This is also a Nash Bargaining Solution (NBS).

**Proof:** The proof follows from equations (4) and (5).

The above proposition tells us that an incumbent can make transfer payment  $t$  in such a way that a successor will find that the return of family business is higher than his outside option, hence, a successor will join family business.

**Case 2:** Successor is committed to join family business

If the successor is committed to join the family business then an incumbent will make transfer payment  $t^* = 1/4 c^2$  (see equation 2;  $d_s = 1$  in this case) to a successor and each player will get the following share of the return of family business and this is also NBS:

$$X_s = X_i = 1/2 R^* = 1/2 [1/4c + r/c] \quad (6)$$

This follows from the equations (3) and (4). We also assume that if the agreement is reached between an incumbent and a successor then the disagreement points for each player will be zero i.e.  $D_i = D_s = 0$ .

We need to compare the two transfer payments:  $t^*$  (when a successor is committed to join family business) and  $t^{**}$  (when a successor is not committed to join family business). This develops the following lemma:

**Lemma 2:** if  $c > 1/w$ , then  $t^* > t^{**}$ .

**Proof:** We know that  $t^* = 1/4 c^2$  and  $t^{**} = 1/4 \cdot c/w$ . Putting  $t^* > t^{**}$  one will get  $c > 1/w$ . This completes our proof.

Lemma 2 tells us that if  $c > 1/w$ , then the incumbent will always make higher transfer payment in the case where a successor is committed to join family business.

We are now in position to develop our second proposition, which is as follows:

**Proposition 2:** If Lemma 2 holds, then the return for the family business will be higher when the successor is committed to join the family business than in the case when he/she is not committed to join the family business.

**Proof:** Put the value of  $t^*$  and  $t^{**}$  in equation (1). Then one can easily show that  $R(t^*) = [1/4c + r/c] > R(t^{**}) = [1/2\{(c/w)^{1/2} - 1/2 \cdot 1/w\} + r/c]$ , provided that lemma 2 holds.

Proposition 2 is very important for policy implication as it tells us how the succession process is related to the return of family business. The fact is that if an incumbent does not know the commitment of his successor – as to whether he/she will join the family business or not, the incumbent will invest less (i.e. make less transfer payment to the successor) which also reduces the return of family business and produces suboptimal outcome. In other words, uncertainty in the succession process has a negative impact on the return of family business. Furthermore, the marginal cost ( $c$ ) of social capital ( $N$ ) plays a crucial role in determining the family earnings on return.

The following numerical simulation (figure 2) illustrates our proposition 2. We normalize  $w$  to 1 and lemma 2 implies if  $w = 1$  then  $c > 1$ . Based on these we draw the following figure where  $w = 1$  and  $c = 1.1 \dots \dots \dots 100$ .

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From figure 2 it is obvious that the return for the family firm is greater when the successor is committed to return to the family firm. However large investments from the incumbent would only follow when the incumbent is certain that the successor will return to the family firm. For the incumbent to know with more certainty that the successor will continue with the family firm, he/she might consider, if possible, making the family firm option more attractive than external options.

## CONCLUSION

A key contribution of this paper is contained in proposition 2. This proposition provides valuable insights for owner/managers of family businesses in determining appropriate strategies for succession planning, specifically when deciding on how much investment they should made toward the successor's development of social capital.

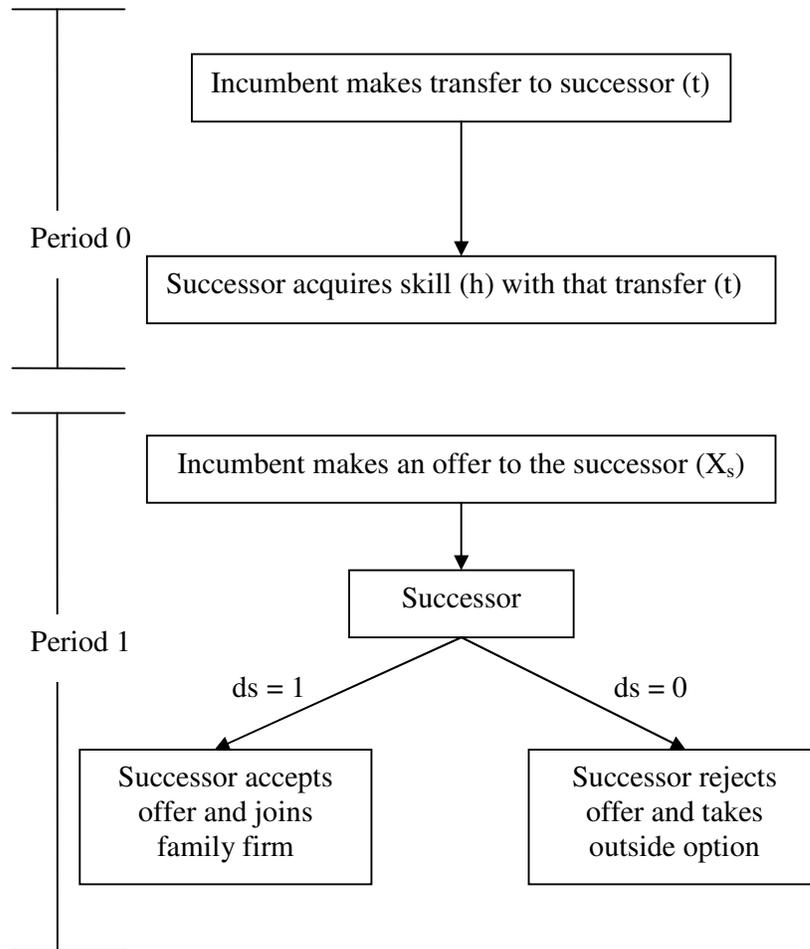
The commitment of the successor is imperative for the realisation of a return to the family firm from the investment in the successor's social capital (some of which is gained through education). To gain such commitment the incumbent should make the option of remaining with the family firm more attractive than external options. For

some firms this may be in the form of remuneration and financial incentives, for others it is important that the incumbents articulate both short term and long term benefits. Some times the long term benefits will only be possible if short term benefits are achieved and the long term benefits for the chosen successor may be manifested by them one day becoming the incumbent. In these cases perhaps the best strategy for the incumbents is to discuss the succession plans with timelines with the chosen successor.

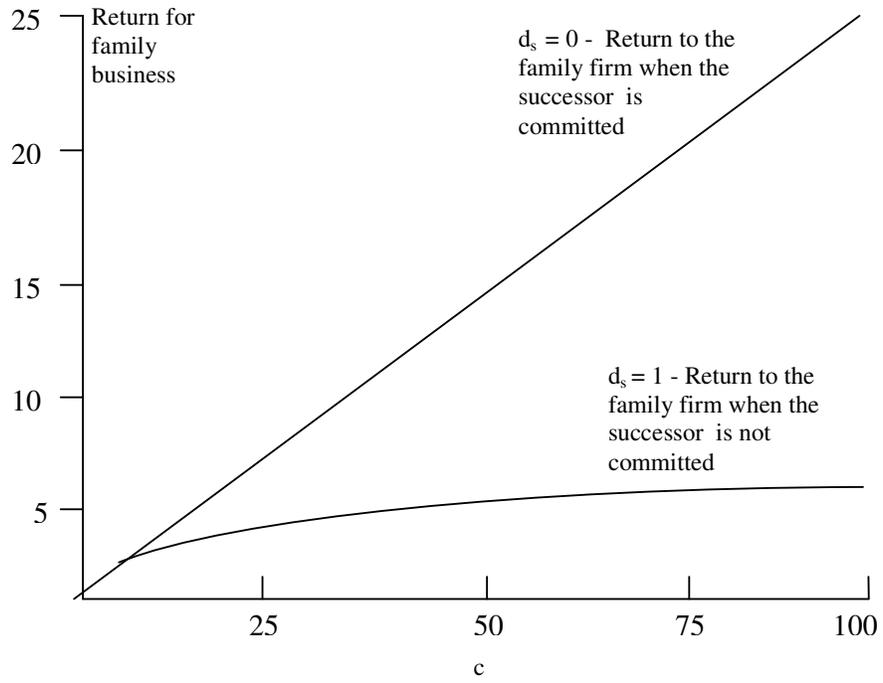
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## FIGURES



**Figure 1: An Illustration of the game**



**Figure 2: Numerical simulation of results of decisions made by successor**

## A PERFORMANCE MEASUREMENT SYSTEM FOR SME NETWORKS

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### Abstract

The present study is based on two perspectives, by means of which we try to produce added value to discussion on SME-networking. These perspectives are a system view and a view that considers networks as entities. Previous performance measurement systems have focused on the level of single enterprises. *The objective of this paper is to create a network-level performance measurement system by presenting a theoretical framework for a network-level performance and by presenting preliminary measures in different parts of it.* A network-level performance measurement system emphasizes win-win situations in the network between the leader enterprise and the other members of the network.

The suggested framework for a performance measurement system is composed of the factors that enable action and success, of the processes, and of the productivity and profitability of activities. The issues enabling success are (1) the values and culture of the network, (2) resources, competences, as well as the (3) modes of action of the networks. The profitability of activities can be divided into (4) the profitability of internal processes, into (5) the customer satisfaction and into the (6) financial key ratios of the network.

Developing a performance measurement system for a network headed by a leader company is important from both a theoretical and a managerial perspective. These results are needed in order to understand the successful and the unsuccessful development and performance of vertical networks, and in order to develop an analyzing, designing and measuring tool for managerial needs in regard to SME networks.

## INTRODUCTION

### Gaps in the previous networking and performance measurement research

During recent years, the authorities have attempted to promote inter-firm co-operation very actively by trying to persuade small and medium-sized enterprises to enter different alliances. Nevertheless, the results are not always very flattering. Different promoters of networking have had limited knowledge about how to contribute to successful development in cooperative groups. Evidently, practitioners (consultants as well as entrepreneurs) do not have effective enough tools at their disposal when trying to form networks. It is very conspicuous that there has been hardly any research about the management tools and the holistic performance measurement of SME networks. For instance, network accounting has been approached mainly theoretically, introducing some evident problems (Järvenpää, Partanen & Tuomela 2001; Tomkins 2001; Kulmala 2003). Applying system level control mechanisms and performance measurement tools to a network is very important when managing networks. A network is not an intrinsic value but a tool to organize the operations between companies, and that is why there is so much interest in the ability of networks to succeed in their tasks. The companies in a network are interested in the benefits and costs of networking, the investors are interested in the revenue opportunities involved in a network, and the customers in the value chain are interested in the ability of the network to manage production tasks as well or better than an integrated single company.

The units of analysis in previous networking studies have varied all from an individual person (Birley 1985) to a firm (e.g. Tikkanen 1997), to a dyadic relationship (e.g. Vesalainen 2002a,b; Toivonen 2000; Malinen 1998; Holmlund 1997), to a network or a group (e.g. Varamäki 2001; Nummela 2000; Hyötyläinen 2000) and to a network or regional industry (Kalantaridis 1996; see also Oliver & Ebers 1998: 556). A great amount of research has, however, been done on dyadic or bilateral relationships between two partners in a vertical chain including buyer-seller relationships, channel dyads, buyer-supplier alliances, and distributor-manufacturer partnerships (Gulati 1998). However, new cooperative ventures involve increasingly multiple partners (see also Doz & Hamel 1998: 7) instead of only two partners. The system view of networks is currently becoming of theoretical interest. From a managerial point of view, applying system level control mechanisms and performance measurement tools to a network is very important when managing networks.

At the moment, the research on applying management accounting (MA) methods in network environment is in its early stage. Perhaps the most studied area in the field of network management control is *cost management* in networks (e.g. Kulmala & Paranko 2002; Kulmala 2003). Networking sets special challenges for cost accounting; single companies should be aware of their product costs. Furthermore, open book costing and wide dissemination of cost information is required. (Tomkins 2001; Kulmala & Paranko 2002). In this area, the overall goal is to minimize the total costs and to maximize the revenues in the network.

### Objectives of the paper

The present ongoing study is based on two perspectives, by means of which we try to produce added value to discussion on SME-networking. These perspectives are a system view and a view

that considers networks as entities. A network-level performance measurement system emphasizes win-win situations in the network between the leader enterprise and the other members of the network. In the present paper, *the objective is to create a network-level performance measurement system by presenting a theoretical framework for a network-level performance and by presenting preliminary measures in different parts of it.*

Ebers and Grandori (1997: 268) have indicated, among other things, that more research is needed to focus on certain types of networks and to assess and predict which models of networks produce certain results. In the present study, we are concentrating on SME networks headed by a leader company, because that model is the most common one in practice and research results have proven the fact that this way is also the most successful model of networking. In many cases, in vertical networks, co-operation between the leader company and the other cooperative members, which usually are subcontractors, resembles more a zero sum game than win-win co-operation. Our assumption is that not even a leader company can succeed in the best possible way if the network around it is not performing well.

We employ a *constructive research approach* developed by Kasanen, Lukka & Siitonen (1993), by working as an exceptionally large research team, which includes 13 researchers representing different disciplines of managerial research, such as accounting, management and entrepreneurship. The research project started in 2002 with a pre-study. This part was funded by Sitra (The Finnish National Fund for Research and Development) and during the project, a theoretical framework for the network measurement system was created. (Varamäki, Pihkala, Järvenpää & Vesalainen 2004). The project is now continuing with the financing and steering by Sitra, Tekes (National technology agency in Finland) and case firms. There are four case networks in the study. All of them are so-called leader-driven networks, including one strong leader firm. During year 2004, we have carried the theoretical pre-work needed and conducted case studies in network companies. So far, we have conducted 60 interview sessions, lasting approximately 1.5 to 2 hours per session. Additionally, we have conducted phone interviews, meetings and e-mail queries. We have gathered plenty of documents and detailed information from the case networks. Four networks actually include 20 different companies as case sites of this study.

## **A FRAMEWORK FOR A PERFORMANCE MEASUREMENT SYSTEM IN NETWORKS**

According to our pilot study (Varamäki et al. 2004), the suggested framework for a performance measurement system is composed of factors that enable action and success, of processes, as well as of the productivity and profitability of activities. The issues enabling success are (1) the values and culture, (2) resources, competences, as well as the (3) modes of action of the network. The performance of activities can be divided into the (4) performance of internal processes, into (5) customer perspective and into the (6) financial perspective of the network. The *values and culture* of the network describe the mental state of the network through trust, commitment, partnership values and communication within the network, such as interaction manners and openness. *Resources and competences* are connected in particular to the ability and capacity of the network to produce core output to the business effectively and, on the other hand, to create and to develop new modes of action. The resource base of the network is comprised of the

tangible and intangible resources of the individuals and the companies in the network, and of the compatibility, specialization / overlapping of those resources. The *modes of action of the network* describe the ability of the actors in the network to design and to exploit different modes of action in the network; for instance, the elements and models of bilateral and multilateral co-operation.

In the network, the above-mentioned enabling elements (values and culture, resources and competences, modes of action) are the *structural* and *operational choices, achievements* and *capabilities*, which are the seminal value drivers creating the base for the financial performance and profitability of the network. This performance could be evaluated by using the familiar logic of the Balanced Scorecard (BSC). In the causal logic of the BSC, it is generally assumed that a learning and well-being organization is 1) able to make innovations, and, furthermore, 2) effective and high-quality processes. Moreover, if these innovations and processes are customer-driven, the firm or the network will achieve 3) satisfied and profitable customers. This success in the eyes of the customer and customer profitability will be also reflected in the 4) overall financial success (profitability, solvency and liquidity) of the company/network, according to the logic of the BSC. In a well-run network, the profit is not divided in a zero-sum game, in which a profit increase in one part means a profit decrease in some other part. The framework is illustrated in the following figure.

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Figure 1 about here

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In the following, the different perspectives of the suggested framework for a performance measurement system will be conceptualized in more detail.

### **Values and culture in the network**

Market exchange is embedded in social relations; therefore, the social element has an effect on the different aspects of this exchange. In this study, network is defined as an intermediate form between markets and hierarchies. In line of the definition of a network, network culture is defined as a shared mindset of the actors in the network. The shared mindset is constructed on the basis of trust (relational dimension) and feeling of community (cognitive dimension).

As the measurement method for analysing the performance of the network comprises the dimension of values and culture, they are expected to support the performance of the network. The social dimension is argued to reduce transaction costs (partner search costs, negotiation costs and monitoring costs) (Gulati 1995; Zaheer, McEvily & Perrone 1998; Dwyer, Schurr & Oh 1987; Sako 1992), induce commitment (Morgan & Hunt 1994), induce customer loyalty (Foster & Cadogan 2000), support specialization, and to support information sharing and learning (Parkhe 1998; Ring & Van de Ven 1992; Hamel 1991). Here it is suggested that the network values and culture have an enabling role in the network. It enables profitability and growth by bridging and bonding the actors.

In this study, the social dimension is defined as network culture consisting of three sub-dimensions: relational, cognitive and structural (Nahapiet & Ghoshal 1998). The relational dimension mainly consists of the element of trust in this study. Trust is defined as a belief

consisting of eight different sub-beliefs. Trust as a belief refers to an attitude based on the cognitive rationalization of one's experiences and feelings. The sub-beliefs are the 1) capability belief, 2) predictability belief, 3) integrity belief, 4) benevolence belief, 5) honesty belief, 6) deterrence belief, and 7) reciprocity belief. The measurement of trust is based on these sub-dimensions. (McKnight, Cummings & Chervany 1998; Blomqvist 2002; Butler 1991; Butler & Cantrell 1984; Kee & Knox 1970; Swan, Trawick & Silva 1985; Coulter & Coulter 2002; Dasgupta 1988; Good 1988; Luhmann 1988; Rotter 1967; Coleman 1990; Gustafsson 2002.)

The cognitive dimension is based on the shared feeling of community between the actors in the relationship. This sharing forms the core element of the feeling of the community, the feeling that "*we're in this together*". This means the actors have a 1) shared vision, 2) shared mission and purpose, 3) shared goals, 4) shared rules and, to some degree, 5) shared values. This dimension does not suggest that the network should share exactly the same values, but the emphasis is rather on the first four dimensions, implying that the network needs a shared purpose and rules but accepts diversity among the actors. Still, shared values are often raised as an important factor of performance in the earlier literature. (Lewicki & Bunker 1996; Hart, Capps, Cangemi & Caillouet 1986; Coulter & Coulter. 2002.)

The structural dimension refers to the structure of network from the leader company's point of view. Typically, the core of the network structure can be described by measuring the number of the weak and strong ties or the number of the structural holes. Fourthly, the amount of communication is an interesting aspect to measure.

The measurement of the dimensions is based on a three-level scale: 1) calculativeness, 2) knowledge and 3) identification. The first and lowest level refers to calculativeness, meaning a typical market relationship, which is based purely on short-term exchange. In a calculative relationship, there often exist deterrence-based trust and trust in reciprocity. In these relationships, the parties expect to gain. The second level refers to a knowledge-based relationship, in which the actors have knowledge about each other. On the basis of knowledge, some indications of trust (trust in a) predictability, b) capability, c) integrity, d) honesty) and shared rules exist and can be identified. Trust is typically interpreted as knowledge-based. The third and highest level is based on identification. At this level, it can be expected that the actors trust each other's benevolent intentions and behaviour, but they also share the same purpose and values that drive their partnership and strategic network forward. Both the relational and the cognitive dimensions are difficult to measure, while the structural dimension can be evaluated more objectively.

## **Resources of the network**

When considering the resources in the network environment, the value of the whole network and its resources could be described as the sum of the (1) resources fit with customer needs, (2) the co-operation ability and willingness of the network and (3) the entrepreneurial capability of the network to reach new business opportunities. This means that the resources within a network are valuable only when particularly the leader company of the network is able to see the potential of the network resources correctly and is able to co-operate with the network resources and their owners and, at the same time, is able to coordinate the resources to fulfill the customers' existent

or potential needs. This model of resource measurement within the network aims to be a tool for analyzing the subjective value of the network resources within their own context. The purpose is not to find the absolute values or market prices for the resources. The main contribution of this type of tool and measurement process could be that it allows the companies to see positive or negative progress within the network by the aid of longitudinal measurements.

The value of a resource depends on the process it enables, and the value of the process is determined by the market where it takes place. Hence, the demand of the market and the competition among the companies in the market are essential value drivers. The ultimate value of the resource depends on the resources fit to the customers' needs. The process that the resource of the supplier provides must have interaction with market demand through the customer's acts - in this case, the leader company's acts. Without the willingness and ability to cooperate, the resources of the network will not have that interaction and the value adding potential will be lost.

From the customer's point of view - in this case, from the leader company's point of view - one additional requirement for the full utilization of the resources in a network is the ability to recognize and to evaluate the resources correctly. Without it, the leader enterprise is unable to use the resources in the strategy. If the leader company does not know the resources of the network or makes an inadequate evaluation of them, it is forced to build its strategy upon its own resources. The sum of the perceived value of the network resources for the leader company is the comparative value of the suppliers' resources in relation to the value of the resources of their competitors and the leader company's valuation of them. The better the valuation, the better the opportunities to bring the resources into interaction with market demand. Again, without cooperative skills and willingness to cooperate, the evaluation process of the network resources is often too demanding and likely to be inaccurate.

In our framework, the measurement of resources starts from the (1) evaluations of the resources of a single supplier, continues with the (2) evaluations of the awareness and familiarity, and with the (3) evaluations of the applicability of the suppliers resources and ends with the (4) evaluation of the allocation and development practices within the network. The logic in the measurement tool is that these dimensions will provide the assessment of the value and also value potential of the resources within the network headed by the leader company.

### **Models of action in the network**

By models of action in networks, in this study we refer both to bilateral and multilateral inter-organizational relationships, where the intensity of relationships is varying. This approach has been applied to dyad relationships between a customer and a supplier. Dyad relationships always form a ground for a larger network (e.g. Johannisson 1988) and although the level of analysis in our study is that of a *network*, it is evident that bilateral relationships between a leader company and suppliers have to perform well in order to guarantee success in the whole network. In addition to the quality of bilateral relationships, the quality of multilateral co-operation has to be taken into account in a system-level performance measurement. The assumption in our study is that inter-organizational relationships in a network are regarded as deeper if the links between parties are highly organizational, i.e. structural, highly strategic and more multilateral (see Vesalainen 2002a; 2002b).

When analyzing the models of action in a network, business integration and organizational integration between the companies are considered. Business integration is divided into two sub-dimensions, which are strategic integration and the features of the exchange between the companies. Organizational integration is divided into the sub-dimensions of structural integration and social capital. The basis of analysis of the network intensity of organizational links is about the same in the cases of bilateral and multilateral relationships, where the structural links (interface structures, system and process integration) are multiple compared to a dyad relationship. The organizational arrangements are just more challenging when there are more actors taken into account. The analyzing of social capital could be based on a study of trust between two persons or two organizations. The study should also include the consideration of trust in the group as an entity, interaction in the group, as well as cultural cohesion and the cohesion of objectives within the group.

Business cohesion at the network level is evaluated through joint development, joint products and joint public presence. Strategic integration and all its sub-dimensions are considered in the same way in both bilateral and multilateral relationships. In a bilateral relationship, the dependence between the actors is two-way dependence of a supplier and a client. Also in multilateral relationships, there is two-way dependence, but the dependence is between a single company and a group of the other companies. Strategic planning is roughly similar in both cases, but in the case of multilateral cooperation, strategy is the collective strategy of the companies within the network. In multilateral cooperation, the risk is also shared, but there are more than two partners to take the responsibility. Additionally, profit sharing and win-win policy between the partners has the same logic in both multilateral and bilateral cooperation, where success depends on the ability of the companies to enhance the volume or to produce more effectively.

### **Performance of processes in the network**

In a network, the above-mentioned enabling elements (values and culture, resources and competences, modes of actions) are the *structural* and *operational choices*, *achievements* and *capabilities*, which are the seminal value drivers creating the base for the financial performance and profitability of the network. This performance could be evaluated by using the logic of the Balanced Scorecard (BSC). It is generally assumed in the causal logic of the BSC that 1) a learning and well-being organization is able to make innovations, and, furthermore, 2) effective and high-quality processes. The outcomes will be realized as quality, speed, effectiveness, flexibility, innovativeness, etc. in a supply chain.

One major aspect in the development of network processes is optimization. Firstly, it is a question of synergies between the development attempts related with the different activities. Development achievements in one activity might lead to unfavourable results in some other activities. In this study, the development of the network process performance is further subdivided into product development and manufacturing processes. Performance is further categorized into external and internal efficiency. Internal efficiency is realized in the efficiency of the manufacturing process. Productivity and time-based measures play a key role here. External efficiency deals with the ability to develop and launch new and competitive products into markets. (Vesalainen 2004)

Manufacturing processes in networks are divided into 1) normal processes, 2) the development of normal processes, and 3) problem-solving processes. A problem-solving process is about handling disturbances in a normal process. Accordingly, the performance of the normal processes of a manufacturing process could be measured with terms of productivity and time. The two other processes - development and problem solving – have an impact on the performance of the normal process. A development process is aimed at improving a normal process and associated costs could be allocated annually into the normal process in the case of the developments related with continuous improvement. Larger development projects should be treated as long-term assets and allocated annually as depreciations at the first stage and in a normal process as overhead costs at the second stage. (see Vesalainen 2004)

### *Process measures; towards shared reality and learning*

Common measures of operation processes (order-manufacturing-delivery processes) are generally applicable also in network conditions, depending on the specific business of each network. What is important, however, is that there is a clear and shared strategy about the shared future and direction behind these measures. One key notion related with this is that the measurement of the network processes creates a shared awareness of the shared network alongside the network. The measurement clearly creates a socially constructed reality (e.g. Berger & Luckmann 1966; Hines 1988), which is most important to the meaningful management and development of the network as an entity.

Measurement of a network process raises the process as an object of control by directing peoples' attention towards it. The basis of network learning and its measurement is the examination of supply and value chains as systems of modularity in which different product, process and knowledge architectures are described as the antecedents of learning and the effect of learning on the effectiveness and the performance of the processes in a supply chain and on the ability of a value chain to yield positive economical outcome to all the participants in the cooperation network. The ability of a value chain to yield added value is examined as the ability of the cooperation network to yield added value to its customers, generated by the price and/or the properties of the product. The analysis of the cost structures produced by activity-based cost accounting indicates which are the factors affecting the added value in the value chain in a negative way. On the other hand, factors affecting the properties of the product in a negative way are discovered by an analysis of the product and production architectures.

### **Customer perspective in networks**

According to studies (e.g. Malmi 2001; Puro 2001; Toivanen 2001), the customer perspective is commonly judged as the most important perspective of strategic performance measurement systems. This is obvious, because customers constitute one essential stakeholder group, particularly because money is received from the customer and the success in the marketplace is determined by the customer. To some degree, customers' focus is thus an absolute necessity. Also customer-orientation and the quality movement in business life further underline the importance of the customer. The elements of the customer perspective are presented e.g. by Kaplan & Norton (1996)

The logic of the customer focus is simple. It is expected that customer orientation increases customer satisfaction, which, in turn, increases customer loyalty, which, in turn, increases profitability and improves shareholder value. Of course, this relationship is neither straightforward nor linear and has many limitations in real life. (cf. Tuomela 2000)

Customer satisfaction is not only an issue in the customer perspective, but this phenomenon is multidimensional. Customer satisfaction is not only an issue in the customer perspective, but this phenomenon is multidimensional. Some core measures suggested by Kaplan & Norton (1996) are market share, customer loyalty, customer satisfaction, customer acquisition and customer profitability. So far, there is no reason to expect that overall customer measures in networks differ from those in single companies. The challenge is merely to manage the network in a way that these critical success factors could be achieved from the customer perspective. This kind of measurement has thus the potential to visualise the end customer perspective in network conditions and, therefore, to create customer-oriented reality (Hines 1988) by quantifying the customers and making them calculable (Vaivio 1999).

### **Financial data and financial statement indicators in estimating the economic performance of a network**

In this part, a framework is presented for the measurement of the economic performance of the network and of the network member firms. The primary objective is to make an approach towards network financial statement analysis. This analysis consists of estimating and predicting the economic effectiveness of the network and the economic efficiency of its member firms, with the help of indicators based on the public financial statement information and the internal (intranet) financial data of the network firms.

The amount of internal financial statement information (openness) determines what and how reliable results are obtained from the analysis. However, the objective of the analysis is to create at least a coarse idea of the effectiveness of the network and of the fairness of the distribution of the economic advantage of the network between the member firms, irrespective of the amount of this information. The more reliable figures the member firms desire to have about these matters, the more they should invest in developing accounting systems and in the openness of information. Especially, the member firms should be able to separate their mutual network transactions from their other business.

The objective of networks-specific financial statement analysis is to estimate the effectiveness of the network and the efficiency of its member firms. The frame of reference developed in the study contains the basic factors of the economic analysis of the network and of relationships between them (a strategic map). In this approach, the *resources* of the network are considered as a starting point for the operation of this network. These resources will generate causal links towards three different directions. In the first direction, the *growth* and *concentration* of the resources of the network are analyzed between the member firms. In the second direction, both the *productivity* and the *profitability* of these resources are estimated. The third direction describes the *mutual (internal) flows* of the network (in other words, the business interaction matrix, BIM) between its member firms, containing inside the network the flows accomplished

by the resources. These flows are vital to the operation of the network and they also have an effect on its growth and profitability.

The variability of the flows, which is manifested in the interaction matrix, contains a *risk* related to the network. Information about growth (or concentration) and profitability makes it possible to make a coarse prognosis about the economic advantages produced by the network in the future, i.e. about the future flow of net income. When this predicted flow of net income (containing the separate effect of the network) is discounted at the moment of analysis with the interest rate adjusted for the risk, an estimate of the *value* of the network (network capital) will be obtained. The determination of the network value is one of the most central tasks of financial statement analysis because it shows in particular the economic effectiveness of the network.

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Figure 2 about here

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## Summary

Next, in Table 1 we provide a summary of the perspectives and preliminary measures of the network measurement system created in this research project. In Appendix some examples of concrete measures of the framework are presented as well. The next step of the study is to define and implement systems for each single network and to define the general measurement model with general and network-specific measures.

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Table 1 about here

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## DISCUSSION

After the theoretical part, we will now continue our study by testing a network-level performance measurement system in practice with four vertical case networks. In this sense, our study aims to contribute both to a theoretical and a managerial perspective. These results will help us understand the successful and the unsuccessful development and performance of vertical networks in the spirit of a strategic map (Kaplan & Norton 2001). The potential benefits of this *total research project* for practical actors, entrepreneurs, small business managers, network promoters, authorities, and network investors will be the following:

1. It is possible to inform companies and other practitioners of how a network headed by a leader company acts “ideally” in different areas of networking.
2. Members of networks and investors in networks are able to use the “ideal model” for a network headed by a leader company as a tool to analyze, evaluate and to develop networks.
3. Within networks headed by a leader company, it is possible to utilize this model to consider suitable networking strategy and to choose the most suitable level of networking.
4. The “ideal model” to be developed allows companies, consultants, authorities, and investors to use it as a tool for education.

5. The “ideal model” will produce new innovative methods and ways of action.

## **APPENDIX.**

**Some examples of measuring Culture and Values in the network (Scale 1=strongly disagree – 5=strongly agree).**

1. Our partner acts in a double-dealing way.
2. Our partner provides aid for us when we need it.
3. Our partner does not overestimate their own capabilities to serve us.
4. Our partner acts are predictably in different situations.
5. Our partner is capable to fulfill the objectives we set.
6. Our partner does not betray us because of the fear of losing their reputation in the eyes of other suppliers.
7. Both parties of the relationship are trying to develop a common business process.
8. We feel we are “in the same boat” with our partner.
9. When meeting each other, both parties in the relationship are able to freely express their opinions about the relationship and its development.

## **Some examples of measuring Resources in the network.**

**Questions related to evaluation of the value of the resources of single companies (Scale 1=strongly disagree – 5=strongly agree).**

1. The technical service we offer our customers is rare in our region.
2. The integrated service package we offer our customers (delivery deadline, delivery reliability, price, capacity, extent) is rare.
3. In certain things, we are clearly better than our competitors.
4. The service we offer is essentially connected with our customer’s core know-how
5. Our customer’s activities are strongly dependent on our enterprise.
6. It is difficult for our competitors to copy our strengths.
7. Our relation with our customer would be difficult to replace by a new supplier.

**Questions related to awareness of others’ resources (Scale 1=strongly disagree – 5=strongly agree).**

1. We know very well our suppliers’ capabilities to serve us in relation to both quantity and quality.
2. We are aware of possible complementary know-how and resources with our suppliers.
3. We know the products and services offered by our customer well, regarding both quantity and quality.
4. We are aware of possible complementary know-how and resources with our customer.
5. We know the products and services offered by the other enterprises in the network, regarding both quantity and quality.
6. We are aware of possible complementary know-how and resources with the other companies in the network.

**Questions related to applicability of the resources (Scale 1=strongly disagree – 5=strongly agree).**

1. The products and services offered by our suppliers correspond well to our needs, also in the future.
2. In their activities, our suppliers concentrate on factors essential for our strategy (e.g. product development, price, quality, delivery reliability, flexibility, etc.).
3. What we primarily want from our suppliers is a priority also in our suppliers’ activities (e.g. price, quality, delivery reliability, etc.)
4. In our network (the other enterprises in the network), there is no significant overlapping know-how.
5. The know-how and resources of the other enterprises in the network complete our own know-how and resources.
6. The business activities of the other members of the network are mainly in lines in some way connected or touching our own activities..
7. The development of the resources among the members of the network would help us serve our customer better.

8. The joint development of the resources of the network is essential for the competitiveness of the network.
9. The joint development of the resources in the network would help us develop our own business activities.

**Questions related to allocation and development of resources (Scale 1=strongly disagree – 5=strongly agree).**

1. In addition to our enterprise's own strategy, we have a common network-level strategy, which also acts as a guideline to our own activities.
2. We feel we are "in the same boat" with the other enterprises in the network.
3. The enterprises belonging to the network have highly similar goals regarding their business operations.
4. The enterprises in the network are able to cooperate in a straightforward and fluent way.
5. Our suppliers adapt themselves rapidly to our changing needs.
6. We develop know-how and learn new things with the other members of the network.
7. We discuss the future investments of the network together with the other members of the network.
8. We seek to develop different roles for each enterprise within the network.

**Some examples of measuring Models of action in a network in terms of multilateralism**

**Common product development**

- |          |  |
|----------|--|
| 3 points | New products and services are developed in the business group in such a way that all the firms are involved, but none of them gets individual compensation; the results of development are jointly owned and utilized.   |
| 2 points | New products and services are developed in the business group in such a way that all the firms are involved, but none of them gets individual compensation; the benefits are mainly owned by a certain company in the group, but each of the companies is compensated when the product reaches the market. |
| 1 point  | New products and services are developed in the business group in such a way that all the firms are involved and also compensated according to their prime costs of the development process; the benefits are shared when the product reaches the market.   |
| 0 points | There is no common product development in the group.   |

Present state:  Objective state:

**Common brand and image**

- |          |  |
|----------|--|
| 3 points | The business group has developed a common image or a common brand for their products or services; the common image or brand is well-known in the market.   |
| 2 points | The business group uses a common brand or image, but each company has still their own individual brands and images; the common brand or image is not widely known in the market.   |
| 1 point  | The business group has joint public presence, common brochures or another kind of loose cooperative arrangements, but the group is not trying to build up a common image or a common brand for their products or services. |
| 0 points | The business group does not try to appear as a group.  |

Present state:  Objective state:

**Decision-making**

- 3 points      The decisions are made in consensus, i.e. all the parties must accept the important decisions.
- 2 points      The business group makes their decisions democratically, i.e. the majority makes the decisions
- 1 point        The business group makes their decisions hierarchically, and the leader company has the most important role in decision-making.
- 0 points      The business group does not have common decision making practices; all the decisions are made inside the individual companies or in the dyad relationships.

Present state:       Objective state:

### **Some examples of Financial measures in the network**

Network resources

Tangible assets / Total assets for each member firm and for the whole network

Network growth

Growth in net sales for each member firm and for the whole network

Network concentration

Distribution of net sales among the member firms in the network

Network productivity

Net sales / Total assets for each member firm and for the whole network

Network profitability

Return on investment ratio for each member firm and for the whole network

Network flow

Mutual sales and purchases (cash flows) between the member firms of the network

Network risk

Variability in mutual cash flows for each member firm and for the whole network

Network value

Discounted cash flow of net profit from the network for each member firm and for the whole network

### **ACKNOWLEDGEMENTS**

This paper is part of a broader research project, Pyranet, funded by Tekes and Sitra and the four companies involved. We thank all of them for their financial support for this research.

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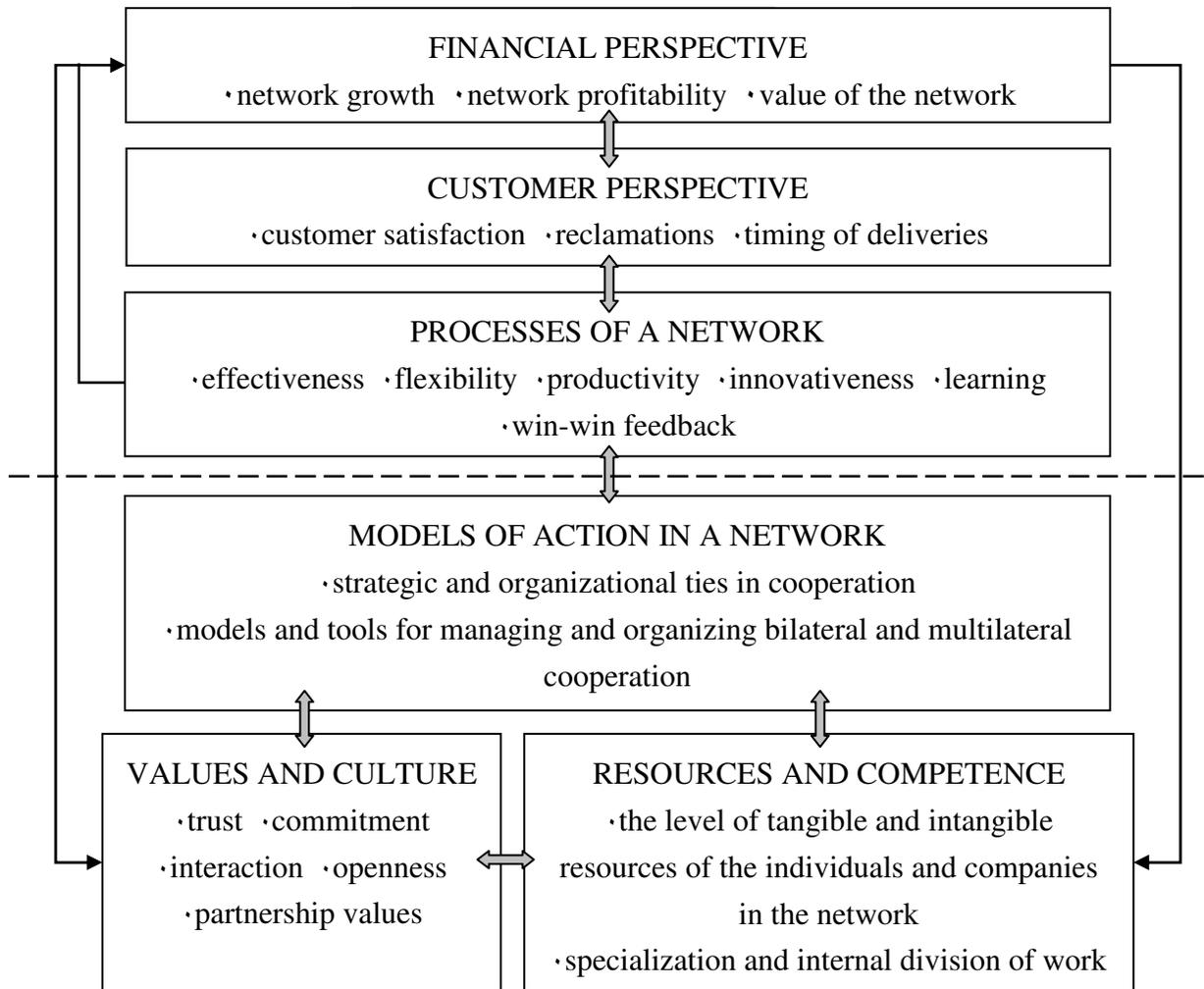


Figure 1. A framework for analyzing performance measurement in networks.

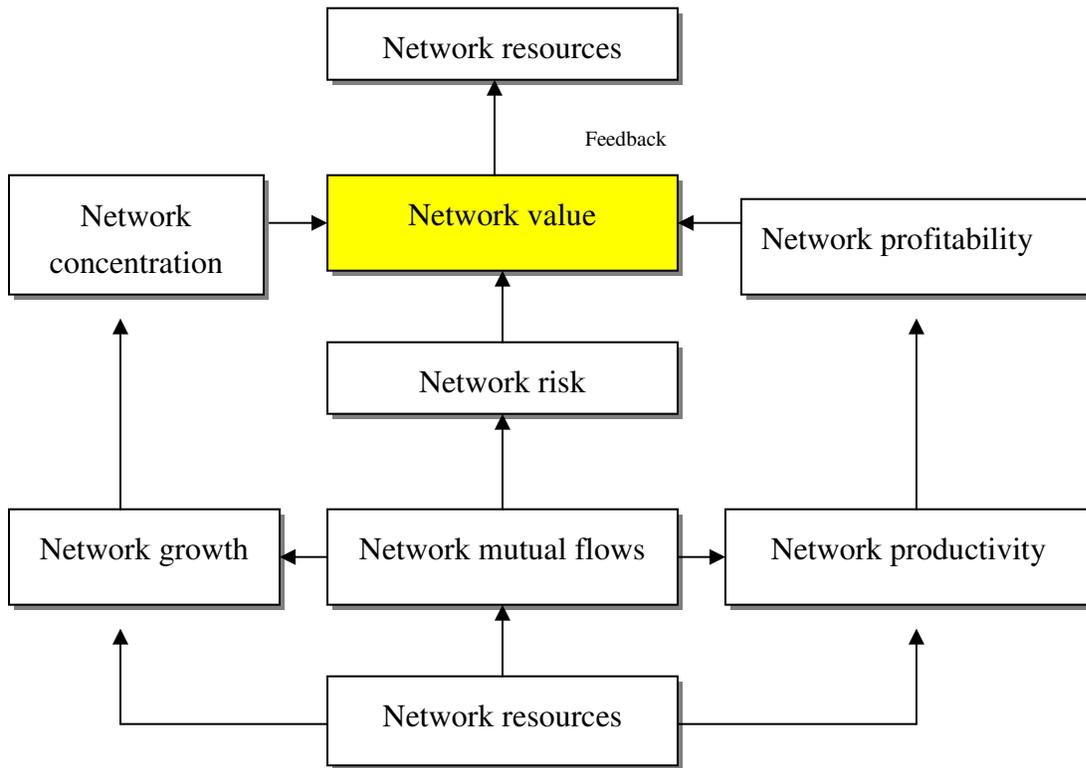


Figure 2. A framework of the network financial statement analysis.

Table 1. Summary of elements and concepts to be operationalized in a network-level performance measurement system.

| <b>Element of the performance measurement system (“perspective”)</b> | <b>Measured phenomenon</b>  | <b>Concepts to be measured</b>  |
|--|---|---|
| Network values and culture   | Calculability<br>Knowledge<br><br>Identification  | Trust in deterrence and reciprocity<br>Trust in predictability, capability, integrity and honesty.<br>Shared rules<br>Trust in benevolence<br>Shared purpose, vision and values   |
| Network resources and competencies                                   | Evaluation of the value of the resources of single companies<br><br>Awareness of others’ resources<br><br>Applicability of the resources<br><br>Allocation and development of resources | Double frame (networking strategy)<br>Common objectives<br>Cooperation capability of a network<br>Flexibility of a network<br>Development work in a network<br><br>Awareness of the resources of the suppliers<br>Awareness of the resources of the other cooperative partners<br><br>Applicability of suppliers’ resources to the needs of the leader company<br>Applicability of the other cooperative partners’ resources to one’s own needs<br>Common needs for development of the resources<br><br>Double frame (networking strategy)<br>Common objectives<br>Cooperation capability of a network<br>Flexibility of a network<br>Development work in a network |
| Models of action   | Structures<br><br>Social capital<br><br>Business integration<br><br>Strategic integration   | Group structures<br>Group systems<br>Group processes<br><br>Group cohesion<br>Trust on group<br>Interaction in the group<br><br>Joint development<br>Joint products<br>Joint public presence<br><br>Dependency as a group<br>Common strategy within the group<br>Risk taking<br>Pricing and win-win policy  |
| Network processes  | Efficiency<br><br>Flexibility   | Productivity development<br>Cost accumulation<br>Unit costs<br>Waste<br>Capacity utilization<br><br>Internal customer satisfaction  |

|                                  |   |   |
|----------------------------------|---|---|
|                                  | Learning  | (experienced by network partner)<br>Throughput times<br>Internal delivery accuracy<br>Problem solving ability (measure?)<br>Identification of the disturbance factors on the modularity surfaces<br><br>Improvement % of the efficiency and productivity in processes   |
| Customer perspective in networks | Customer orientation<br><br>Customer management | <i>Common measures:</i><br>Delivery accuracy<br>Customer satisfaction<br><br><i>Common measure:</i><br>Operating profit /customer<br><i>Network specific measures:</i><br>Market share<br>Average age of customer relationship<br>New customer %<br>Sales to key customers<br>Customer participation % in product development<br>Success in supplier ranking<br>Order hit ratio %<br>Customer complaints %<br>Reclamation handling time |
| Financial key ratios             | Network value                                   | Network resources<br>Network growth<br>Network concentration<br>Network productivity<br>Network profitability<br>Network flow<br>Network risk<br>Network value  |

# **“UNCHAINING FACTORS IN THE ENTREPRENEURIAL CAREER DECISION”**

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## **ABSTRACT**

This research's objective is to know and describe the predisposition factors, the unchaining factors and the maintenance factors in the development of the Entrepreneurial Career of a group of entrepreneurial professionals. The research was based in Dyer's Entrepreneurial Career developed in 1994, the career planning concepts of Schein and contributions from other researchers. The sample used was made of forty four Business Administration, Systems Engineering and Industrial Engineering graduates from three universities from the city of Cali, Colombia, who actually manage their own company or work for family business. The research used the "In-depth interview technique", carried out by psychologists, in order to investigate aspects like family environment, educational development, juvenile experiences, managerial development stages and many other psycho-social aspects related to the entrepreneurial process. From the results you can determine certain specific factors that supplement Dyer's pattern, especially it was determined that there are situational variables, deeply defined by family formative experiences and work experiences, that frame the whole model. In the same way, we could detect that formal education in Entrepreneurial Spirit, is more a complementary tool and a stimulant of previous situations than a fundamental variable of the entrepreneurial process.

## **INTRODUCTION**

A person's transformation process into a manager, has been a matter of study in which many researchers have worked through the years, giving birth to a body of knowledge on: Motivations (McClelland, 1962, Schein, 1978), Characteristics (Hornaday 1971), Processes (Shapiro 1980, Rostand 1985, Timmons 1999 Gibbs 1987, Vesper, 1980), Entrepreneurial Career (Schein, 1990), educational models, factors and many other aspects associated to that human transformation that permits the outcome of a new entrepreneur and of a new company.

The great majority of all those theories has been conceived in developed countries and many of them have not been validated in the Latin American environment. This investigation was oriented to validate and supplement Dyer's Entrepreneurial Career model, using a sample of

44 professionals, entrepreneurs, Business Administration, Systems Engineering and Industrial Engineering graduates, from three Cali city universities.

### **ANTECEDENTS AND METHODOLOGY**

During 1999 and 2001 and with the support of the Corona Foundation, the Center of Development of the Entrepreneurial Spirit from the Icesi University, carried out a longitudinal research of graduate students in Business Administration, Systems Engineering and Industrial Engineering, from three main universities of the city of Cali. The purpose was: to determine the percentage of those graduate students who have decided to enter new entrepreneurial activities, to characterize those organizations, to identify the motivational factors, to value the role played by the educational system and to determine the factors and facts that influenced their decision.

The results of the first two phases of this study were reported in Varela, Jiménez (2001<sup>a</sup>, 2001b). The third phase of this research that implied in-depth interviews to 49 graduates, is the objective of this work. First of all, a theoretical study was made on the topic of Entrepreneurial Career, based on Dyer's model (1994), which was supplemented with diverse theories, that permitted to establish a series of categories to organize the information given in the interviews and to identify some fundamental factors in the beginning, during the establishment and during the strengthening of the entrepreneurial career.

### **DYER'S ENTREPRENEURIAL CAREER MODEL**

W.G. DYER (1994) using Schein's concepts (1978, 1990) developed an Entrepreneurial Career model that is summarized in Figure # 1

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|--|
| Figure # 1 Entrepreneurial Career Model. Dyers (1994) about here |
|--|

The model outlines 4 components: **Career Selection**, which explains the reasons for a person to decide to create a company, **Career Socialization**, that shows the personal experiences pushing the individual to assume the creation and managing of a company; **Career Guidance**, that describes the existing different development alternatives for those who opt to become an entrepreneur, and **Career Development**, that shows the different entrepreneur roles and his/her challenges, goals and conflicts arising through out their life.

The results of the analysis made to the interviews, based on the development of the present model, are shown bellow.

### **RESULTS ANALYSIS BY CATEGORIES**

Here is the method used to structure the results from the 44 interviews, which allows to consolidate the model outlined by Dyer (1994) in each one of its components. A new component that analyses the influence of the situational factors, outlined by Shapero, 1980, will also be presented like a contribution to the model.

#### **Career Selection**

Career Selection is defined as "the individual, social and economic factors influencing and guiding a person to look for his/her independence as an entrepreneur" (Varela,2000). Among those elements related to Career Selection, there are three identifiable basic factors: the individual, the social and the economical factor, which will be analysed at once.

**Individual Factors:** When Dyer’s model speaks of the individual factors, it emphasises on the relationship between a person’s attitude, his/her motivations and its cognitive style, factors guiding or pushing for a career selection. Among case studies, there are some comments like:

*“Since I was a little kid I’ve been restless and also a mediocre student, and have little social relationships”*

*“I was assembling and disassembling things all the time, I was curious about knowing how things functioned”*

*“I always wanted to be an inventor. Now I design and improve my own company machinery”*

Table 1. In-depth interview –Individual Factors. About here

Some of these variables may seem contradictory, however, it is necessary to keep in mind that each human being interprets every situation in a different way. Therefore, the value assigned to each act will depend on each individual's previous experience.

**Social Factors:** For Dyer, these factors were related to the family, economy and social environment conditions, same as the cultural and geographical differences and those of social support, to be the unchaining entrepreneurial actions ready to break up all those negative conditions, people sometimes go through. The results are:

*"Since I am a kid, I have seen a business family, not only for my father but also for my uncles and the different type of business we were in"*

*"My family has always motivated me. All the economic restraints we had, that pushed me to work harder and harder and to give more to my family”*

Table 2. In-depth interview - Social Factors about here

**Economic factors,** make reference to the financial reasons leading to the career decision, such as the economic crises that turned into a learning process. These crises were caused by administration errors, lack of knowledge and control of the environment and of the competition, or just by organizational restructuring processes. Here are some of the comments found:

*"We always had economic problems in the childhood. That’s how we got a living, doing whatever was at hand"*

*" Actually, violence forced us to get out from our land and start again someplace else”*

Table 3. In-depth interview – Economical Factors about here

### **Career Socialization**

Another important component of the Entrepreneurial Career, is the career socialization, defined as “the diverse experiences that prepare the person for his/her performance like manager” (Varela, 2000). These results grouped themselves in childhood, work, education, personal networks and the entrepreneurial experiences.

**Childhood Experiences,** are all those situations lived in early years specially related to the family and that family support offer or offered to the career socialization process. Here are some statements in relation to the childhood experiences:

*“I developed the ability to sell all kind of stuff and make money. I designed, made and sold kits and the money I made I used to give it to my mother”*

*“My father left home and then everybody else was forced to work to support the family”.*

Table 4. In-depth interview – Childhood experiences. About here

Work Experience. Many times these work experiences permitted us to find models or to assume influencing roles on the entrepreneurial career, as can be seen from the next statements:

*“I started working as a handyman in my uncle’s company, then I started to help organizing products little by little, and finally I got to the salesman position, I was doing very well”*

*“I was always ready to help in everything. I always wanted to learn how to do different things, I was always trying to bring new ideas in my job, things like home delivering products”*

Table 5. In-depth interview – Work Experiences. About here

Education. Results show that formal or non-formal educational processes offer the necessary tools, to access the technical knowledge needed for an entrepreneurial career. It is possible to identify a relationship between the needs and the search for alternative solutions in the continuing education. Next, some comments from the interviewees:

*“ I didn’t really like to study. I finished my high school because I thought it was important. It wasn’t only until my company started to grow that I thought about seriously studying a career. It happened many years later”.*

*“Formal education taught me to save time, money, and processes; I used to apply everything I learned”*

Table 6. In-depth interview – Education. About here

Personal networks like childhood relationships, university relationships and the labor ones, show contrasting results, since, while in some cases one could say that they have not been very significant, being replaced by a great influence of the family relationships, in others, they have been the success key of their organization.

*“ I learned about values and work performance value, through my uncle’s company manager. That gave me leads to my own company ethics”*

Table 7. In-depth interview - Personal Networks About here

The entrepreneurial experiences, where differences were found among the interviewees as a function of the type of work every one had. In family businesses the communication between generations it is very important, and also the progressive linkage of the organization itself with the family philosophy. When managing your own business you can see the efforts made to make better every day and you can see the search for support from friends or couples. We found some comments like these:

*"Somebody told me a business was for sale. My working partner and I became business partners and bought it. We paid off all the business debts and it was growing little by little. It expanded out and it had a horizontal growth"*

*" All others businesses were created for our families, so they could have their own Business too. We put all the principal"*

*" After I finished making myself up, we started to generate what is called "franchises". This has given us some difficulties, but it is a new business projection"*

|   |
|---|
| Table 8. In-depth interview - Business Experience. About here |
|---|

### **Career Guidance**

Career guidance is defined as "the different roles and specific ways in which a person develops his/her own career" (Varela, 2000). Although not all the interviewees are clear as to what is their main motivation to determine their job linking, one can observe that it is more influenced by life circumstances, although some have it clear from the very beginning that they want to have their own business. In the interviews it is possible to identify: the importance of social support in the moment of the creation of companies; the difficulties encountered in the administration and in the generation of change alternatives, and the innovation, investigation, and the development of the organization and diversification.

The career guidance is one of the stages in which the process of the person's identification like a business owner, is fundamental. The elaborated structure allows to identify the moments the business owner goes through, from the time the company is born. The managerial behavior as a consolidation of his/her manager role, having into account that he/she must carry out different parallel processes, that he/she must correct his/her first management errors, and to initiate his/her own ideas about starting a vertical or horizontal company development, which will, somehow, consolidate his/her management skills.

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| Table 9. In-depth interview - Identity Development about here |
|---|

### **Career Development**

After selecting a career and being a little clearer respect to the career's identity, three clear moments are identifiable in its development through out the years. According to Dyer, these three stages are: the starting point, the middle way and the end of the career. Results are as follows:

*"I thought it was going to be a conflict to work together with my husband, and it was difficult at times"*

|   |
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| Table 10 – In-depth interview – career development about here |
|---|

The personal dilemmas bring the highest managerial career related information, especially with the conformation of the life's plan. The main managerial dilemmas arise from crisis due to robbery problems, people relationships, the closing down of the company or economic crisis.

Each one of the interviewees defines success as a function of their own priorities, some mainly identified with satisfaction from personal success (learning, creation of own company, etc), others identified with managerial success from their professional background, from

goals achieved (organization's own growth). As to family success, the overcoming of crisis and work family achievement, are mainly mentioned.

Table 11 – In-depth interview - Dilemmas about here

*"The fears from working as a couple were overcome and the couple's relationship was strengthened thanks to the much love we had for each other"*

*"I always dreamed of having my own business running. Now that I am 32, I have it made, I made it through; one is the company, all of us are the company"*

Table 12 – In-depth interview – Success about here

### **Situational Factors**

Situational factors are all those significant events that marks people's specific landmarks. This can be considered a breaking out factor, mainly because it determines life changes due to personal or family economic crisis (parents separation, moving out of the city, all sort of experiences, couple's own growth, etc); these situational factors may, in the same way, include aspects related to opportunities. Few of the interviewees who had made it clear, as to what their career was going to be, understand the importance of all the aforementioned factors, only understanding the influence on their own career development when they speak retrospectively of them.

One of the statements greatly supporting this factor is:

*"The main reason was the family crisis, then the displacement from our own land due to the violence, next my parents' separation and the economic necessities that were generated"*

Table 13 – In-depth interview - Situational Factors About here

### **CONCLUSIONS**

The results allow us to conclude that family and childhood experiences have been one of the fundamental aspects in order to make the decision of becoming business owners. These experiences have favored the development of skills and managerial attitudes, being the emotional crises by couple and family factors, something of a great importance.

During the career socialization it is possible to identify some biasing factors like childhood experiences, where incipient business creation behaviors or economic activities are modeled. Work projection related to the life plan, something sometimes not well defined, and the work background which brings models to be followed, are in many cases, the bases to start a business career.

The formal education helps to get a theoretical and methodological support in order to improve the business behavior, and to develop a humanistic vision in the process of creating new companies and to keeping them on the going.

Among the most influential elements in the Business Management career process, we find the emotional landmarks, the personal dilemmas and the personal success and that of the business. The interviewees are very aware of the economic crises and the ways to come out of them, looking at it not only from the company's point of view, but from the country's own domestic influential conditions.

The opposing results inside the analysis of the interviews show an emotional alternative, generated by family problems inside the process of the managerial career, which is in some cases, a reason for personal and business endurance in some cases, but a factor of personal lack of equilibrium and business bankrupt.

One of the contributions of the investigation is therefore the relevance given to the situational factors as promoters of the managerial process. It would then be important to deepen in them, to design methodologies or strategies able to develop skills, ready to confront their effect towards the development of a successful managerial career.

Keeping in mind some of the queries that Dyer proposes in his article " Toward a Theory of Entrepreneurial Careers" 1994, like a foundation to strengthen a theory of managerial career, we can write down that the obtained results starting from the in-depth interviews, allow us to suggest that we cannot determine a certain sequence of experiences of socialization of the managerial career, but rather that these experiences together with the variables mentioned in the investigation, are presented in a recurrent way, not in a sequential way, allowing to accumulate formation experiences that may not necessarily have a managerial meaning, just as the interviewees mentioned it at a certain time in life, like it is, for example, the childhood or the adolescence.

However, these same cumulative experiences along the life cycle, can be interpreted in a very different manner, when situational factors arise, which unchain the decision of starting up with a new company.

From all research results we can present an enhanced Business Career model, having Dyer's 1994 model as an example. It is suggested to do the model development analysis, in a cyclical way, which allows to value the influence of the situational factors in the different process stages, either as development promoters or as factors inducing the person to restart the cycle, according to the new outlined conditions.

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| Table 14 Research Contribution to the Business Career Model Dyer 1994. about here |
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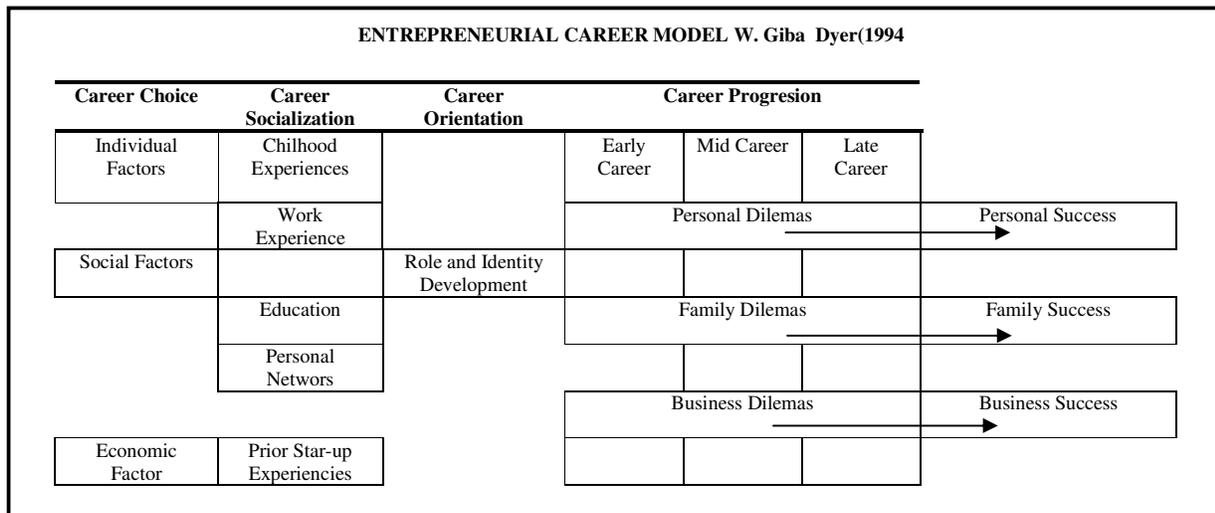
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**TABLES AND FIGURES**

**Figure # 1 Entrepreneurial Career Model. Dyers (1994)**



**Table 4. In-depth interview –Individual Factors.**

| Behavior  | Cognitive Style  | Motivation   |
|---|--|--|
| Impulsiveness<br>Rebelliousness<br>Taste for business<br>Work and discipline seriousness<br>Organization<br>Tranquillity<br>Ability<br>Good relations with people<br>Pesimistic to study<br>Analysis<br>Creativity<br>Cooperation | To believe in things allows you to meet goals<br>The emotional factor is fundamental in success<br>To learn the most from what you doing | Study<br>Work<br>Research<br>Interest for learning something according to your likes and independent from your career vision.<br>They chose a career by reference not for knowing it<br>Coincidence between the career chosen and the original thoughts. |

**Table 5. In-depth interview - Social Factors**

| Cultural Characteristics  | Family and Networks support  | Society  |
|---|--|--|
| Clear methodologies are used to confront work and study<br>To share with the family<br>The influence of each region and family idiosyncrasy<br>The handling of stereotypes according to sex | Principles and family values foundation<br>Business learning models<br>The influence of brothers and family ancestors in the present performance | The influence of the country's or region own political situation<br>In some cases, intra family relationships strengthens the social and business structures |

**Table 6. In-depth interview – Economical Factors**

| Economic crisis   | Growing economy   | Business and employment opportunities  |
|---|---|--|
| Mistaken investments<br>Bad administration of the business<br>Liquidations<br>Crash of companies generated lay-offs<br>Influence of the domestic crisis | Family earnings<br>Access to loans thanks to work engagement<br>Diversification of services | Social bonds<br>Random offers<br>Better job positions in the organization<br>Detection of market needs |

|                    |  |  |
|--------------------|--|--|
| Market Competition |  |  |
| Natural disasters  |  |  |

**Table 4. In-depth interview – Childhood experiences.**

| Recreational Activities  | Formative Activities  | Economic Activities  | Emotional Landmarks   |
|--|---|--|---|
| Group recreation and team games<br>Activities to do business in school<br>Parents support for own business<br>High competition games | Home activities participation<br>Family or friend business involvement during the vacation period<br>Teachers request to do oral presentations<br>To stand out in school and in business<br>Foreign academic exchange | Sales inside the school<br>Collaboration in the family business<br>Vacation job<br>Group activities<br>To teach others | Relative or friend death<br>Conflict in selecting a career<br>Accidents of beloved ones<br>Parents separation<br>Personal or family disease<br>Affective difficulties |

**Table 5. In-depth interview – Work Experiences.**

| First job  | Work Projection   | Economic Satisfaction   | Job Satisfaction   |
|--|---|---|--|
| Apprentice in an organization<br>Sales<br>Professional practice<br>Other jobs (waiter, watchman, etc)<br>Factory<br>University monitor | Professional career development<br>Company growth<br>To have your own business<br>To live abroad<br>To change job area or job<br>Work group coordination<br>Entrepreneurial career<br>International Expansion | Objective achievement through saving culture<br>Good quality of life<br>Business plans<br>Investments | Entrepreneurial Career<br>Satisfaction in the present job<br>New challenges inside the company<br>Company organization |

**Table 6. In-depth interview – Education.**

| Non-formal education  | Formal Education   | Professional updating  |
|---|--|--|
| Home learning<br>Work for different companies and sectors<br>Formal education parallel courses (Systems, English) | More open to changes<br>Basic education was fundamental<br>Good academic performance<br>Importance of friends<br>Solid bases to have criteria when needed<br>It was fundamental to go from empiric to theoretical<br>Development of interaction skills<br>Family influence<br>Good companies for professional apprenticeship | Specializations bring better horizons<br>Great expectations from Icesi careers and offers<br>Personal and professional growth<br>Based on needs and goals<br>Constant search<br>Participation in congresses (not too frequent) |

**Table 7. In-depth interview - Personal Networks**

| Childhood relationships                                    | University relationships  | Work relationships   |
|--|---|--|
| Neighborhood friends<br>School friends<br>Parent's friends | University Directives' links<br>Friends that will become a support<br>Work partners | Force union to work as a team<br>Good relationship with the bosses<br>Importance of the work linkage |

**Table 8. In-depth interview - Business Experience.**

| Employee  | Family business  | Own business  |
|---|--|---|
| High responsibility level<br>High learning level<br>The establishment of high goals | Progressive company linkage<br>The establishment of family and working agreements<br>Management family models follow up<br>Establishment of limited partnerships | Importancia del crecimiento horizontal<br>Establecimiento de franquicias<br>Inicio de la empresa solo, con amigos o en pareja |

**Table 9. In-depth interview - Identity Development**

| Creation of a company   | Management outcome   | A consolidated company owner   |
|---|--|--|
| Line family follow up<br>Different kinds of services and products<br>Starting at home<br>Economic family support and bank loans<br>Association with friends | Looking for opportunities(facing of difficult situations)<br>Family and friends ideas that will enhance the Business scope<br>First errors in the making of the company<br>Professional career fulfillment in the companies he/she works for.<br>Research and Development of products.<br>Franchises | Initiation of different kind of companies<br>Salary is not assigned but sales percentages<br>Midterm Growth expectations (2 to 3 years)<br>Expansion to other cities and horizontal growth |

**Table 10 – In-depth interview – career development**

| <b>Career starting point</b>   | <b>Career middle way</b>                | <b>End of the career</b>  |
|--|---|---|
| In search for survival<br>Entertainment and exploration with high expectations<br>New experiences. The middle man was no longer needed | Academic strengthening (marketing plan) | Hope for more own personal time and for the family environment. |

**Table 11 – In-depth interview - Dilemmas**

| <b>Personal Dilemmas</b>  | <b>Family Dilemmas</b>   | <b>Company Dilemmas</b>  |
|---|--|--|
| What, where and when to study.<br>To be an employee or self-employed.<br>High demanding standards<br>Outsiders comments on the type of labor contracts<br>Emotional and economic crisis due to family death | To work with very close relatives (husband)<br><br>Life goals evaluation | Robbery from one of the working partners or workers.<br>Difficulties with one of the working partners due to unbalanced working loads among them<br>Beginning of the own company<br>Closing down of the family company |

**Table 12 – In-depth interview – Success**

| <b>Personal success</b>   | <b>Family success</b>  | <b>Business success</b>   |
|---|--|---|
| Better company position<br>Personal achievement<br>From being an employee to be the owner<br>Meeting of expectations<br>Application of acquired knowledge<br>Professional achievement | Couple's better understanding<br>Family work<br>Crisis surmounting | To make your own company<br>Evaluation of the first productive stage (33 years)<br>Continuous learning and strength<br>Organizational growth. |

**Table 13 – In-depth interview - Situational Factors**

| <b>Personal</b>   | <b>Family</b>  | <b>Company</b>   |
|---|--|--|
| Lack of professional advice<br>Drug addition and gambling crisis<br>High responsibility and the need to have self-esteem (self-sufficiency) | Generational differences<br>Accidents and diseases<br>Limited economic resources | Robberies at the geographic area<br>Closing down of companies<br>Difficulties in intra-personal relationships<br>Learning process inside the company<br>Job opportunities in formal education. |

**Table 14 Research Contribution to the Business Career Model Dyer 1994**

| Career Choice   | Career Socialization  | Career Orientation            | Career Progresion                   |            |             |
|---|---|-------------------------------|-------------------------------------|------------|-------------|
|   |   |                               | Early Career                        | Mid Career | Late Career |
| Individual Factors  | Early Childhood Experiences   |                               |                                     |            |             |
| Behavior Characteristic<br>Cognitive Style<br>Motivation                  | Recreational Activities<br>Formative Activities<br>Financial Activities<br>Important emocional Experiencies |                               |                                     |            |             |
| Social Factors  | Work Experience   |                               | Personal Dilemas → Personal Success |            |             |
| Characteristic<br>Family Relationship<br>Networks                         | First Job<br>Professional Career<br>Financial Satisfacción<br>Laboral Satisfaccion                          | Role and Identity Development |                                     |            |             |
|   | Education   |                               | Family Dilemas → Family Success     |            |             |
|   | Formal Education<br>Informal Education<br>Educacional and Profesional Update                                |                               |                                     |            |             |
| Economic Factor   | Personal Networks   |                               | Business Dilemas → Business Success |            |             |
| Economical Crisis<br>Grow Up Economy<br>Employ Opportunities and business | Childhood Relationship<br>Collage Relationship<br>Laboral Relationship                                      |                               |                                     |            |             |
|   | Prior Start-up Experiencias   |                               |                                     |            |             |
|   | Employer<br>Family Business<br>Owner Business   |                               |                                     |            |             |

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□ Dyer Model 1994      ■ Research Contribution

# PICKING THE WINNERS – EXPLAINING FACTORS OF NEW VENTURE GROWTH

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## Abstract

This study is a part of a longitudinal research project which has followed the development of 200 SMEs in the branches of metal-based manufacturing and business services since their start-up in 1990. The paper concentrates on 86 survived respondents after seven years activity. We develop a model for testing the factors that differentiate growing new ventures from the non-growth companies. One half of the respondents (43 firms) appeared to be steadily growing (over 10 % annual growth in turnover). The combined model classifies correctly 89.2 % of observations. The high total classification rate is based on the successful classification of growing ventures. The model classifies correctly 39 of 43 growing ventures. Growing ventures are opportunity driven (pull motivation), and applying group management style, have increased their production capacity and their external network relations, and adopt a specialized product policy, i.e. are aiming to differentiate their products from the products of their competitors. Subcontracting and specialization as a firm's strategy were successful differentiators, too. The successful differentiators in the combined model did not include any statistically significant entrepreneur specific variables. It could be argued that the fit of entrepreneur is necessary but not a sufficient condition for successful performance. The implications of this study for academics, educational institutions, entrepreneurs, and other practitioners is encouraging. The most of those factors that differentiate growing ventures from non-growth companies could be taught and learned, and are dependent on strategic and operative choices of the entrepreneur.

## Introduction

Over the past twenty years, much research has been devoted to answering the question what factors explain the performance of the firm. Sandberg (1986) carried out one of the earliest studies integrating the effects of various forces on new venture performance. Sandberg and Hofer (1987) tested their model on a sample of 17 ventures drawn from the files of venture capital firms. They found no support that success would be based solely on entrepreneurial

characteristics but introduced the view that venture strategy and industry structure should be included in the venture performance model. Even if entrepreneur's characteristic were not supported in testing of their propositions they concluded, on the basis of venture capitalist's strong belief in the importance of the entrepreneur as a source of success, that some characteristics of the entrepreneur are important determinants of new venture performance but biographical data are not amongst those characteristics (Sandberg and Hofer 1987). McDougall (1987), and McDougall et al. (1992) set forth a model that explained a great deal of the variance in new venture performance. McDougall et al. (1992) demonstrated, parallel to Sandberg and Hofer (1997), that not only strategy and industry structure by themselves are important, but also the interaction between strategy and industry structure affects new venture performance.

Chrisman et. al. (1999) analysis of the determinants of new venture performance extended the model developed by Sandberg and Hofer (1987). Their extended model specified that the performance of a new venture was a consequence of a confluence of factors that encompass attributes of entrepreneurs, industry structure, business strategy, resources, and organizational structure, processes, and systems. They propose that new venture performance will be a function of the decisions and behaviours of entrepreneurs in recognizing environmental opportunity, assembling resources needed to pursue opportunity, developing a strategy to align resources to exploit opportunity, and designing an organization capable of putting the strategy into action. But as Shane and Venkataraman (2000) note the attributes that increase the probability of opportunity exploitation do not necessarily increase the probability of success.

As an essential part of new venture performance firm growth has been studied widely starting from the terms of management and the development of new activities as well as the reformulation of a firm's problems and goals. However, several authors have noted that there is no single theory that can adequately explain new business growth (Gibb and Davies, 1990). According to Gibb and Davies (1990), previous studies on growth have included four main types of approach: the impact of the entrepreneur's personal characteristics, the strategic factors affecting the firm's performance, sectoral and broader market-led approaches and organisational development approaches (e.g. Smallbone et al., 1995). Cooper et. al. (1994) studied the determinants of high growth versus marginal survival and found that the chances of both survival and high growth were positively associated with having a higher level of education, greater industry-specific know-how, and larger initial financial resources. Davidsson and Wiklund (2000) state that a lot of studies focusing on new firm growth have been completed within last 20 years but these studies have several theoretical and methodological shortcomings and are generally lacking longitudinal designs.

Based on the problems of testing wide models we decided to test the impact of different variables separately and there after include their interaction. First we studied the impact of entrepreneurial characteristics, motivation and environment as well as their interaction as differentiating factors between growing and non-growing firms (Littunen and Virtanen, 2004). The results were parallel with Sandberg and Hofer (1987) otherwise but analysis suggested that the age of the entrepreneur could be personal characteristic to explain the performance, meaning that experience induces growth. Vocational training was also dis-

covered to be a statistically significant explanatory variable. The form of motivation (pull motivation) to seize the opportunity was discovered to be the most effective differentiator between growing and non-growing firms. This analysis reformulates the model including only those entrepreneurial characteristics found to be statistically significant with motivation (push and pull) factors and including also the decision and behavioural variables (business strategy, style of management, changes in production and markets etc.).

### **Theoretical background and hypothesis**

The purpose of this study was to investigate which factors involved in the firm's birth, start-up and the first seven years' development differentiated growing from non-growth firms. As suggested by Sandberg and Hofer (1987) we build our analysis on contingency model of performance. According to contingency theory, the start-up and growth of firms cannot be examined in isolation from their specific context and environment (Gilad and Levine, 1986). The analysis of start-ups by utilizing contingency theory makes it possible to evaluate the factors affecting the birth of new firms on a broad scale (Gilad and Levine, 1986; Storey, 1994) and including the founder's phase of life at start-up in the analysis. Moreover, contingency perspective takes into account uniqueness and discontinuity which are the typical characteristics of entrepreneurial markets by suggesting that universal theories cannot be applied to organizations because each is of them is unique. Virtanen (1997) suggests that we should use different theories in different contexts. But if we have longitudinal data about growth of a firm we may have different contexts in the same model and thus contingency approach seems to be the most appropriate one.

The various situational factors that describe the founder's phase of life at start-up can be seen as reflections of the overall situation of the economy, and these provide the link between founder's previous experience and the start-up situation (Littunen, 2000; Littunen and Tohmo, 2003). Situational factors link the success of new firms with the kinds of entrepreneurial knowledge and skills considered to be important to growth (Cooper and Dunkelberg, 1987; Cooper and Gascon, 1992). Different management styles are seen as central factors in the entrepreneurial competence of the individual. The contingency theory framework notices the changes of situational factors, for example changes in the strategies of a firm, too. In this study we analysed the situational factors at start-up and the changes of those situational factors during first seven years of development.

The entrepreneurial motives ( $E_m$ ) for founding and running a business could be divided into 'push' and 'pull' factors (Gilad and Levine, 1986; Storey, 1994). The model distinguishes those entrepreneurs motivated by a positive idea, those with specific knowledge of a market opportunity, and those primarily forced into entrepreneurship. The motivations of those attracted by the opportunity are in accordance with conventional economic theory and in the core of the current entrepreneurship research (e.g. Shane and Venkataraman 2000). A "forced" motivation exists when the founder feels to be pushed into starting a firm under the pressure of circumstances. Individuals may be dissatisfied with their present jobs or promotion aspects or may also be faced with the prospect of unemployment. Psychological "pull" factors, like a desire to work independently or to realise own ambitions are included also in the entrepreneurial characteristics which were studied separately. The founders of

growing firms might have had different motives for setting up and running a business compared to the founders of non-growth firms. Thus the variable “Motives at start-up”(external push and pull factors, internal motives) was constructed to reveal the motives behind founding a business.

The strategy of a new firm must be designed to utilise its management capabilities in order to attain its goals and ways of realising them (Sandberg and Hofer, 1987). According to Mintzberg (1987), the strategy of a firm can be conceptualised as a plan, position in the market, vision concerning the future and the firm’s state or as a model for actions in the stream of decisions. In this study the basic strategic choices of firms were studied as models for actions. The conceptualization of a firm’s strategy as a model for actions is based on the view in which the business plan and the operative management are connected. One purpose of this paper was to study how changes in the competitive situation of a firm affect its growth. Thus the action is approached from the point of view of the firm’s market orientation. Four categories based on the firm’s market orientation were formed: a) sales as a sub-contractor (co-operation), b) concentration on local markets, c) specialization and d) internationalisation. The firms which had reported specialization as their strategy were further classified into those specializing in products and those specializing in satisfying customers’ needs, as the resources connected with these two strategies are very different. These strategies and management actions were studied in relation to products and markets, changes in ownership, changes in product and marketing policy, changes in production processes and changes in networks (Storey 1994).

On the bases of the above reasoning we developed a model for new venture growth:

$$(1) \text{ NVG}_{1...j} = f(\text{Es}_{1...j}, \text{Em}_{1...j}, \text{F}_{1...j}, \text{IS}_{1...j}, \text{St}_{1...j}, \Delta\text{St}_{1...j}),$$

where NVG is growth a firm and j stands for the number of firms,  $\text{Es}_{1...j}$  includes the characteristics of entrepreneur discovered to be statistically significant in our previous analysis,  $\text{Em}_{1...j}$  describes motives,  $\text{F}_{1...j}$  demonstrates financing and  $\text{IS}_{1...j}$  industry sector up,  $\text{St}_{1...j}$  represents the strategy variables of firm, and  $\Delta\text{St}_{1...j}$  the changes of strategy variables during first seven years’ development. Based on the above discussion and former studies we derived the following hypothesis and tested each group of variables separately before combining the model.

H1: Experience factor (age) differentiates growing new ventures from the non-growth firms.

H2: Skills and education (vocational training) of an entrepreneur or entrepreneurial team differentiate growing new ventures from the non-growth firms.

H3: Motives at start-up situation differentiate growing new ventures from the non-growth firms.

H4: Financing at start-up situation differentiates growing new ventures from the non-growth firms.

H5: Management style of an entrepreneur (entrepreneurial team) differentiates growing new ventures from the non-growth firms.

H6: Strategic orientation of the venture differentiates growing new ventures from the non-growth firms.

H7: Change in the strategic orientation of the venture differentiates growing new ventures from the non-growth firms.

### **Description of the data**

This study is a part of a longitudinal research project which has followed the development of 200 SMEs in the branches of metal-based manufacturing and business services since their start-up in 1990 (Littunen, 1992). The owner-managers were personally interviewed for the first time at the beginning of 1992. Follow-up data were collected annually through telephone interviews held between 1993 and 1996 and in 1998. In addition, each year the second author conducted 20-25 interviews personally in order to spot possible inaccuracies in the telephone interviews. For the first personal interviews, 200 firms were selected as subjects from the SME register of Statistics, Finland.

The sample consists of 138 metal-based manufacturing firms and 62 business service firms from all over Finland. At the seven-year follow-up 86 firms responded, 55 firms had closed down and 59 firms refused to participate in the follow-up. We classified the respondents into two growth groups on the basis of their performance during 1990-97 (e.g. Smallbone et al., 1995). This paper concentrates on the 86 survived firms where from 43 firms were discovered to be growing (average annual growth rate more than 10 % in 1990 – 1997). About one third of the growing firms (14 firms) could be considered to be the so called gazelles whose annual growth was more than 25 % per year (4,8 times the turnover in seven years).

The studied firms were mostly small: about 60 percent had less than five employees at the start-up. The connection between the firm and the entrepreneur was strong and the studied firms were often dependent on the entrepreneur's own labour and that of his/her family. The strategy of the firm was chosen by the entrepreneur. Over 45 percent of the entrepreneurs in the study had basic education no higher than elementary school. Empirical studies suggest that new entrepreneurs start their firms by relying on work experience gained earlier as employees in a firm owned by someone else. The most of the new entrepreneurs had come from SMEs and in the most of the firms the selection of products was in the first place based on the entrepreneur's previous work experience, too. Other important factors affecting the choice of the firm's product were a combination of previous work experience, vocational training and identification of the needs of customers in the market.

The data were analysed by grouping the features of the respondents and their firms by means of cluster analysis. The aim of these groupings was to unify the rather varied interview data. The management styles of firms were described according to four different dimensions: a) group management (2 items), b) action planning (6 items), c) innovativeness (4 items), and d) interactivity (2 items). Using cluster analysis the firms were classified into three categories portraying styles of management, according to the participation in the firm's management of different interest groups. The *situational style* of management characterizes the entrepreneur who takes an independent position and does not make very much

use of personal networks. In the *network building style* the entrepreneur has obtained ideas about how to manage a firm through discussions with customers as well as with his entrepreneurial and other business contacts or with specialists. In the *group management style* the key affairs of the firm are managed by a group of people (see Littunen and Tohmo, 2003).

Logistic regression analysis was used as statistical technique in locating differences between growing (growth of turnover more than 10 % annually) and other firms and their owner-managers in the selected attributes. We chose logistic regression analysis because it captures synergistic relationships between variables but does not require as restrictive assumptions as e.g. discriminant analysis. The purpose of the analysis is to find out those variables which differentiate growing ventures from the non-growth firms. With logistic regression we also avoid one impediment identified by Davidsson and Wiklund (2000). They state that using current variables to predict past process breaks with the principle that the cause must precede the effect. By using logistic regression we do not explain the growth process but are trying to find out which factors differentiate growing firms from non-growth companies.

## Results

First we tested entrepreneurial characteristics, the motives, the importance of management capabilities in terms of internal/external networks, and the importance of strategies for the growth separately. The estimated models explained the location of the observations rather well classifying correctly about 69 % and 76.5 % observations. In separate testing age (experience) did not appear to be statistically significant but vocational training and motives for establishing a firm were discovered statistically significant factors. This means that H1 should be rejected whereas H2 and H3 got support from the analysis. In the second model the statistically significant factors were: financing at start-up (H4 supported), firm's strategic choice (H6 supported), change in product policy and change in target market (= old versus new customers, H7 supported). Management style of an entrepreneur (entrepreneurial team) did not appear to be a statistically significant differentiator between growing new ventures and the non-growth firms suggesting that we should reject hypothesis 5.

After separate testing we combined the model to include all the variables and experimented several different versions to reach the best model. Table 1 presents our selection as the best logistic regression model describing growth of firms as function of the following start-up variables: age, vocational training, motivation, main product selection, financing and industry sector. From these variables motives and industry sector appeared to be statistically significant.

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Style of management, strategy variables including firms strategy choice and change in product policy, in production process, in target market conditions and in external personal networks were the variables selected in the model from those variables collected after the third year of operation. From these variables style of management, firm's strategic choice,

change in production process and change in external personal networks were discovered to be statistically significant. Change in product policy, in production process and in target market conditions after seven year of operation were also included in the model. From these variables change in product policy was the only statistically significant variable. The results suggest that group management style was emphasised in the growing firms whereas situational style and network building style were linked mostly to non-growth firms. The combined model suggests that we should accept hypothesis H3, H5, H6, and H7 but reject H1, H2, and H4.

The estimated model explained the location of the observations in the growth/non-growth firms very well. Over 89 per cent of observations were classified correctly by the logistic regression model. The high total classification rate of the model was mostly based on the successful grouping of the growing firms (92,1 %) which means that 40 from 43 growing firms were classified correctly.

## **Conclusions**

This study has examined what factors differentiate growing firms from the non-growth ventures. Doubling of turnover during 1990-97 (over 10 % annual growth) was used as the criterion of continuous growth. Contingency theory was used as the starting point in the study. First we tested separately the start-up factors including entrepreneurial characteristics (experience, skills and training of the entrepreneur), motives, financing, product selection and industry as explanatory variables. Thereafter style of management and strategy variables and changes of those variables were tested.

As a separate testing education (vocational training) and motives of the entrepreneur (positive situational and “pull” motives) were discovered as statistically significant differentiating variables whereas experience (age of the entrepreneur) was not significant. The results suggest that we should accept our second and third hypothesis but reject the first one. The second partial model included management style, strategic choice and changes of strategic characteristics (product policy, production process, target market, networks) of a firm.

The growing ventures of this study come more often from the branch of metal-based manufacturing, are opportunity driven (pull motivation) and applying group management style, have increased their production capacity, have increased their external network relations, and adopt a specialized product policy. In most cases active strategies, particularly with respects to markets, were necessary to achieve growth over an extended period. Change in product policy (developing new products) in the seventh year of operation was statistically significant. Obviously, the best performing new firms are aiming to differentiate their products from the products of their competitors. In addition to above strategy variables the subcontracting and specialization as a firm’s strategy differentiated growing firms from non-growth companies. However, the signs of these explanatory variables were conflicting so that this relationship needs further investigation.

The study suggests that those variables which quite successfully differentiated growing ventures from non-growth firms in the combined model did not include any statistically

significant entrepreneur specific variables confirming the results of e.g. Sandberg and Hofer (1987). However, some biographical variables appeared to be statistically significant when they were tested separately at the start-up phase. Thus it could be said that fit of the entrepreneur is necessary but not a sufficient condition for successful performance. The implications of this study for academics, educational institutions, entrepreneurs, and other practitioners is encouraging. The most of those factors that differentiate growing ventures from non-growth companies could be taught and learned. Moreover, the most of them are dependent on the strategic and operative choices of the entrepreneur.

Even if the combined model succeeds very well in differentiating growing from non-growth firms (total classification rate 89.2 %) we need further information and data on these relationships to be able to interpret all of the findings. For example, the management style was not statistically significant in the second separate model but appeared to be statistically significant in the combined model. Overall, in interpreting the findings of this study and planning future research, certain limitations need to be kept in mind. Entrepreneurs and the processes they use in starting their firms will vary by line of the business, by region and in background and aims. Since the study was restricted to firms in two industries, caution must be exercised in generalising the results across other sectors. At the time the research was conducted the Finnish economy was in the middle of a recession, which undoubtedly affected the results. Future studies, conducted during a less turbulent time period and with larger samples from a wider-range of industries and regions, would yield more conclusive findings.

### **Acknowledgements**

Financial support from Jenni and Antti Wihuri Foundation is gratefully acknowledged.

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**Table 1.:** Logistic regression model (Dependent variable: other firms vs. growing firms)

| Theoretical model:<br>NVG <sub>1...j</sub> = f (Es <sub>1...j</sub> , Em <sub>1...j</sub> , St <sub>1...j</sub> , ΔSt <sub>1...j</sub> )<br>Independent variables | Model 3:<br>Coefficient                 | Std. Error | Significance |
|---|---|------------|--------------|
| <i>Start-up phase:</i>  |   |            |              |
| Age   |   |            | 0.138        |
| Age (1)   | 2.760                                   | 1.834      | 0.132        |
| Age (2)   | -1.331                                  | 1.085      | 0.220        |
| Vocational training   |   |            | 0.267        |
| Training (1)  | 3.155                                   | 1.959      | 0.107        |
| Training (2)  | 0.974                                   | 1.384      | 0.482        |
| Motive  |   |            | 0.037*       |
| Motive (1)  | 1.694                                   | 1.081      | 0.117        |
| Motive (2)  | -1.998                                  | 1.544      | 0.196        |
| Financing at start-up   |   |            | 0.443        |
| Financing (1)   | -1.447                                  | 1.144      | 0.206        |
| Financing (2)   | -0.681                                  | 1.421      | 0.632        |
| Main product  | -1.008                                  | 1.063      | 0.343        |
| Industry sector   | 2.384                                   | 1.348      | 0.077*       |
| <i>Third year of operation:</i>   |   |            |              |
| Style of management   |   |            | 0.161        |
| Style (1)   | -3.601                                  | 2.073      | 0.082*       |
| Style (2)   | -1.887                                  | 1.143      | 0.099        |
| Change in product policy  |   |            | 0.705        |
| Product policy (1)  | -0.156                                  | 1.204      | 0.897        |
| Product policy (2)  | 1.206                                   | 1.889      | 0.523        |
| Change in production process  | 3.603                                   | 1.673      | 0.031*       |
| Change in target market   | -0.085                                  | 1.066      | 0.936        |
| Change in external personal networks  | -3.680                                  | 1.467      | 0.012*       |
| Firms' strategic choice   |   |            | 0.077*       |
| Choice (1): Subcontracting  | -5.829                                  | 2.825      | 0.039*       |
| Choice (2): Local market  | -3.976                                  | 2.516      | 0.114        |
| Choice (3): Specialisation  | -6.697                                  | 2.601      | 0.010*       |
| Choice (4): Internationalisation  | -4.551                                  | 2.714      | 0.094        |
| <i>Seventh year of operation:</i>   |   |            |              |
| Change in product policy  |   |            | 0.130        |
| Product policy (1)  | 0.326                                   | 1.496      | 0.827        |
| Product policy (2)  | 3.414                                   | 1.745      | 0.050*       |
| Change in production process  | -0.677                                  | 1.065      | 0.525        |
| Change in target market   | -1.820                                  | 1.217      | 0.135        |
| Constant  | 3.283                                   | 3.079      | 0.286        |
| Model of Chi-square =0.001; Df=25   | Total classification rates (%)<br>=89.2 |            | * p < 0.09   |

## The Happy Story of Small Business Financing

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### Abstract

An examination of U.K. and U.S. small- to medium-sized enterprises (SMEs) reveals that SMEs are not constrained in their access to financing. We show that SMEs do not, in the first instance, seek external funding for growth, and when they do they usually receive the funding they seek. The entrepreneur's level of educational attainment, age, net worth, and number of years on-the-job inform us about the SME's likelihood of applying for external capital. We conclude that the market for distribution of capital works well for the SME sector and that SMEs are contented with their access to financing.

### I. Sources of Small Business Financing

How do SMEs obtain funds to finance growth opportunities? Unlike publicly held businesses, unlisted businesses are not required to provide private information to prospective investors, regulators, creditors, and customers (Ang, 1992). In the absence of transparent disclosure, SMEs are less able to send credible signals to venture capitalists, banks, or trade creditors. This lack of transparency implies that SMEs have limited access to external funds due to informational asymmetries. Further, the difficulty with gaining external capital impedes SMEs' accumulation of revenue-generating assets and potential growth. In general, this has been labelled as the finance gap for privately held businesses (Storey, 1994; Deakins, 1996).

Berger and Udell (1998) advocate a complementary concept for explaining SMEs' capital structure decisions. In their framework, SMEs are viewed through a financial-growth cycle paradigm where different capital structures are optimal at different points in the cycle. Most SMEs rely on internal sources of funds in their early years of operation. As SMEs grow in size and age, they ought to have better access to external sources of funds. This is due to the fact that bigger and older SMEs have better collateralizable assets and technical sophistication to reduce informational opacity. Using a sample of more than 500 SMEs, Rutherford and Oswald (1999) document empirical evidence in support of the financial growth cycle: firm size, industry type, owner age, and organizational form are found to be important discriminators of financing sources. However, the degree of informational opacity and firm age are not relevant in characterizing the financing patterns of small businesses. In terms of financing sources, Ou and Haynes (2003) find that internal equity, as opposed to external equity, is the main source of finance for SMEs. Most SMEs rely on internal sources of funds (owner's starting capital, owner's loans, and retained earnings) and external debt from financial institutions to finance their business operations and real options for growth. This suggests that there appears to be a pecking order of SME finance from insiders to financial institutions, then to non-financial lenders.

While these studies suggest that SMEs experience a finance gap as compared to listed businesses, it is not clear if SMEs inevitably have limited access to external funds to the point that their growth aspirations are frustrated. In our analysis, two conditions are required for SMEs to be financially constrained.

- Firstly, the typical SME owner ought to hold high growth ambitions such that retained profits are insufficient to fulfil investment plans.

- Secondly, given the importance of ongoing social relationships for the supply of capital, the potential impact of loan denial is greater for growth-oriented SMEs. Thus we would expect these firms to apply for new loans less often. Further, if the finance-gap hypothesis holds true, growth-oriented SMEs are less likely to acquire loan approval to fund growth opportunities.

These two conditions are indispensable because finance is a constraint for SME expansion if and only if SMEs want growth finance *and* growth-oriented SMEs cannot obtain external loans to finance venture outlays. Also, it is assumed that most owner-managers are aware of the finance gap, if it exists. Growth-oriented SMEs potentially upset the well-established social relations with the existing creditors with loan denials. We would expect owner-managers to self-select and apply less often for new loans in times of growth, in order not to damage their access to capital. Following this line of reasoning, SMEs whose growth ambitions are above average are said to be financially constrained if and only if their loan applications are least likely to be approved. This critique motivates our empirical examination of the finance-gap issue.

Discussions of the finance gap have been on-going since the 1931 report of the Macmillan Committee identified that the financial needs of small businesses were not being met by the existing financial services institutions (Jarvis, 2000). Within the U.K., the persistence of the ‘Macmillan gap’ was reported in subsequent Government enquiries (Bolton Report, 1971; Wilson Committee, 1979), though more sophisticated analyses re-conceptualised the ‘finance gap’ more accurately as a function of market failure or credit rationing (Stiglitz and Weiss, 1981; Storey, 1994). Successive reports suggest a narrowing of the finance gap over the past thirty years, as policy initiatives have sought to reduce small business barriers and smooth capital market imperfections (Jarvis, 2000). Recent questioning of whether the finance gap still exists (Deakins, 1996) has been disputed on empirical and theoretical grounds (Harrison and Mason, 1995), while others point to special cases (such as new technology based ventures, ethnic minority owned firms and women owned firms) as continuing evidence of market failure (Timmons and Sapienza, 1992; Storey, 1994; Timmons and Bygrave, 1997; Brush, Carter, Greene, Gatewood and Hart, 2001; Ram, Smallbone and Deakins, 2002).

This paper examines the alternative hypothesis that SMEs obtain sufficient funds to fulfil their growth ambitions. This hypothesis works if and only if the two conditions discussed above are not met. In support of our hypothesis, there is evidence within the literature to suggest that most SMEs do not opt for rapid growth (Curran, 1986; Hakim, 1989; Headd, 2003), and also that SMEs whose growth ambitions are above average have better access to external finance (Storey, 1994). We investigate these two statements through secondary analysis of two pre-existing large-scale datasets. In the next section, we use a U.K. dataset to examine the demand for growth finance for U.K. SMEs. Thereafter, we use a U.S. dataset to investigate the sources of growth finance for U.S. SMEs. While these two survey datasets are uniquely different, the results are complementary and help ascertain the robustness of the alternative inference discussed above.

## II. Analysis of U.K. SME Financing

### II.A. Descriptive and univariate analysis

The U.K. data is derived from the third biennial membership survey of the Federation of Small Businesses (FSB), undertaken in 2004 (Carter, Mason and Tagg, 2004). With 155,000 members, the FSB is the largest voluntary membership business association, and its biennial membership survey the largest business survey, in the U.K. For the 2004 survey, 18,635 responses were received, a response rate of 12.02%.

### II.B. Logistic analysis

To see if U.K. SMEs face limited access to external sources of funds, we run the following regression:

$$\begin{aligned}
 MSF_i = & \beta_{YRbusi} YRbusi_i + \beta_{OwnAge} OwnAge_i + \beta_{GrowthAmb} GrowthAmb_i + \beta_{\ln S} \ln S_i + \beta_{SG} SG_i + \beta_{PG} PG_i \\
 & + \sum_{i=1}^5 \gamma_{1,i} OrgForm_i + \sum_{i=1}^{10} \gamma_{2,ii} SW_i + \sum_{i=1}^7 \gamma_{3,i} MainCus_i + \sum_{i=1}^6 \gamma_{4,i} MainMar_i \\
 & + \sum_{i=1}^3 \gamma_{5,i} OwnGender_i + \sum_{i=1}^7 \gamma_{6,i} BusiObj_i + \sum_{i=1}^3 \gamma_{7,i} Rate_i
 \end{aligned} \tag{Eq 1}$$

It is found that both the number of years owning the business and the main owner’s age are negatively related to SMEs’ access to more than two sources of funds (p-values less than 0.0001). This implies that the accumulation of experience and wisdom exacerbates the owner’s level of loss aversion. In turn, this increase

in loss aversion leads to a lower propensity to seek alternative sources of capital. Indeed, this finding also reflects the fact that older and more sophisticated SME owners are less likely to seek alternative fund contributors. For U.K. SMEs, it is easier to ask for more capital from the existing lenders (as compared to new creditors) due to the establishment of social networks and firm reputation. Furthermore, it is found that entrepreneurs who have higher growth ambitions are likely to access more sources of finance (p-value less than 0.0001). This finding contradicts the finance-gap hypothesis proposed by Ang (1992) and Berger and Udell (1998). Contrary to the conventional wisdom, the significantly positive association between growth expectations and actual access to multiple sources of funds suggests that SMEs do not experience a severe finance gap. Instead, entrepreneurs who anticipate expansion for their businesses are able to gain sufficient finance to fulfill their expectations. Thus, the efficient mechanism of SME financing ensures that growth is not limited by the provision of capital.

In addition to the above, we observe a size effect. That is, bigger SMEs have more alternative sources of funds. This is because bigger SMEs usually have superior track records to convince prospective creditors and angel investors for loan approval. While size implies survival for SMEs, it also indicates healthier access to alternative financing means. Moreover, we find that there is a significantly positive relation between recent sales growth and access to at least three sources of funds (p-value equal to 0.001). Sales growth translates into greater cash flows, which can be directed into investments in capital goods, internal training, and quality control. All these factors help SMEs broaden the network of refinancing sponsors. Further, it is found that recent improvements in profitability help dampen the need for keeping multiple sources of funds (p-value less than 0.0001). This is consistent with the pecking-order notion that profitable firms have abundant internal cash flows to finance investment plans and thus are less likely to seek alternative funds (Myers and Majluf, 1984).

Next, we independently assign ranks to the sample SMEs according to the corresponding values of sales growth and size (sales). We then form four growth-sales groups for comparing the implied propensities to maintain multiple sources of funds: low-growth and low-sales (LGLS), high-growth and low-sales (HGLS), low-growth and high-sales (LGHS), and high-growth and high-sales (HGHS).<sup>8</sup> In this subsection, we would like to see if growth-oriented SMEs face the so-called finance gap due to lower propensities to have multiple sources of funds. Table IV summarizes the mean estimated probabilities – denoted as  $\pi$  – of having more than two sources of funds for the four growth-size groups. Also in this panel, we compute a) the differences in  $\pi$  between the high- and low-growth groups in the vertical right-hand column, b) the differences in  $\pi$  between the high- and low-size groups in the horizontal bottom row, and c) the difference in  $\pi$  between the LGLS and HGHS groups in the bottom-right cell. The respective medians, standard deviations and t-statistics are also reported in the table. It is found that high-growth firms are more likely to have multiple sources of funds in a probabilistic sense. For the two size groups, the differences in  $\pi$  for high- and low-growth SMEs are 18.2 and 18.3 percentage points (t-statistics equal to 66.57 and 81.35 respectively). Also, we observe a reliable size effect: the differences in  $\pi$  for big and small SMEs are 3.4 and 3.5 percentage points for the two growth groups (t-statistics equal to 15.77 and 12.97 respectively). Combining the growth and size effects together, we find that HGHS firms are more likely to maintain multiple sources of funds than LGLS firms by 21.7 percentage points (see the difference in  $\pi$  down the diagonal cells). Figure 1a gives a graphical illustration of the difference in  $\pi$  for the two extreme growth-size groups. For U.K. SMEs, the growth effect magnifies the size effect. In sum, we claim that there is sufficient evidence to reject the finance-gap hypothesis. Alternatively, we find support of our happy story that SMEs are able to obtain finance required for new investment plans.

To verify that our happy story is not only descriptive of SME financing in the U.K., we replicate the same logistic methodology on U.S. data. The use of the 1998 U.S. Survey of Small Business Finances (SSBF) not only helps us ameliorate data-snooping bias, but it also helps ascertain the robustness of our happy story outside the U.K. In the following section, we show results that are substantially similar to the U.K. case.

### III. Analysis of U.S. SME Financing

#### III.A. Descriptive and univariate analysis

We use the 1998 Survey of Small Business Finances (SSBF) to examine the finance gap for SMEs.

#### III.B. Logistic analysis

Ou and Hayes (2003) find that most SMEs rely on internal funds such as retained profits, owners' equity, and loans from stockholders while too few SMEs (34 out of 3,561 firms) acquire equity from external parties. This suggests that the use of external equity appears to be an exception, rather than a rule. Thus, we assume away the use of external equity (as opposed to debt) in reconciling the finance-gap issue. That is, we re-

examine whether finance is a constraint for SME expansion via an examination of SMEs' probabilistic access to external debt. In our analysis, two response variables are used to indicate the degree of SMEs' access to external debt. These variables are drawn from the following questions in the 1998 SSBF survey:

- MRLR3 Did your firm apply for new loans for one time or more than one time in the past three years?
- MRLR4 Was the recent loan application always approved?

### III.C. Frequency of Loan Applications

It is found that Dun and Bradstreet's risk scores fail to attain statistical significance in capturing SMEs' propensities to apply for external loans. This means that entrepreneurs may have quite different perceptions about the risk-return payoff. In a sense, exposures to manageable risks are irrelevant in SMEs' decisions to seek outside debt. Also, most financial traits such as revenue growth, return on assets, and net profit margin are unimportant discriminators of new loan applicants. Among the financial variables, only firm size (natural logarithm of sales) conveys information about SMEs' propensities to apply for outside loans (p-value less than 0.0001). At least two reasons are responsible for this. First, the track records of sustainable growth for bigger firms are above average and thus help justify loan applications. Second, size means survival for SMEs, and so most SMEs self-select to scatter their shots for finance everywhere. This does not mean that SMEs choose to grow faster because inherent growth requires a clear orientation towards expansion. Instead, the persistent size effect reflects the fact that SMEs apply for external debt to minimize the likelihood of distress or involuntary exit.

Among the firm characteristics, only firm age is crucial in singling out loan applicants (p-value less than 0.0001). Unlike young firms whose capital needs are greater, old SMEs are less likely to apply for outside debt. This evidence suggests that entrepreneurs often value control more than business expansion. Apart from firm age, none of the firm characteristics (management responsibility, family involvement, operational focus, female ownership) are important discriminators.

Moreover, the net worth of the main owner(s) does not help capture SMEs' propensities to apply for new loans. Apart from this variable, most of the owner characteristics are found to be important discriminators of loan applicants. Both the SME owner's level of educational attainment and age are negatively associated with the propensity to access external loans (p-values equal to 0.0053 and less than 0.0001 respectively). This suggests that the accumulation of wisdom induces SME owners to be reluctant to acquire funds from outside parties. Also, higher education heightens the burden of overconfidence bias on the part of the entrepreneur. Consequently, this creates disproportionate weights to the SME owner's personal involvement vis-à-vis outsiders' interests. It is also found that entrepreneurs whose equity share of the business is high tend to avoid external loans (p-value less than 0.0001). These phenomena confirm previous studies that most SME owners prefer to retain control by not applying for external capital (Curran, 1986; Jarvis, 2000). With no a priori knowledge of the median objective for SMEs, it is hard to judge whether entrepreneurs' reluctance to access external funds is detrimental to the business. We suggest that these behavioural phenomena simply reflect SME owners' shift in focus from wealth maximization to utility maximization. That is, if control helps raise the level of entrepreneurs' contentment, SMEs' dormant financing policies need not harm their long-term sustainability.

We calculate the mean estimated probabilities ( $\pi$ ) of having applied for new loans during 1996-1998 for the four groups. Contrary to the finance-gap hypothesis, we find that high-growth firms tend to apply for new loans more frequently than low-growth firms. For the two size groups, the differences in  $\pi$  for high- and low-growth SMEs are 2.8 and 6.2 percentage points (t-statistics equal to 4.4 and 7.2 respectively). In addition, we observe a strong size effect: the differences in  $\pi$  for big and small SMEs are 14.8 and 18.1 percentage points for the two growth groups (t-statistics equal to 20.6 and 23.5 respectively). Combining both of the growth and size effects, we find that HGHS firms are more likely to apply for new loans than LGLS firms by 20.9 percentage points (t-statistic equal to 28.3). Figure 2 clearly shows the difference in  $\pi$  for the LGLS and HGHS groups. This evidence rejects the conventional wisdom and supports our happy story.

### III.D. Probabilistic Likelihood of Loan Approval

Next, we turn to the probabilistic likelihood of loan approval. The relation between Dun and Bradstreet's risk scores and SMEs' propensities is significantly negative at any reasonable level of confidence (p-value equal to 0.017). While Dun and Bradstreet's risk scores do not convey information about SMEs' propensities to apply for new loans as discussed in the previous subsection, these risk scores indicate that potential creditors are less likely to lend funds to riskier SMEs.

Firm-level attributes such as management responsibility, family involvement, and operational focus are not important in characterizing the likelihood of loan approval. We find that firm age is critical in screening out successful loan applicants (p-value 0.012).

Also, we examine the roles of owner characteristics in singling out successful loan applicants. Similar to the previous subsection, we find that both the SME owner's level of educational attainment and age are negatively associated with the likelihood of loan approval (p-values less than 0.043).

Moreover, the associative relation between the accretion of work experience and the likelihood of loan approval is significantly positive (p-value equal to 0.006).

We report the mean estimated probabilities ( $\pi$ ) of successful loan applications for four growth-size groups. It is found that high-growth firms tend to have more successful loan applications in probabilistic terms. For the two size groups, the differences in  $\pi$  for high- and low-growth SMEs are 1.7 and 4.4 percentage points (t-statistics equal to 3.68 and 5.43 respectively). Also, we notice a strong size effect: the differences in  $\pi$  for big and small SMEs are 15.9 and 18.5 percentage points for the two growth groups (t-statistics equal to 25.7 and 28.6 respectively). Combining both of the size and growth effects, we find that HGHS firms are more likely to obtain loan approval than LGLS firms by 20.3 percentage points (see the difference in  $\pi$  down the diagonal cells; t-statistic equal to 29.8). Figure 3 gives a graphical illustration of the difference in  $\pi$  for the two extreme growth-size groups. Once again, our evidence rejects the finance-gap hypothesis but supports our happy story.

### IV. Conclusions

We first conclude that growth is not the primary objective for SMEs because too few SMEs view profitability, expansion, or other financial measures as the most serious problem of the business. Our findings show that the vast majority of SMEs receive utility from simply being in, and remaining in business. Most SMEs are 'happy' with the level of their existing operations. Further, SMEs that seek external funding usually get what they want. They, too, are 'happy'. Since most entrepreneurs value control and so prefer not to access external debt, lower propensities to acquire outside funds need not imply financial constraints for SMEs. In contrast, our happy story suggests that control creates contentment for entrepreneurs. Our findings reject the conventional wisdom first of the existence of a finance 'gap' and second that informational opacity deters SMEs from acquiring external funds to take advantage of their growth opportunities (Ang, 1992; Berger and Udell, 1998). Few seek to grow beyond their ability to control such growth, and those who do seek external sources of funds usually get them. This describes a financially satisfied, or sustainable form of business. Our evidence shows that human elements are more important than financial attributes in quantifying SMEs' propensities to obtain funds from external parties. Owner characteristics such as the entrepreneur's level of educational attainment, age, amount of personal investments, and number of years of on-the-job training convey information about SMEs' likelihood to apply for external loans. Only two firm characteristics (firm size and age) are found to affect SMEs' probabilistic access to external capital. This is different from the analysis of publicly held firms where firm characteristics are viewed as vital discriminators (Fama and French, 1992, 1996; Daniel and Titman, 1997; Berk, Green, and Naik, 1999). In other words, it could be argued that SMEs are not financial clones of publicly listed businesses (Vos, 1992). We await future research to unveil the key dimensions for assessing the performance of SMEs.

It is the human condition to be aware of our connectedness. Entrepreneurs, as human beings, understand the need to establish and maintain their networks and connections. To understand our findings, the value of the connections can help explain why SMEs are happy. It is commonly established that social relations are crucial for SMEs to broaden the available sources of funds (Petersen and Rajan, 1994, 1995, 2002). For instance, Cole (1998) shows that potential lenders are more likely to extend credit to SMEs in the presence of pre-existing transactions. This is due to the fact that previous banking relations help convey private information about SMEs' near-term financial performance. Conditional on past experiences with viable and trustworthy small businesses, lenders perceive further loans to be less risky (Diamond, 1991).

In conclusion, our results are consistent with the alternative hypothesis that small- to medium-sized businesses are not subject to severe financial constraints. Direct comparisons of access to funds for SMEs

with and without above-average growth expectations support the happy story of SME financing. SMEs are found to be able to finance new projects from a sufficient number of external sources. This inference is robust across the U.K. and U.S. markets.

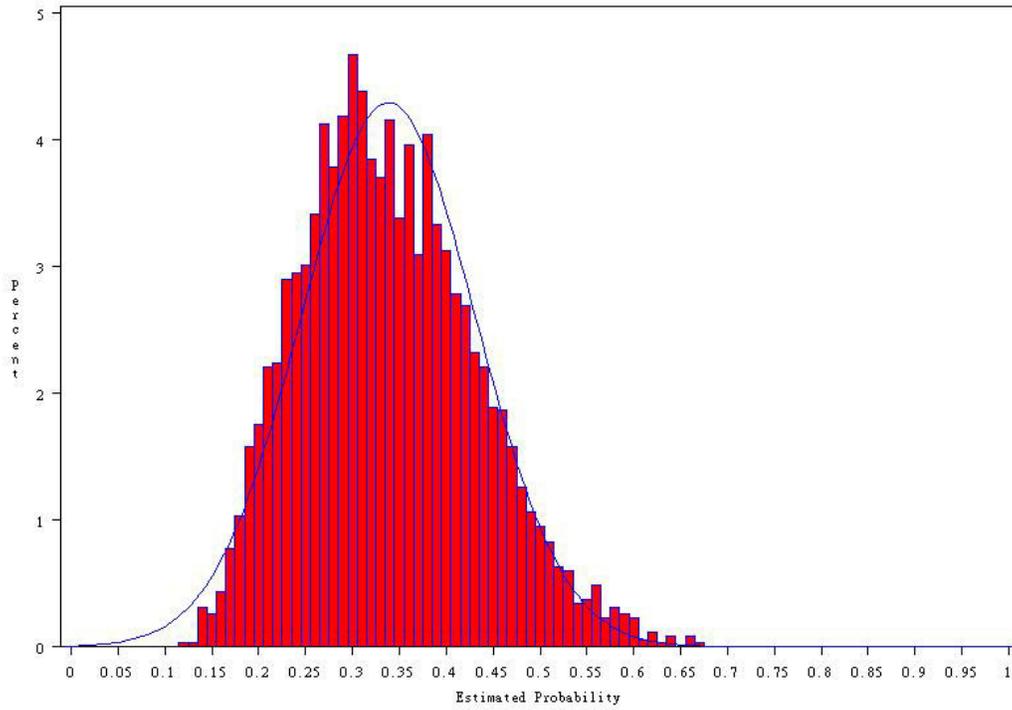
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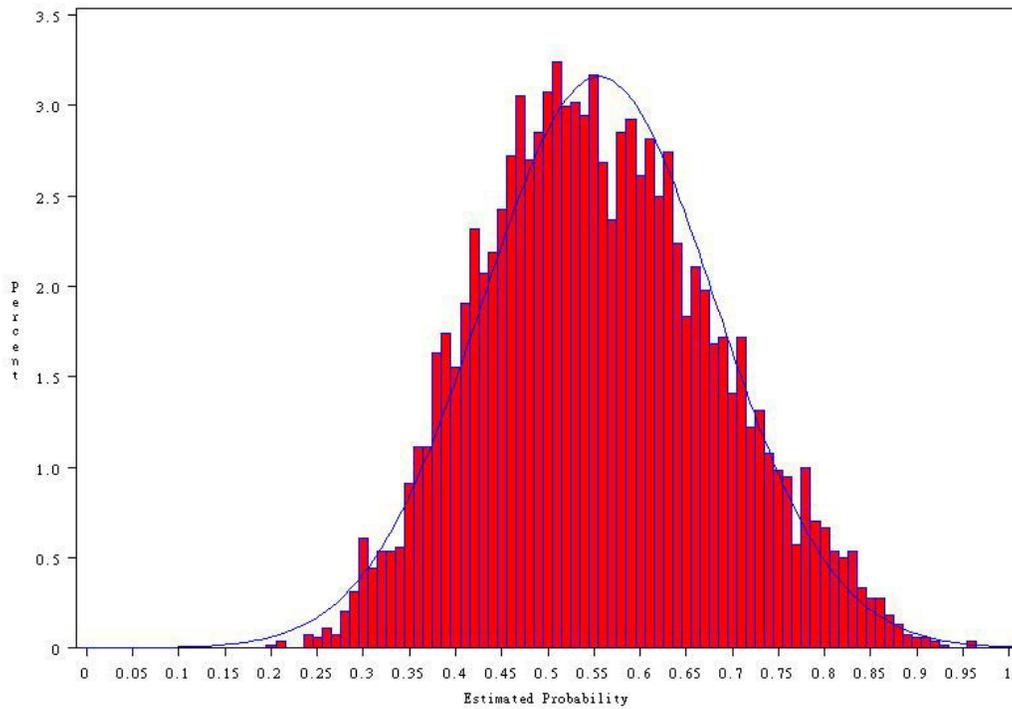
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**Figure 1: Implied probabilities of having multiple sources of funds (U.K.)**

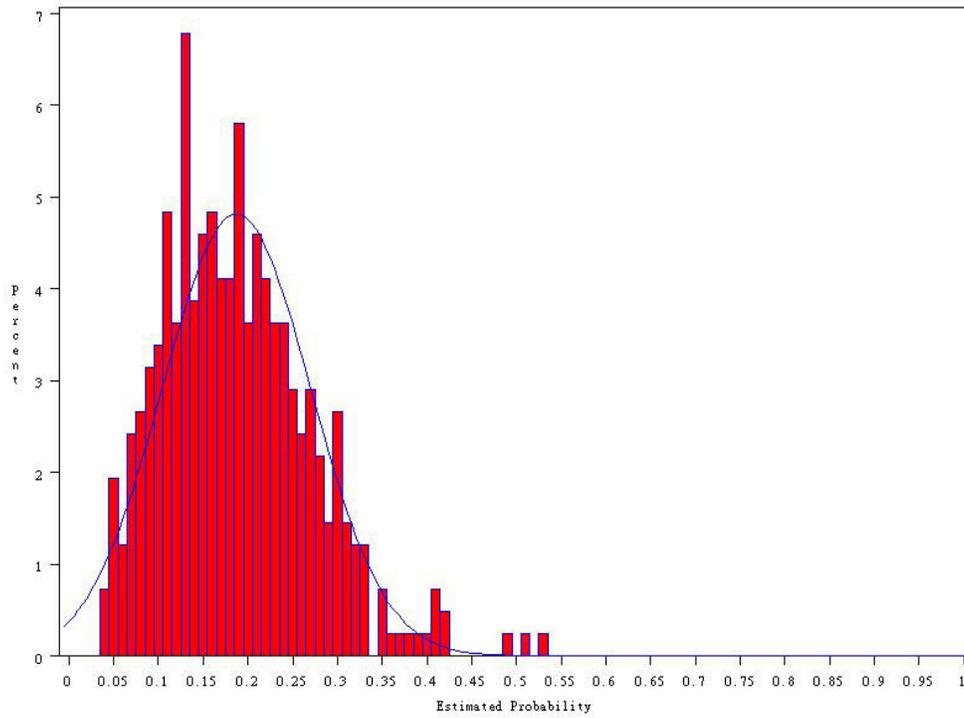
Low growth, low sales (LGLS)



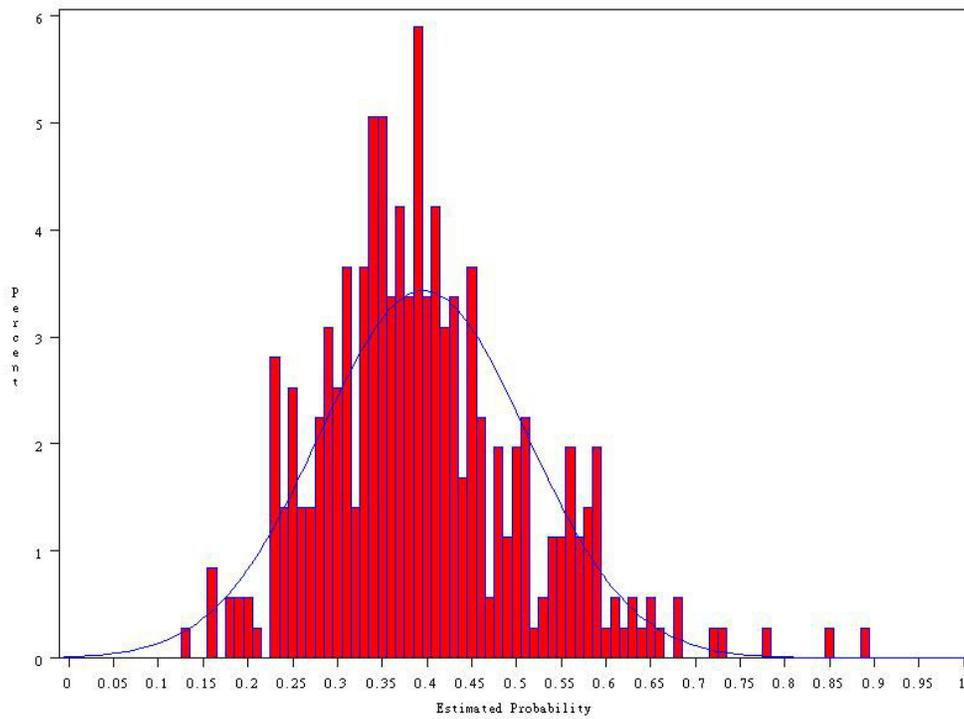
High growth, high sales (HGHS)



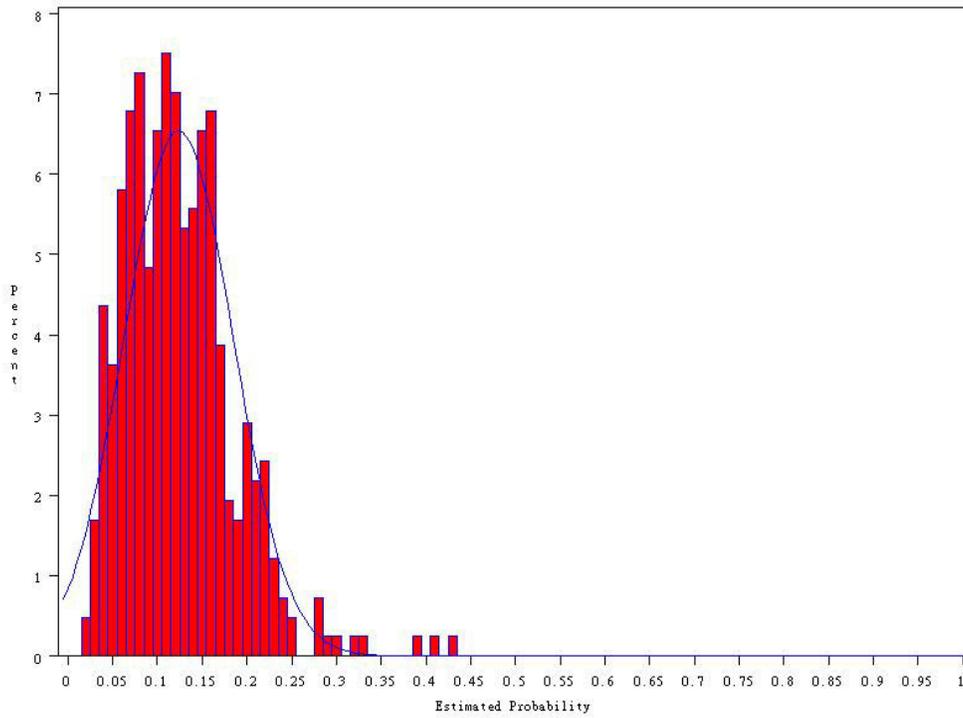
**Figure 2: Implied probabilities of having applied for external loans (U.S.)**  
Low growth, low sales (LGLS)



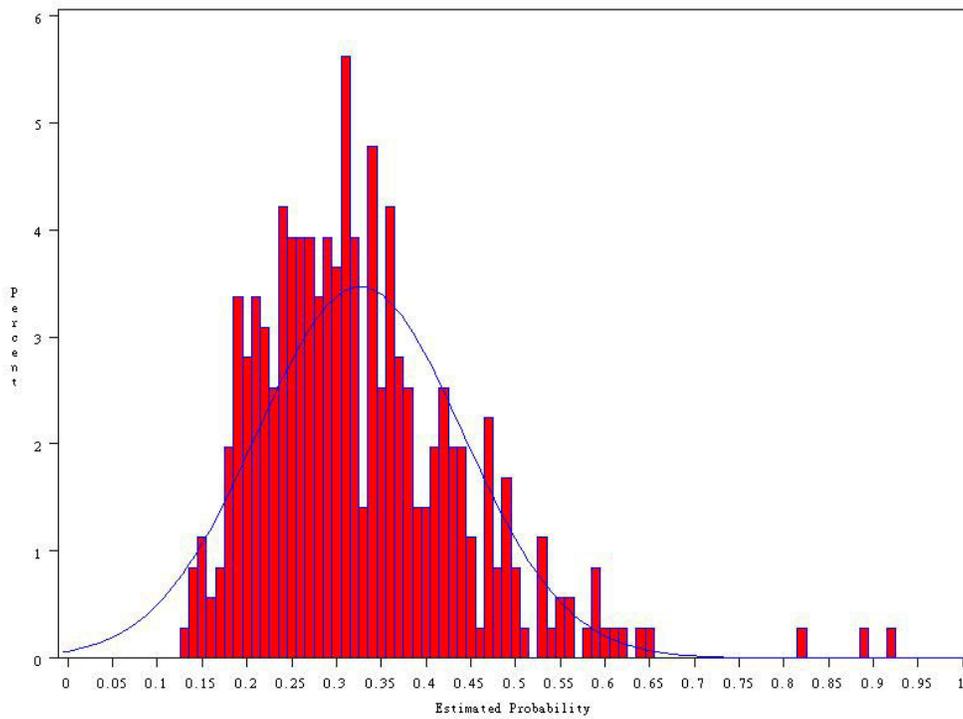
High growth, high sales (HGHS)



**Figure 3: Implied probabilities of successful loan applications (U.S.)**  
Low growth, low sales (LGLS)



High growth, high sales (HGHS)



**ENTREPRENEURIAL RESILIENCE:  
AN ANALYSIS OF THE RESILIENCE FACTORS IN SME OWNER-MANAGERS**

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**ABSTRACT**

In this paper, the concept of resilience is used in the study of career and entrepreneurial sustainability. This research contends that resilience can be thought of as a ‘set of qualities’ and as such, an entrepreneurial resilience construct can be thought of as an amalgamation of behavioural characteristics. Behaviours that have been identified in the construct are: *flexibility* displayed through a high tolerance for ambiguity and adaptability; *motivation* reflected in self-efficacy and a need for achievement and autonomy; *perseverance* as in being very accepting of situations, determined and responding well to problems or adversity; and *optimism* demonstrated by a positive outlook and viewing failure differently.

To test the nature of the entrepreneurial resilience construct, working entrepreneurs (owner-managers of SMEs) were interviewed about their experiences in building a sustainable enterprise. The study involved intensive interviews with the entrepreneurs, based on the interview framework developed by Timmons (1999). Content analysis was applied to the data by codifying the resilience factors. Results identified strong resilience factors among study participants predominantly in respects to *Holistic Positivism* (optimism), *Motivation* and *Perseverance* and to a lesser extent in *Flexibility*; and within each construct specific patterns of behaviour were determined.

**INTRODUCTION**

The concept of resilience is often used in the study of career sustainability and transition to describe how individuals overcome set-backs to career aspirations. This resilience construct has recently been used by Green & Campbell (2004) to describe a characteristic unique to New Zealander’s in their demonstration of entrepreneur activity in action. As the existing entrepreneurial theory has evolved from the traits perspective of entrepreneurs to encapsulate the process model which focuses on actions and outcomes as a means of defining entrepreneurs (Aldrich & Martinez, 2001) to further assess the nature of the ‘entrepreneurial resilience’ construct, this research views resilience as a ‘process outcome’. As such, resilience results from life experiences, rather than being an inborn personality trait.

This research takes a qualitative approach to studying entrepreneur’s resilience behaviour and contends that resilience can be thought of as a ‘set of qualities’ rather than a specific characteristic. As such the construct can be thought of as an amalgamation of other personality

and behavioural qualities. Identified qualities, which are to be tested, are: flexibility, motivation, perseverance and optimism.

## LITERATURE REVIEW

### Entrepreneurship

Small and medium sized enterprises (SMEs) account for about 95% of businesses and 60-70% of employment in most economies (Ministry of Economic Development, 2004). International comparisons of the SME impact on a country's development, however, are often difficult to make due to the different methods used to collect data and different firm size classifications. Business creation and the entrepreneurs at the heart of such ventures have, never-the-less, gained significant international attention from researchers.

Aldrich and Martinez (2001) suggest that entrepreneurial thinking has moved away from the figure, characteristics and intentions of entrepreneurs themselves to concentrate more on their actions and outcomes as a means of defining them. Morris (2002) supports this contention in saying that taking the entrepreneurial plunge has something to do with psychological and sociological characteristics, but that the sustainability of a venture, which encompasses the true entrepreneur, is more a matter of various behavioural capabilities. Davidson, Low, and Wright (2001) add further weight to this argument and suggest that, today more emphasis is placed on behavioural and cognitive issues rather than personality characteristics. Moreover, they assert that conceptual contributions to the field have clearly de-emphasised 'characteristics' of small business owners and their firms in favour of behaviours associated with 'emergence.' This emergent quality encompasses part of what is meant when we say that a person is 'resilient'.

### Defining Resilience

Resilience can be thought of a 'set of qualities' rather than a specific characteristic (Cooper, Estes, and Allen, 2004). As such, the construct is asserted to be an amalgamation of other personal and behavioural qualities including: flexibility, high motivation, perseverance, and optimism. Each of these is examined in more detail below.

Resilient People are Flexible: London (1993) asserts that the resilience factor is related conceptually to the notion of flexibility (Lofquist & Dawis 1984, as cited in London). Flexibility is demonstrated when: the individual shows a high tolerance for ambiguity (Hagevik, 1998), demonstrates that they are adaptable to changing circumstances (Cooper Estes & Allen, 2004, London, 1993); and welcomes rather than resists changes (London). According to Hagevik (1998) a resilient person is a flexible person who views change as a manageable process – he or she feels empowered by transitions (Cooper et al.), welcomes changes, and looks forward to new and different situations (London). According to Green and Campbell (2004) a resilient person will apply a number of different strategies to deal with a challenge.

Resilient People are Highly Motivated: Another aspect of resilience is a strong motivation for achievement (McClelland, 1965 cited in London, 1993). Resilient people are not satisfied with achieving only one goal however – once reached; attention turns immediately to the next goal, and the one after that – in a cycle of continuous improvement. In addition, it might be proposed

that resilient people have differing reward needs that go beyond extrinsic motivators such as money and include intrinsic motivators such as pride in self and satisfaction from helping others. Another dimension to motivation that a resilient person possesses is a driving need for autonomy (Benard as cited Cooper, et al., 2004) – wanting to be in control of one’s environment and able to directly influence outcomes. Benard says that a resilient person has a strong sense of purpose – they are goal seeking. In approaching their goal, a resilient person possesses a high level of self efficacy (Bandura, cited in London, 1993). In essence, resilient people have a ‘hardiness’ about them (Kobasa, Maddi & Kahn, 1982 as cited in London) that comes through in their willingness to work hard in order to reach their goals and aspirations.

Resilient People are Persevering: London (1993) asserts that the resilience factor may be related conceptually to the notion of perseverance (e.g. the amount of time an individual will continue on in a situation in which rewards do not match needs). Resilient people demonstrate determination in their quest for success particularly when encountering a major challenge (Green & Campbell, 2004). In doing so, they will often respond to problems with ‘more power and more smarts’ (Cooper, Estes & Allen, 2004).

Resilient People are Optimistic: One of the components of resilience is a positive outlook - remaining positive when encountering a major challenge (Green & Campbell, 2004) and working to improve a situation beyond simply doing what’s expected (Hagevik, 1998). Resilient person views failure differently – they often see it disguised as opportunity (Green & Campbell) and demonstrate ‘constructive reactions’ to disappointment or failure (Educational Leadership, 2004) by actively learning from their mistakes. In this way, a resilient person shows a strong learning orientation and ‘proactive’ personality (Hagevik, 1998).

In summary, the concept of resilience can be seen to be made up of multiple attributes that work together to give a person a reservoir of skills, knowledge and abilities to draw on as they face ongoing challenges in their business venture.

If resilience is believed to be a critical factor in understanding the entrepreneur’s capacity to sustain the business venture - it is appropriate to look at this quality as it may manifest in entrepreneurs who are successful in their ventures. In looking at entrepreneurialism through an emergent lens whereby qualities of sustainability in a small to medium sized business venture are a function of learning over time, it can be expected that the concept of resilience can be assessed by looking at behaviours and thought patterns exhibited by successful entrepreneurs.

## METHODOLOGY

To test this theory of the nature of the entrepreneurial resilience construct, entrepreneurs (New Zealand SME owner-managers) were interviewed about their experiences in building a sustainable enterprise. Respondents were required to meet the criteria of (1) the GEM definition of an entrepreneur (Frederick & Carswell, 2001) ‘*someone who creates workplace settings for him or herself and for others*’; (2) at least three annual cycles (financial years) of current business activity to ensure substance to the entrepreneurial activity; (3) operating with less than fifty FTE which constitutes 98% of all business in New Zealand and increases the likelihood of immersion of entrepreneur in the day-to-day activities of business. A random sample of twenty entrepreneurs was selected from a database of one thousand SMEs previously established by the

researcher (de Vries, 2004). Of the twenty entrepreneurs contacted, thirteen met the criteria and agreed to interviews.

This study utilised a biographical approach requiring narratives from entrepreneurs from the aforementioned sample. As entrepreneurship is imbedded in social relations, networks and biographical processes (Kontos, 2003) each participant was asked to: sketch a broad narrative of his/her background emphasising those relating to self-employment, outline elements of their business performance and future aspirations, and reflect on the business environment and their personal experiences. Each face-to-face interview was recorded on audio tape and then transcribed. Content analysis was applied by codifying the resilience factors: motivation, flexibility, perseverance and optimism.

## RESULTS

As shown in Table 1, the results of the qualitative analysis of the interview data suggest strong support for the overall resilience construct developed from the literature review. The four main themes that emerged were an emphasis on: holistic positivism, motivation, perseverance and flexibility. Each of these four main factors is discussed in detail below.

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Insert Table 1 about here

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### 1. Holistic Positivism (Optimistic)

This characteristic was represented strongly in the interview data. However, as a result of the qualitative analysis it was decided that optimism about the business alone was too narrow a description and that a more holistic view of the concept was required. The study identified that all (n=13) SME entrepreneurs demonstrate an ability to focus on goals for the business or themselves. The majority of participants have a strong sense of purpose in their goal setting and focus on the overall aims of being in business in the first place. They also mentioned behaviours that suggest they have an ability to shift focus as necessary. While not as clear at the beginning of their business start-ups their goals became clearer as time went on. Overall, their goal focused orientation can be thought of as emergent – they were focused on what their needs were for the business or themselves at the time.

Their positive outlook was also reflected in the finding that learning is important to respondents (n=10). There were differences however in the type of learning they felt was necessary with some interviewees viewing knowledge development through more education as important, while the majority emphasised the importance of ‘hands-on’ experience and understanding the marketplace.

The majority of respondents (n=10) indicated a willingness to take a chances and some seem to get a sense of enjoyment and thrill out of taking risks where there is some level of uncertainty about how things will turn out. Others, while not comfortable with the uncertainty, were accepting of risk as a necessity. Interviewees were opportunistic about their ability to take advantage of situations. They are adept at tracking trends and keeping a record of their ideas

with the aim of following them through to their obvious conclusion – a profitable business venture.

A large number of respondents expressed a positive attitude toward risk taking (n=8), in that they see failure and problems as part of the successful business process. The entrepreneurs recognise the cyclical nature of the business with its inherent highs and lows. Given that, experience has taught them humbleness in their success knowing that failure is a potential in the future. While they see failure at some point as inevitable, they have learned to manage the stress that comes with uncertainty.

## **2. Motivation**

The study identified that all the SME entrepreneurs interviewed (n=13) have a high need for continued achievement and seek further fulfilment with each step of the process. Underpinning this achievement focus was that the majority of SME entrepreneurs look beyond extrinsic rewards such as money for fulfilment. Many spoke of the satisfaction they felt with building something meaningful and that gave them their identity. This self identity helps them build a sense of self worth. The entrepreneurs interviewed indicated that they also view intrinsic rewards such as helping others develop and providing job security for their employees as important. Overall, they experience a sense of self confidence and pride in their accomplishments. This pride is often tempered by a sense of humbleness as they recognise that times could become difficult in the future.

A desire for autonomy was also featured among all interviewees as a motivating factor. Many reported going into business because of the freedom and flexibility entrepreneurship offered. This is accompanied by a desire to have ‘control’ over their work and, by extension, control over the rewards they receive. However, three respondents identified some negative effects from their desire for personal control. As a prerequisite to autonomy and control, the majority of the entrepreneurs interviewed display a strong sense of personal purpose – they know who they are. They were able to easily identify their strengths and what they were good at. Similarly, they recognise the things that are not their strengths. They do not perceive barriers limiting what they can achieve and are not hesitant about simply getting ‘stuck in’. This perhaps accompanies their willingness to take risks as they are not hesitant to try new things even if they are unsure how they will work out.

Most of the respondents (n=10) conveyed a strong sense of self-confidence and belief in their own abilities. By their own admission some respondents possess large egos. They demonstrate strong people management skills, seeking to understand people and build relationships, and often attribute their success to being able to deal with people.

## **3. Perseverance**

Analysis of the interview data identified that all the entrepreneurs exhibit a sense of “hardiness” which is demonstrated in their willingness to endure consistently long and hard working conditions. Nearly all of the respondents (n=12) discussed the personal costs of being in business for themselves. The biggest cost incurred is the time commitment it takes to grow the business – a condition that has increased as the business has grown. To offset this increasing demand, many

have put systems and people in place to reduce the time demands placed on them. Even so, many entrepreneurs reported working 60 or more hours per week. While the hours are long, they work hard out of choice and are accepting of the costs. In addition to time lost with family, there is a 'bleeding effect' of work and family life in which there is no 'leaving it at the office' – work is wherever they are.

Most of the respondents (n=10) take a long-term view to business activity and recognise that there may be short-term costs, set-backs and obstacles to be overcome. Even when success has been achieved they show sustained determination. Once a target is reached, respondents report that they generally set a new one. They use one success to help them reach a new goal. As part of this characteristic, half the respondents identified situations where they responded positively to adversity. Two of the entrepreneurs clearly showed their ability to bounce back from significant adversity by re-conceptualising their business or themselves.

#### **4. Flexibility**

The study identified that the majority of respondents demonstrate a high tolerance for ambiguity and are adaptable to changing circumstances in their business environment (n=9). They are accepting of changing circumstances even if they do not know what's going to happen. Even if they are not happy with a situation, they manage to deal with it and, though they have long term aspirations, tend not to lock themselves into 'fixed' long term planning. This adaptableness is underpinned by a common view among interviewees that change is a manageable process which they have some control over. Furthermore, they commonly feel empowered by transition, in essence, many looked forward to change. Overall, it can be said that the entrepreneurs adapt by trying to manage the change process.

### **CONCLUSIONS**

This pilot study attempts to quantify the entrepreneurial resilience construct and offer a 'resilience model' for measuring such behaviours among entrepreneurs operating in the SME environment. The research concluded that resilience can be thought of as a 'set of qualities' rather than a specific thing and that a pattern behavioural factors influence the propensity for resilience in business activity. The study also concludes that all factors identified in the literature *flexibility, motivation, perseverance optimism* were evident, to some degree, among those entrepreneurs interviewed. Prominent features among the respondents were their goal focus (holistic positivism), need for continued/unmet achievement and personal control (motivation) and strong work ethic and acceptance of personal costs (perseverance).

A limitation of this research is its small sample size. However, given the nature of the study – exploratory – results provide insights that may be used in the development of an entrepreneurial resilience scale to be used in future research. Future research therefore will continue to build on this research through further testing and defining of the resilience construct. Further studies will also be undertaken to identify differing construct patterns among entrepreneurs' differentiated by national classifications and a comparative study of entrepreneurial and corporate resilience factors is proposed.

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| CONSTRUCTS  | Frequency of factors | Pervasiveness among respondents |
|---|----------------------|---------------------------------|
| <b>HOLISTIC POSITIVISM (OPTIMISTIC)</b> (124 factors)   |                      |                                 |
| <b>Focused on goals</b>   | <b>21</b>            | <b>12</b>                       |
| • Shifts focus as necessary   | 9                    | 7                               |
| • Strong sense of vision  | 10                   | 8                               |
| <b>Strong learning orientation</b>  | <b>20</b>            | <b>10</b>                       |
| <b>Recognises when the time is right to act and sees when change is inevitable &amp; advantageous</b> | <b>19</b>            | <b>10</b>                       |
| • Responds to adversity   | 8                    | 6                               |
| <b>Positive attitude towards risk</b>   | <b>16</b>            | <b>8</b>                        |
| • See failure/problems as part of the process   | 12                   | 8                               |
| • Constructive reaction to stress   | 9                    | 8                               |
|   |                      |                                 |
| <b>MOTIVATION</b> (115 factors)   |                      |                                 |
| <b>Demonstrates a high need for continued/unmet achievement</b>                                       | <b>24</b>            | <b>13</b>                       |
| • Different reward needs (more intrinsic)   | 10                   | 9                               |
| <b>Autonomy and personal control</b>  | <b>23</b>            | <b>13</b>                       |
| • They know who they are hence display a strong sense (of ?)  | 12                   | 9                               |
| • “can do” - do it yourself/give it a go attitude   | 11                   | 8                               |
| <b>Self-confidence – self efficacy</b>  | <b>16</b>            | <b>10</b>                       |
| <b>Social competence – emotional intelligence</b>   | <b>19</b>            | <b>9</b>                        |
|   |                      |                                 |
| <b>PERSEVERANCE</b> (73 factors)  |                      |                                 |
| <b>Hardiness – strong work ethic/enjoy work</b>   | <b>25</b>            | <b>13</b>                       |
| <b>Accepting of costs as part of the process</b>  | <b>28</b>            | <b>12</b>                       |
| <b>Takes a long-term view &amp; demonstrates determination</b>  | <b>15</b>            | <b>10</b>                       |
| • Ability to bounce back – responds by reconceptualising the business/self                            | 5                    | 2                               |
|   |                      |                                 |
| <b>FLEXIBILITY</b> (35 factors)   |                      |                                 |
| <b>Demonstrate a tolerance and adaptability to changing circumstances or ambiguity</b>                | <b>16</b>            | <b>9</b>                        |
| • Views change as a manageable process  | 11                   | 7                               |
| • Empowered by transition/adaptable/ looks forward to change  | 8                    | 7                               |
|   |                      |                                 |

Table 1 Summary of Resilience Factors and Characteristics

# **Preferred Performance Measures in Family Firms**

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## **ABSTRACT**

This paper explores the performance measures selected by family firms. It is theorized that the importance of various performance measures shift based upon extant family conditions. Nine propositions are advanced using variables identified in the family business literature as being associated with performance indirectly through conflict.

## **LITERATURE REVIEW**

For the family firm, continued survival and success of the founder's vision is considered one of the most important organizational achievements (Ward, 1987). The sense of achievement in family businesses is affected by a critical factor that can act as a double-edged sword -- the family dynamic (Bork, 1986; Cohn & Lindberg, 1974; Foley & Powell, 1997; Janssen & Graves, 2003; Tagiuri & Davis, 1992), which may be at least a partial explanation as to why fewer than one third of family businesses survive into the second generation of ownership (Aranoff & Eckrich, 1999). An interesting paradox exists where the very factors that can launch and sustain a successful new family business may harbor the seeds of destruction as the family business matures and the family increases in size over generations (Beckhard & Dyer, 1983; Cohn & Lindberg, 1974; Ward, 1987). We assert there may be differences between how the founder of the family business views success versus the definition of success and the performance measures used to gauge business performance by family members in later generations of family business ownership. It may even be that the founder's definition of success drifts over time.

Family business is rightfully viewed as being different from other businesses in that it is a system created by the overlapping subsystems of ownership, management and family (Bork, 1986; Dyer, 1986; Tagiuri and Davis, 1992). Gersick, Lansberg, Davis and McCollum (1997) extend the thought of the Tagiuri & Davis Ven diagram by pointing out that in this diagram there are seven critical overlap areas that may be the source of friction points for the family business; each of the variables (family, business, and ownership) may suffer conflict as well as the combinations of ownership-family, ownership-management, family-management, and ownership-family-management.

In their study of conflict in family firms, Sebor and Wakefield (1998) found evidence for carry-over relationships between business and family as hypothesized by several scholars. These carry-over relationships may be most salient at the friction points identified by Gersick, Lansberg, Davis and McCollum (1997). Wakefield (1995) discovered that families that interacted positively in social settings also interacted positively inside the business. Therefore,

when functioning smoothly, a cohesive family unit may be a source of strength to the organization, however a family consumed with internal conflict can result in insufficient attention focused upon business needs and increase the chance of failure (Kets de Vries, 1993).

Due to the seven critical conflict zones within family business, constant fine-tuning is essential to keep the business healthy and the family healthy. Over time, changes in the family, ownership of the business, and/or the business itself can create problems for the entire system. For example, a family business entering its third generation of ownership may experience multiple family members tied to one another by a variety of familial relationships, and each of the relationships will experience carryover between family interactions and business interactions. Each individual's role may become unclear, and each family member may bring his or her own agenda into the business. As a result, who decides what and when becomes murky in later generations of the business, absent clear managerial direction (Wakefield, 1995), but may reflect how the family normally operates, and this approach spills over into the business.

If decisions become complicated in the family business, we may expect that performance could suffer. Hershon (1975) suggested that the family dynamic affects the performance of the family firm in both positive and negative ways. Indeed, the performance measures selected as the most important to the family firm may be affected by family dynamics and the family situation.

The performance in a typical publicly traded firm is straightforward and relatively easy to measure; the focus is on financial measures such as profit, ROI, ROA and EPS. For family firms, profit, of course is essential, but other concerns may override the drive for profit maximization. For example, employment of family members, or service to the community may score high on the set of objectives for the family firm. Moreover, there may be family carry-over relationships that enhance or inhibit organizational performance. If the family has major expenses, cash flow may become the dominant priority. If the family is interested in wealth creation and passing on the estate to future generations, then building illiquid assets and ownership of the maximum possible amount of stock may be the focus for the business.

Determining the most appropriate measures of performance can be problematic because of each family's unique set of objectives. Additionally, since most family firms are privately held, accessing financial data is often impossible. Given this dilemma we will attempt to solve the problem by allowing family firm leaders to determine their own performance concerns. These measures will comprise the dependent variables.

It is the aim of this paper to determine the performance measures family firms select, and the antecedents of the performance measures selected. As Sebor and Wakefield (1998) discovered, there may be conflict over a variety of issues in the organization: strategic vision, managerial control, ownership, and money. Hershon (1975) presents the belief that conflict in the family will influence family firm performance in an inverted "U" relationship. We accept Hershon's proposition, and we further argue that the variables that predict conflict in the family firm may also determine performance measures considered most important by leaders of the family firm.

In addition to key family characteristics that Wakefield (1995) found to be significant predictors of conflict (number of generations in the business, number of family members working in the business, age of the incumbent, level of education of the incumbent, and the presence of outside boards of directors) other variables will also be considered: owner's gender, year's incumbent has held office in the organization, the amount of debt held by the family

business, the percent of family ownership of the firm, and the overall level of family support for the business.

### **PROPOSITIONS**

Review of the family business literature seems to show interesting linkages between performance and family firm characteristics. On this evidence, we offer nine propositions. Wakefield (1995) found significant support for the number of family members working in the family business. As a corollary, we offer the following proposition:

P1: The perceived importance of firm performance increases with the number of family members who take part in the business.

An interesting finding in Wakefield (1995) is the inverse relationship of age to conflict. Because of experience the older incumbent may be better at controlling the conflict friction points in the organization. However, the older incumbent may also have multiple objectives, perhaps conflicting, for organizational performance toward the end of his/her tenure with the organization. The incumbent may want increase cash flow in preparation for retirement, yet simultaneously maximize wealth creation in the form of assets to be passed on to subsequent generations. The second proposition is:

P2: The perceived importance of firm performance increases with age of the owner(s).

Previous research demonstrates that there is a difference in the way male owners and female owners both view and run their organization (Singh, Hills, Hybels, and Lumpkin, 1999, National Foundation for Women Business Owners; Butner & Moore, 1997; Gillian, 1982; and Kamau, McLean and Ardishvili, 1998). Male owners tend to be more competitive, have larger networks, and want to “keep score.” Female owners, on the other hand, are more nurturing and supportive in the work environment (Butner & Moore, 1997). While financial performance is important for survival, the female owners may see the need to “keep score” in financial terms irrelevant to their primary objectives for the business. Therefore, the third proposition is:

P3: The perceived importance of firm financial performance is higher for male owners than for female owners.

Brockmann & Simmonds (1997) make the argument that success is positively correlated with age. It follows that the firms led by successful managers must also experience success in terms of performance. Thus, the fourth proposition is:

P4: The perceived importance of firm performance is positively related to the leader’s number of years in office.

Sebora and Wakefield (1998) discovered a surprising positive relationship (opposite of the hypothesized direction) between education of the incumbent and conflict over money, management control, and strategic vision. Also, educated incumbents may have been exposed to a higher level of financial analysis than their less educated counterparts. Congruent with Sebora

and Wakefield's findings, and the heightened analytical capabilities of educated incumbents, our fifth proposition is:

P5: The perceived importance of firm performance is positively related to the leader's years of education.

Lack of organizational slack may be a significant cause of conflict in organizations, while an abundance of resources may lead to a sense of complacency among organizational members (Bourgeois, 1981). The amount of debt could heighten concern among members that there are scarce financial resources, and that improved financial performance is imperative in order to meet the debt load. Therefore, the sixth proposition is:

P6: The perceived importance of firm performance varies positively with the amount of firm debt.

Schwartz and Barnes (1991) concluded that outside boards are helpful in providing unbiased views of the organization and force management accountability, while Ward and Handy (1988) in a non-random survey found that 88% of firms using outside board believed their boards to be useful and valuable, compared to 68% of those using inside boards expressing the same opinion. Proposition seven reflects the expected influence of outside boards of directors on the perceived role of performance:

P7: The perceived importance of firm performance is positively related to the number of non-family board members.

The amount of ownership of a family firm held by family members creates a vested interest in firm performance. Congruent with Hershon's (1975) theoretical construct of the inverted "U" between conflict and performance, Davis (1983) suggests that family members will create a work environment and culture that leads to superior organizational performance. The more family members that rely on the family business, the more that family members may exert pressure on the organization to produce positive results for their investment, since the family members may realize the opportunity cost of their capital. Proposition eight:

P8: The perceived importance of firm performance is positively related to the percentage of ownership of the business by family.

Perceptions of whether the family and business share similar values, family support of the business, family loyalty to the business, and whether or not the family is a positive influence can carry-over and impact workplace effectiveness. Family influence on business performance may be mitigated by strong leader characteristics, based on Hambrick's and Mason's (1984) Upper Echelons Theory (for our purposes, technical skill, tenure, educational background, financial skill sensitivity, general management skills, and people skills) and/or

P9: The perceived importance of firm performance is positively related to the family support for the business.

## METHODOLOGY

The authors use a database commissioned by and available from Massachusetts Mutual. The sample size is n=1059. Descriptive statistics and regression will be the primary methods of investigation.

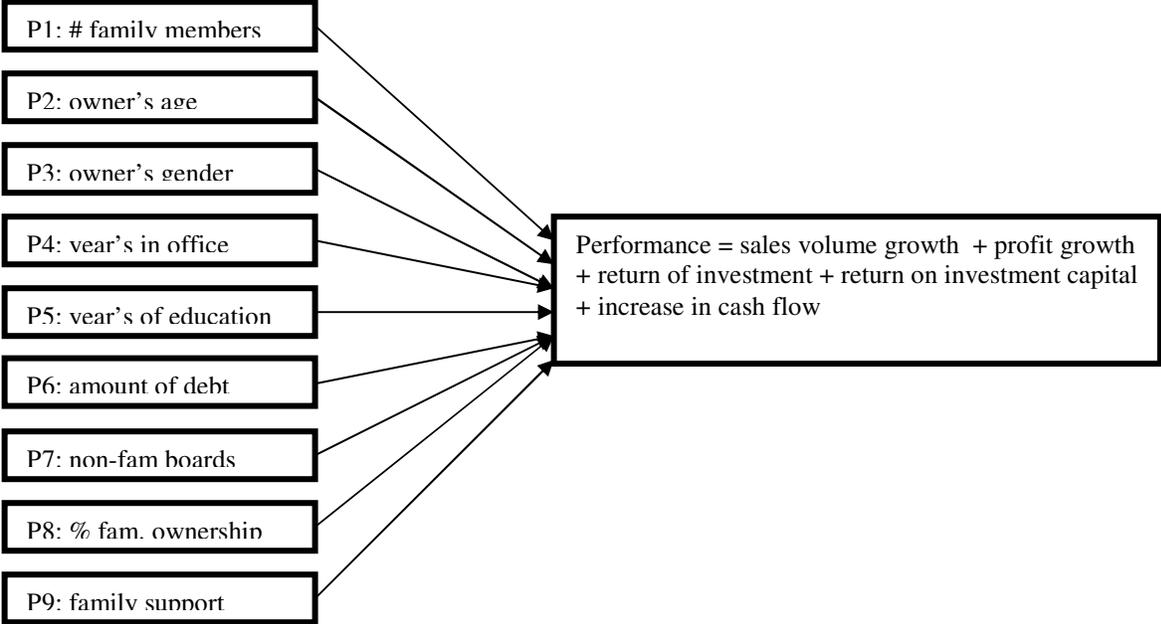
Traditionally, firm performance has been measured on the basis of ROI, ROE, ROA, sales, profitability and others metrics (*Dun & Bradstreet Industry Norms and Key Business Ratios*, 2005). Rather than asking the Mass Mutual Family Business Survey respondents to volunteer financial information, respondents were asked to rate the importance of sales volume growth, profit growth, return of investment, return on investment capital and increase in cash flow. As these are clearly subjective views, it may be that the best overall measure of performance would be all indicators taken cumulatively. Thus, the method of canonical correlation analysis is well suited for this approach, with the dependent variate composed of measures of sales volume growth, profit growth, return of investment, return on investment capital and increase in cash flow will be regressed against the moderating effect of the variables in the prepositions presented above. The relationships proposed by these prepositions are summarized in the conceptual model of interactions (see Figure 1) between the variables: sales volume growth, profit growth, return of investment, return on investment capital and increase in cash flow.

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Insert Figure 1 about here  
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## CONCLUSION

This paper examines the preferred performance measures of family firms. It is our expectation that the data will demonstrate a shift in the perceived importance of selected financial performance measures depending on the characteristics of the key family members involved in the family business. The database used has a single category of “other” that may include both financial measures not mentioned and non-financial measures. Future research should examine the range of relevant non-financial performance measures and the role non-financial measures play in goal setting for family business. Another extension of this research should explore the relationships between family members, conflict, selection of performance measures and organizational performance relative to the performance measures selected.

Figure 1. Conceptual model of Interactions



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***COOPERATIVES AND ENTREPRENEURS: A PARTNERSHIP FOR JOB  
JOB CREATION AND ECONOMIC DEVELOPMENT.***

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**ABSTRACT.**

Unemployment remains a serious concern in any country. Although South Africa has experienced political stability, the economy is characterized by a relative low growth rate and high unemployment rate. If these aspects are not addressed effectively political stability can be deter. Many communities, especially in rural areas, are living in poor conditions. By stimulating economic activities, this problem can be alleviated. Efforts should therefore be to stimulate economic activities by involving members or local entrepreneurs and at the same time keep the generated wealth in the community.

Much emphasis is often placed on the small business sector to create jobs and alleviate poverty. The small business sector can undoubtedly make a contribution to economic development as long as obstacles in its way are bridged and the many difficulties faced by small businesses are eliminated or addressed effectively. One way to do this, is for entrepreneurs to form cooperative alliances. Many entrepreneurs in the same industry

have been forced by these difficulties to organize and to form cooperatives. Not only does this strengthen the position of small businesses to compete with big businesses, but it also contributes to community development. Earnings produced by cooperatives are returned to the member/owner and the end result is that this wealth is kept within the community. Thereby the goal of job creation and uplifting of communities are reached. Looking at the definition of the cooperative, namely an autonomous association of individuals united voluntarily to meet their common economic, social and cultural needs through jointly owned and democratically controlled enterprises, it is obvious why this is the ideal type of business to support and develop communities. The ability to take advantage of the economies of scale, while retaining individual identity, is appealing to entrepreneurs.

The cooperative will only be successful if it promotes the wealth of its members and provide competitive products and services. This will only be possible if the cooperative can survive, innovate and adjust to changes in the economy. The aforementioned can be achieved if there is an effective combination of the entrepreneurial skills and the cooperative type of business with the advantages it can offer. The entrepreneur and the performance of the cooperative are therefore closely linked.

The presence of collective entrepreneurship can offer the cooperative the opportunity to capitalize on individual talents together with wisdom and collective energy. All this will contribute to a competitive advantage and a successful cooperative.

This paper also reports on a model in South Africa where a cooperative alliance has been formed between an existing small business and entrepreneurs in the informal sector. This cooperative model allows unemployed people to participate with an existing entrepreneur who acts as their trainer/mentor. Not only are jobs created, but unemployed people are prepared and equipped to become part of the main stream economy.

## **INTRODUCTION**

Unemployment in South Africa is a matter of serious concern for its effect on economic welfare creation. (Competition News, 2002:1). The economy has also been characterized by both low growth and investment (Makgetla : 2004). Although South Africa has experienced political stability, the high unemployment rate, if not addressed effectively, can deter political stability. Research shows that there is a positive relationship between the level of unemployment and the crime rate and that crime will be mostly efficient controlled by addressing the employment and income earning issues (Blackmore, 2003 : 439).

Many rural communities in South Africa are living in poor conditions. By stimulating economic activities, this problem can be alleviated. Communities must become self-sufficient and initiatives for achieving this should stem from the community itself.

Much emphasis is often placed on SMEs to create jobs, alleviate poverty and contribute to economic development due to the fact that large businesses focus more on shareholder return and not necessarily on job creation. These businesses withdraw money from the

community and the main beneficiaries are those outside the community (Hazen, 2000). Efforts should therefore be to stimulate economic activities in rural communities, involving members or local entrepreneurs in the process of producing that wealth and at the same time keep the generated wealth within the community. By keeping wealth within the community, the desired goal, namely job creation and the uplifting of communities, will be reached. This can be achieved through the creation of worker-owned cooperatives (see discussion later). Earnings produced by cooperatives are returned to the member/owner in proportion to the business conducted with the cooperative (Scarini, 2003:14).

In a developing country, the small business sector is widely regarded as the driving force behind job creation and economic development (Lunsche & Barron, 2000 : 1). SMEs can undoubtedly make a contribution to economic development, as long as the obstacles are bridged. If the small business sector wants to realize its full potential the small business must become a major role player in the mainstream economy, be able to compete with large businesses and become fully sustainable. However, not only the formal sector can contribute to economic development, but worldwide the importance of the informal sectors is being realized and strategies to integrate this sector into the mainstream economy are being developed (Luiz : 2002). The bulk of new employment in recent years, particularly in developing and transition countries, has been in the informal economy, because people find it difficult to get jobs or start businesses in the formal economy (Haskell:299).

The business model which will be discussed later can serve as an example of an effort to include the informal sector into the mainstream economy through cooperation amongst unemployed individuals and formal entrepreneurs.

Entrepreneurs as the driving force behind the small business should be supported and assisted enabling them to fulfill their essential role in economic development and restructuring (Glass & Drnovsek : 2001). Unfortunately, the small business sector faces many difficulties and these difficulties have encouraged entrepreneurs in the same industry to organize and create cooperatives (Scarinci, 2003:12). The purpose and flexibility of the cooperative appeal to many small business owners. The ability to take advantage of the economies of scale, while retaining individual identity, is appealing to many entrepreneurs and convince them to establish cooperatives. Some of the advantages offered by the cooperative form of business are access to services and supplies at a more favorable rate, volume discounts, availability of credit and improved delivery since these are required by a group rather than an individual (Scarina, 2003:14). Cooperatives can indeed have a significant and positive impact on the communities in which they are located. They create and retain local jobs, have a more long-term commitment to remain in the community and provide local leadership and development (Zueli & Cropp, 2003:77).

The use of cooperatives to stimulate rural economies is a worldwide phenomenon (Hazen, 2000; Campbell, 2004). A good example of the utilization of the cooperative can also be found in India where the government has laid emphasis on the strengthening of

the movement to generate employment and reduce poverty. Cooperatives played a significant role in promoting rural development and cooperative development was taken up as a national program in this country (Anon, 2004). This effort might be the reason why there are currently 446 784 agricultural cooperatives in India, compared to the 27076 in the United States (Zeuli & Cropp, 2004:13), and 1264 in South Africa (Scholtz, 2001). Greater support for cooperatives has, however, also come from the South African Government, which has realized the potential of this business form, (Makgetla, N S. 2004) although the sector has not reached the momentum as elsewhere in the world.

## **WHAT IS A COOPERATIVE?**

Cooperation is not a bargaining game in which one person's success is achieved at the expense or exclusion of the success of others. The constant aim is mutual benefit (Thorn, 2000).

Looking at the definition of a cooperative, namely an autonomous association of individuals united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise (DTI, 2003:5), it is obvious why the cooperative is the ideal type of business to support and develop communities. Cooperatives are about people doing good work to benefit themselves. But even more basic, it is people working with other people to make themselves better off. It is people recognizing that together they can do more than they can do by themselves (Haskell, 2003a:2).

Cooperatives can either be client-owned or worker-owner cooperatives. In the case of worker-owner cooperatives members are both workers and employers. Client-owned cooperatives are established by members that have their own enterprises or households. The members use their cooperative to obtain goods at more favorable prices or they use the cooperative as a marketing instrument for their products (DTI , 2003:6).

As is the case with any other type of business the application of proper business principles also applies to cooperatives. Cooperatives must be managed effectively in order able to survive. The fact that the members are also the owners and are jointly responsible for the success of their businesses, places a responsibility on each participant in the cooperative venture. It is expected from members to act like entrepreneurs and to apply their business skills in the cooperative. If cooperatives want to be prominent role players in the economy and increase their ability to make a difference, they will require enhanced internal capacities, professional management, commitment, general membership education and training, and constructive support from government. A study done in South Africa (Van der Walt, 2003) indicated that a large percentage of non-agricultural cooperatives are not operational any more. Some of these cooperatives have not even been operational after they had been established. There are different reasons for this phenomenon although a proper understanding of the nature of the cooperatives and the responsibilities by members play an important role in these unsuccessful efforts.

Research on alliances amongst small enterprises (Hoffmann & Schlosser, 2001:372) also stresses the importance of proper planning and sufficient knowledge regarding the alliance during the strategic and analysis phase of the alliance. Alliances need to be

professionally planned and organized for the full potential of the cooperation to be realized. Individuals interested to establish cooperatives or considering to participate in cooperative alliances should be assisted before committing themselves. This assistance should preferably come from people who are familiar with the cooperative venture. A failure to understand cooperative complexities can lead to inappropriate assistance and advice. Finding developers and other parties who can assist cooperatives and who are familiar with the cooperative model may be challenging (Zeuli & Kropp, 2004:78).

Research in South Africa (Van der Walt, 2003) also indicated that cooperatives, especially newly established cooperatives in rural areas, have a substantial need for training and managerial assistance during the establishment phase. Once the cooperative is in operation, continuous member education is critical to keep members committed to and involved in the cooperative. This education does not only entail knowledge regarding cooperative principles and practices. Haskel (2003b:2) stated that during this education process it is critical that the cooperative form of business is completely understood. It is also important that cooperative education initiatives adequately deal with today's complex business, marketing and financial issues. Training should also be provided to directors and management to improve their entrepreneurial and business skills (Zeuli & Kropp, 2004:78). These training efforts should also extend to youth and the general public (Haskel, 2003b:2). To have an active and vibrant cooperative sector, people in all walks of life should be informed about the nature and advantages of this type of business. It is also important that this education is based on research, otherwise it will be flawed and dated (DES, 2003:8).

In the USA, university-based cooperatives centers plays an important role in this regard. Unfortunately, such centers do not exist in South Africa.

Research that documents positive and negative cooperative practices can form the basis for future cooperative development. Cooperatives may, however, not be in a position to establish their own research centers and will have to rely on other parties to do and finance these research activities. The establishment of such centers is an important part of creating and enabling a sustainable environment for the long-term development of cooperatives, (DES, 2003:8). Currently, limited research on cooperatives are conducted in South Africa.

## **SUCCESS FACTORS FOR EFFECTIVE COOPERATIVES**

In order to have a vibrant cooperative sector, an environment conducive for cooperative development should be created and certain aspects should be addressed. The following factors play an important role in the effectiveness of cooperatives and also the ability to survive.

- *Effective management.* Cooperatives should be managed effectively. Conflict between members and management, including the board of directors, must be avoided (Zeuli & Cropp, 2003:50, Von Ravensburg, 1999:25). The advantages of cooperatives will only be realized if the cooperative continues to operate as a sustainable form of business.

- *The initiative for the cooperative must come from its members.* Those who will eventually enjoy the advantages of the cooperative, must initiate the establishment of the business. Therefore a bottom-up approach should be followed (Bhuyan & Olson, 1998:8).
- *Member support and commitment.* The cooperative will only succeed if continuous commitment and support by its members exist. (Randall, 2001:1). Members must realize that the cooperative basically depends on them for its existence.
- *Entrepreneurial mindset.* A factor often ignored when addressing cooperative success is the entrepreneurial mindset of members (Röpke, 1992:15). Environmental factors influencing the business sector also apply to cooperatives. In order to address the changing needs of members, all role players (including members, management and directors) must be creative and innovative.
- *Cooperative education.* The cooperative as a form of business must be completely understood and education should also deal with business, marketing and financial issues (Haskell, 2003; Campbell, 2003).
- *Government support.* Although a cooperative is member-driven, government support is indispensable. Government should provide the policy conducive to cooperative development (Von Ravensburg, 1999:23, DES, 2003:5).

Cooperatives should not be used as an instrument of the government but must be able to act autonomously (DES, 2003:6).

## **ROLE OF THE ENTREPRENEUR**

To be viable the cooperative should promote the wealth of its members in order to meet these requirements, the cooperative must provide benefits to the members that will exceed the benefits if they had not established a cooperative. Although it is expected from members to support the cooperative (Zeuli& Cropp 2004:50), the expectation that members will automatically support the cooperative is not always valid (Hogeland, 2004:27). Von Ravensburg (1998:25) is of the opinion that the absence of members' involvement can lead to a situation where it is difficult for the cooperative to make a positive contribution to its members and any contribution towards economic development would also not materialize.

Cooperatives compete with other businesses and must provide competitive products and services. Otherwise, the important factor, namely member support, will be lost in favour of competitors. It is therefore important for the cooperative to establish a competitive advantage and this will only be possible if the cooperative can survive, innovate and adjust to changes in the industry and the economy (Scarini, 2003:14). The presence of an entrepreneurial spirit is therefore essential if cooperatives want to meet these requirements and stay competitive. Members can therefore not only be participants or recipients, but they must be entrepreneurs always searching for opportunities. The cooperative is actually dependant on the characteristics and involvement of the

entrepreneur. The entrepreneur and the performance of the cooperative are therefore closely linked.

To describe the entrepreneurship in a cooperative, the term collective entrepreneurs (Morris & Kuratko, 2002:165), where individual skills are integrated into a group and the team's collective capacity to innovate becomes greater than the sum of its parts, is actually very appropriate. Group members learn about each others' abilities. They learn how they can help one another to perform better and how they can best take advantage of one another's experience. The presence of collective entrepreneurship can offer the cooperative the opportunity to capitalize on individual talents together with wisdom and collective energy. All of this will contribute to a competitive advantage and a successful cooperative.

### **THE DEVELOPMENT OF SMALL BAKERIES : AN EXAMPLE OF JOB CREATION THROUGH COOPERATION BETWEEN THE FORMAL AND INFORMAL SECTOR IN SOUTH AFRICA**

The Yebo cooperative in South Africa has been established by the Deutscher Genossenschafts und Raffeisenverband with the purpose to promote cooperative development in the country and support and service member-based self-help organizations (Biyela, 2004).

Yebo cooperative has developed a business model whereby unemployed people who want to get involved in business can partner with existing small businesses who are

willing to give them training and business mentorship, enabling them to become formal business owners. When these entrepreneurs reach the stage where they have adequate business skills and sufficient funds they will become part of the mainstream economy.

The project started with 17 informal entrepreneurs who indicated that they want to get involved in the pilot project. It was decided to start with a bread baking business due to the high demand for basic food and an inadequate supply network. It was also decided to establish the project in a black township where the unemployment rate is high. As the group were unemployed they had limited funds to buy baking equipment and rent a premise. Yebo approached a local small bakery to enter into an empowerment partnership with the group and Yebo agreed to become the facilitator. The local baker accepted the alliance and agreed to make his equipment and premises available to be used by the group during training. During training, the group had to bake for their trainer's business as compensation for his service and the use of his facilities. His requirement was 500 loaves per day. Any production exceeding this quantity was for the account of the trainees. The trainers currently work on a cooperative basis and market their share of the production in the nearby township where they had already decided to open their bakery in future. In this way, training was immediately linked with income generation for the group.

Within two months of the alliance, the group was able to sell about 700 loaves per day to their own market. The profit realized from their sales managed to compensate each of them with an amount of at least R400 per person per month and the potential exists to

increase this income. This model does not only create opportunities for people who want to start their own bakeries, but provide trained people who can enter the labour market if they are not keen to own their own baking operation.

A second initiative taken by Yebo cooperative was to invite other existing small bakeries to join hands and buy their baking ingredients in bulk. Five small bakeries have responded which resulted in a dramatic decrease in their purchasing prices.

The arrangement between the entrepreneur and the trainees is currently an informal cooperative alliance. When the time comes to make a decision the group members can either start individual small bakeries or they can form a formal cooperative and expand their production. Not only has this venture created income and employment, but it transformed formerly unemployed people into competent entrepreneurs which can in turn create jobs and contribute to economic development.

This model and the outcome thereof will be monitored and will serve as a case study for future qualitative research.

## **CONCLUSION AND RECOMMENDATIONS**

Although much has been done in some countries to promote cooperative development, more active steps should be taken in South Africa in this regard. To give more momentum to the process the following recommendations should be considered.

-Cooperative alliances between informal and formal entrepreneurs have huge potential, especially in third world countries and should be exploited.

-The promotion of the cooperative type of business form should be promoted amongst existing small businesses, as well as individuals in the informal economy.

-Cooperative training and education should be a priority, not only at tertiary level, but also at secondary level. Government should play a more active role in providing resources, especially in countries where they have not accepted responsibility in this regard.

-Cooperative research institutes within the university sector is needed to ensure research-based education and management development programs. Cooperative centers, which prove to be effective in other countries, should also be considered in a country like South Africa. Government should accept the responsibility to assist these institutions.

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# SMALL BUSINESS GROWTH THROUGH FRANCHISING: A QUALITATIVE INVESTIGATION

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## ABSTRACT

Although franchising has long been recognised as an attractive means of growing a business, the impact of franchising for small businesses is an area which is relatively under researched and understood. Whilst resource scarcity and agency theory suggest many potential benefits to franchised firms, small businesses wishing to franchise are likely to encounter a number of challenges in translating their business concept into a successful franchise operation. This paper, though a series of case studies of both ‘failed’<sup>1</sup> and successful franchises seeks to provide a rich description and insight into the experiences of six businesses which have tried to expand using franchising, and considers the implications of franchising for small business growth. It appears that many of the ‘failed’ companies were not prepared for the differing nature of the franchisor-franchisee relationship. In addition, the findings suggest that for businesses to franchise successfully, recruitment of suitable franchisees is vital. However, in the early days of system development, the ability to recruit may be impeded by the system’s lack of perceived legitimacy. This is likely to be exacerbated in periods of relative economic prosperity, when all franchise systems appear to find it more difficult to recruit.

## BACKGROUND

The use of franchising has principally been explained through resource scarcity and agency theory. Resource scarcity suggests that franchising enables companies to raise finance through the fees charged to franchisees, and by substantially delegating the costs associated with establishing each additional outlet to the franchisees. For small businesses, for whom raising finance is often difficult (Hall, 1989), franchising may thus provide an attractive solution to financial constraints. However, franchising in itself does not provide a low cost solution to growth because of the costs associated with establishing a franchise system. Indeed, some authors (see, for example, Stanworth et al 2001) have suggested that it may place a substantial financial strain on young systems.

Agency theory contends that franchising, through the incentives it provides to reduce opportunistic behaviour (Mathewson and Winter, 1985) should reduce agency costs. It has been suggested (Barringer and Greening, 1988) that small businesses can find it difficult to establish the controls necessary to attenuate opportunistic behaviour as they expand. By making franchisees residual claimants, franchising should reduce the need for such controls, although as

researchers such as Hunt (1977) have commented, ensuring uniformity across the system can provide a challenge to franchise systems.

It can be seen that franchising may offer partial solutions to resource and agency considerations, but it by no means provides a panacea to the difficulties of expansion, and indeed, may introduce new challenges. This paper explores these issues further, through an examination of the experiences of six companies that have attempted to grow through franchising.

## **METHODOLOGY**

In order to provide a richer description and insight into the key challenges for small businesses in using franchising as a growth strategy it was decided that a qualitative in-depth case approach was appropriate. Thus, the focus of the research is six organisations that had tried to expand using franchising. They were selected using a combination of both purposive and convenience sampling. Three of the companies had successfully grown through franchising, and are now established national chains, and three had all attempted to expand through franchising, but had subsequently withdrawn from it though they remain in operation. Interviews were held with the principals of each of the participating companies, after an initial briefing about the aims of the research. The interviews were semi-structured and lasted between one and a half and two hours each.

## **SUMMARY OF FINDINGS**

Whilst the literature has suggested two principal benefits of franchising, namely relative cost of expansion and the reduction in agency costs, the findings suggest that franchising brings with it additional challenges. One of the key issues appeared to be the differing nature of the franchisor-franchisee relationship to the traditional employer-employee one. It appeared that many of the 'failed' companies were not prepared for this, and struggled to know how to manage the relationship successfully. Certainly, for the 'failed' franchises, it was the stress of the relationship that was one of the key reasons for withdrawing from franchising. In part, this may have stemmed from having recruited unsuitable franchisees; a particular challenge to systems in the early days when the principals have limited experience, and the system is still struggling to establish its perceived legitimacy. Recruitment difficulties are likely to be exacerbated in periods of relative economic prosperity, when all franchise systems appear to find it more difficult to recruit.

Further research is needed to better understand the effect of recruitment on franchise development. In particular the relationship between the economic cycle and the ability to recruit needs to be investigated in order to establish whether, indeed, there is a significant link. It is likely that if such a relationship exists, its effects may be magnified for younger systems, for whom it is more difficult to signal their quality. An examination of franchise systems at different stages of their development would facilitate this.

## ENDNOTES

<sup>1</sup>The companies are termed 'failed' in the sense that they have attempted to franchise but have subsequently withdrawn. Thus, whilst they can be deemed to be 'failed' franchises, in the full business sense they are by no means failures and continue to operate. Failure is thus referred to in inverted commas

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# NETWORKING AFFILIATIONS: GENDER DIFFERENCES AND THE ASSOCIATION WITH SME SURVIVAL

by

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## ABSTRACT

The primary objectives of this paper were to examine (using a large, longitudinal database) differences in the *range* and *intensity* of network affiliations for male- and female-controlled SMEs; and to model the association between network access and firm survival. Although the results suggest that approximately 50% of male and female SME owners access more than four networks during the year, the male owners were more likely to access *formal* networks (such as: *banks, business consultants, industry associations, and solicitors*) while the female owners were more likely to consult with *family and friends* (*informal* network). However, despite the extensive use SME owners make of both *formal* and *informal* networks, the models predicting firm survival based on network access (and a number of demographic control variables) suggest that the majority of these networks do not appear to impact significantly on firm survival. The results suggest that (given limited time for networking) SME owners should ensure they at least maintain regular contact with an *external accountant*; this was the only network source significantly related to firm survival, for both the male- and female-owned SMEs. This might be particularly important for female SME owners with family commitments and limited time available for networking. Further, and contrary to suggestions in the literature, the results show that female-owned SMEs are not failing to make appropriate use of networks. Indeed for both firm survival and growth, the model relating firm performance to network use was strongest for the female-owned SMEs.

## INTRODUCTION

Although human resources 'have long been viewed as ... essential to a venture's ability to survive and grow' (Florin, Lubatkin and Schulze 2003, p.374), recently researchers have begun

to 'focus on the significance of the owner-manager's personal contact network as an aid to business development' (Cromie and Birley 1992, p.237). Social capital theory is founded on the premise that a network provides value to its members by allowing them access to the social resources embedded within the network (Florin et al. 2003, p.376). Networking is a means by which 'entrepreneurs can tap resources that are "external" to them' (Jarillo 1989, p.133).

Research suggests there might be significant differences between males and females in terms of the *range* and the *intensity* of their network access. For example, Singh, Reynolds, and Muhammad (2001) suggested that female-owned enterprises are frequently hindered by a lack of access to networks. Cromie and Birley (1992) argued that networks were the product of personal drive and historical experiences and that the social structure and domestic duties of many women might result in female entrepreneurs having fewer networks than men. However, the research to date on gender differences in networking, and the association between networking activities and firm survival, is limited. Therefore, this study has two primary objectives: firstly, to determine whether there are any major systematic differences in the *range* and *intensity* of network access between male and female SME owners; and, secondly, to determine if there is an association between network access and firm survival.

## **LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT**

In looking at the different types of networks firms access, Cooper et al. (1989) found that larger ventures were more likely to access *formal* networks (such as professional advisors), while smaller ventures were more likely to access *informal* sources (such as family and friends). Given that female-owned ventures tend (on average) to be smaller than male-owned businesses (Carter and Allen 1997; Cliff 1998), it would be reasonable to expect that female-owned firms would

make greater use of *informal* networks and less use of *formal* networks. Also, Orhan (2001) noted that past research has found that the first source of advice for male entrepreneurs was usually professional experts (such as accountants and lawyers) and the second was their spouses; whereas the first source of advice for female entrepreneurs was their spouse, second was their friends, and third was professional advisors. This suggests that male SME owners are more likely to make use of *formal* networks; while female SME owners are more likely to turn to family and friends (*informal* network). Further, due to family responsibilities (Lerner, Brush and Hisrich 1997), women might have less time available for networking and might also find it difficult to access certain networks (such as industry associations, which generally meet after hours). These views are supported by the comments of Aldrich (1989) who noted that past research suggests that female entrepreneurs might be embedded in different types of networks than their male counterparts.

In summary, it would seem past research suggests that men are likely to have a broader *range* of networks, which they pursue more *intensely* than women. However, it is conceivable that although women might access fewer networks in total than men, they might make greater use of *informal* networks (particularly family and friends). This gives rise to the first four hypotheses to be examined in this study.

Hypothesis 1: Male SME owners access a greater *range* of networks than female SME owners.

Hypothesis 2: Male SME owners make more *intense* use of networks than female SME owners.

Hypothesis 3: Male SME owners make more *intense* use of *formal* networks than female SME owners.

Hypothesis 4: Female SME owners make more *intense* use of *informal* networks than male SME owners.

Brüderl and Preisendörfer (1998) argued that entrepreneurs who have access to a diverse set of networks, which they access regularly, should be more successful than those who make limited use of networks. Given this argument, it is reasonable to expect a relationship between network access and firm survival, for both male- and female-owned SMEs; even though female SME owners might access networks differently to (not as frequently as) their male counterparts. This gives rise to the final two hypotheses to be examined in this study.

Hypothesis 5: Network access is positively associated with firm survival for male-owned SMEs.

Hypothesis 6: Network access is positively associated with firm survival for female-owned SMEs.

### **DESCRIPTION OF DATA**

A major strength of this study is its use of a large longitudinal data set (funded by the Australian federal government) on the growth and performance of Australian employing businesses. The Australian Bureau of Statistics (ABS) Business Register was used as the population frame for the surveys. All employing businesses in the Australian economy were included in the scope of the survey except for businesses in the nature of: government enterprises; libraries; museums; parks and gardens; private households employing staff; agriculture, forestry and fishing; electricity, gas and water supply; communication services; government administration and defense; education; and health and community services. Data collection was through self-administered questionnaires distributed by the ABS for the periods 1994-95, 1995-96, 1996-97, and 1997-98.<sup>1</sup> Because the ABS can legally enforce compliance with its data requests (under the *Census and Statistics Act 1905*) response rates were very high (typically in excess of 90%). A non-response normally meant the ABS was unable to locate the business proprietor (or the business) and this was, therefore, treated as a business closure. For confidentiality reasons, information on all large

businesses (those employing more than 200 people) was excluded from the data set made available to researchers outside the ABS.

The second (1995-96) ABS survey contained a question relating to the frequency with which SME owners accessed a variety of networks during the year. Specifically, the question asked respondents to indicate how frequently (never; between one and three times; or more than three times) they accessed advice during the year from each of ten different sources: *banks; business consultants; external accountants; family and friends; industry associations; local businesses; others in the industry; the Small Business Development Corporation (SBDC); solicitors; and the Australian tax office*. The question did not ask respondents how often they accessed each listed source for other networking purposes and, therefore, the data provided might not be representative of the full extent of networking by SME owners. However, as seeking advice (and information) is one of the major purposes of networking (Hoang and Antoncic 2003), the data should provide a reasonable indication of how widely networks are used, and allow a comparison between male- and female-owned businesses. As this question was not repeated in the surveys for the remaining two years of the longitudinal study it is assumed that the SME owners did not change their behavior patterns significantly over those subsequent years. This is acknowledged as a potential limitation of the study.

There were 5,027 responses to the 1995-96 survey. However, on examining the data, it was found that 13 businesses had no income (sales or other income). Therefore, these businesses were excluded from the analysis on the assumption they were not active businesses. As this study is interested in the differences between male and female SME owners, a further 1,914 firms had to be excluded because, either they did not have a single major decision maker, or the sex of

that person was not reported.<sup>2</sup> This left 3,100 firms (2,919 male-owned and 181 female-owned) that could be examined over a three-year period.

## RESULTS

The results presented in Table 1 indicate there were no significant differences between the male and female owners in terms of the *range* of networks they accessed during the year 1995-96. The results show that about 85% (88% for males and 85% for females) of SME owners accessed at least one network during the year and in approximately 50% of cases (52% for males and 46% for females) the SME owners accessed more than four different networks. Although contrary to hypothesis 1 (male SME owners access a greater *range* of networks than female SME owners), this finding is consistent with Cooper et al. (1989) and Robson and Bennett (2000) who reported that entrepreneurs sought information from a number of different sources and with Cromie and Birley (1992) who found that the personal contact networks of women were just as diverse as those of men.

### INSERT TABLE 1 ABOUT HERE

Table 2 provides a summary of the *intensity* with which both the male and female SME owners made contact with a variety of *formal* and *informal* networks during the period 1995-96. Table 2 shows that the networking group most frequently contacted by both the male and female SME owners was *external accountants*: 47% of males and 44% of females contacted an *external accountant* on more than three occasions during the year. This finding is consistent with Robson and Bennett (2000) who reported that, from the private sector, accountants were the most widely used source of advice. Interestingly, there was no significant difference between the male and female owners use of this *formal* network. Similarly, *others in the industry* were also frequently

accessed by both the male and female SME owners; 27% of both males and females accessed this *informal* network on more than three occasions during the year. Unlike Birley (1985), who found that entrepreneurs relied heavily on *informal* networks (but seldom tapped into *formal* networks), the results presented in Table 2 suggest that Australian SME owners (male and female) make extensive use of both *formal* and *informal* networks. As there was no statistically significant difference between the male and female owners in terms of the average *intensity* with which they accessed all network sources (both *formal* and *informal*), hypothesis 2 (male SME owners make more *intense* use of networks than female SME owners) is not supported. This result is consistent with Cromie and Birley (1992) who found that females were just as active in their networking relationships as men.

INSERT TABLE 2 ABOUT HERE

There is some support provided in Table 2 for hypothesis 3 (male SME owners make more *intense* use of *formal* networks than female SME owners). The average *intensity* with which the male owners accessed *formal* networks was significantly higher than for females. In particular, the males were much more likely to regularly network with: *banks; business consultants; industry associations; and solicitors*. In terms of accessing *informal* networks, the results reported in Table 2 do not support hypothesis 4 (female SME owners make more *intense* use of *informal* networks than male SME owners). The overall *intensity* with which the female SME owners accessed *informal* networks was not significantly different to that for men; although the females were significantly more likely to seek advice from *family and friends*. This result is contrary to Cromie and Birley's (1992) finding that women were no more likely to consult with *family and friends* than men.

While Table 2 indicates some notable differences between the male and female SME owners' use of specific networks, overall the *intensity* with which males and females accessed networks was remarkably similar. The results indicate that many female SME owners make extensive use of a variety of both *informal* and *formal* networks and, therefore, it is questionable that female-owned SMEs should experience poorer performance as a result of limited access to networks. Social feminist theory (Fischer, Reuber and Dyke 1993) suggests that men and women are inherently different due to differences in their early and ongoing socialization and, as a result of these differences, we might expect males and females to behave and access networks differently. However, 'These differences do not imply that women will be less effective in business than men, but only that they may adopt different approaches' (Watson and Robinson 2003, p.775).

Given that many SME owners (both male and female) access a variety of networks for advice and support, and the findings of Larson (1991) suggesting that a firm's ability to identify, cultivate, and manage network partnerships is critical to survival, the next step is to determine the association between network access and SME survival rates. Before proceeding, however, it is necessary to consider key demographic variables that might potentially confound the analysis. Table 3 provides a comparison of the survival rates for the male- and female-owned SMEs in this study (Panel A), together with demographic variables relating to the owner (education and years of experience - Panel B) and the firm (industry, age and size - Panel C). These demographic variables are regularly reported in the literature as impacting SME performance (Robinson and Sexton 1994; Robson and Bennett 2000) and have also been found to vary significantly by gender (Fischer et al. 1993; Fischer and Reuber 2003; Watson and Robinson 2003).

INSERT TABLE 3 ABOUT HERE

Table 3 (Panel A) reports the number (and percentage) of male- and female-owned firms that survived over the three-year period of this study. While comparing the survival rates for male- and female-owned SMEs was not an objective of this study, it should be noted that the lower reported survival rates for female-owned SMEs would most likely disappear after controlling for age and industry (Watson 2003). With respect to the owner demographic variables (Panel B), a significantly higher percentage of male SME owners had a business degree or trade qualification; with a significantly higher percentage of female SME owners having a non-business degree or school qualification. In terms of firm demographic variables (Panel C), the male-owned SMEs were over-represented in manufacturing and construction, while the female-owned SMEs were over-represented in: retail trade; accommodation, cafes and restaurants; and personal and other services. The male-owned businesses also tended to be both older and larger than the female-owned SMEs. Given the existence of significant demographic differences between the male and female owners and their firms, it is reasonable to expect there might be notable differences in terms of the models derived to predict firm survival for these two groups of business owners.

Binary logistic regression was used to examine the extent to which the probability of firm survival was associated with the various networks accessed by SME owners (and to the two owner and three firm demographic variables reported in Table 3). For the purposes of this analysis, surviving firms were coded “1”, while discontinued firms were coded “0”. Each of the ten potential networks was entered as a categorical variable: if a particular network had not been accessed during the year it was coded “1”; where a network had been accessed between one and three times it was coded “2”; and where a network had been accessed on more than three occasions it was coded “3”. Similarly, education, industry and age were entered as categorical variables with four categories for education, eleven for industry and five for age, as shown in

Table 3. Years of experience and size of the business (measured in terms of the number of employees) were entered as continuous variables.

For the male-owned SMEs in this study, Table 4 provides the results of running a forward conditional binary logistic regression to model firm survival. In conducting this (and the remaining) analysis, the SPSS default cut-offs of 5% for variables entering the model and 10% for removal were used. To check the robustness of the results, the logistic regression was also run backwards, with no significant differences found. Before examining the results provided in Table 4, it should be noted that SPSS converts the categorical variables into a set of ‘dummy’ variables with the last category (the reference group) excluded. For example, Table 4 reports separately both the overall significance of age (on the likelihood of firm survival) and also the impact of each of the first four age categories relative to the last (reference) category. The final column of Table 4 (Exp(B)) reports the ‘odds ratio’ for each individual category of age (relative to the last category). The ‘odds ratio’ is a measure of the impact of a one-unit change in the independent variable (in this case, being in a certain age category relative to being in the last age category) on the dependent variable (in this case firm survival). An odds value of 2 would mean that a firm in this particular age category is twice (.67/.33) as likely (or 100% more likely) to survive, relative to a firm 20 or more years old. An odds value close to 1 would mean that a firm in this particular age category has an equal (.5/.5) chance of survival relative to a firm 20 or more years old. An odds ratio of .67 would indicate that the firm is two-thirds (.40/.60) as likely (or 33% less likely) to survive, relative to a firm 20 or more years old.

INSERT TABLE 4 ABOUT HERE

As can be seen from Table 4, age of firm and accessing *external accountants*, *industry associations* (*formal networks*) and *others in the industry* (*informal network*) appear to be significantly associated with the survival of male-owned SMEs. For example, compared to firms that were twenty or more years old, firms less than two years old and firms that were between two and five years old were 95% (1-0.05) and 34% (1-.66) *less* likely to have survived, respectively. There is no difference in the survival rates for businesses between five and ten or between ten and twenty years old relative to those that were twenty or more years old. Similarly, compared to SMEs that accessed *external accountants* on more than three occasions during the year, those that did not access an *external accountant* were 76% (1-0.24) *less* likely to have survived. There is no difference in the survival prospects of firms that accessed accountants more than three times during the year and those that accessed accountants between one and three times during the year. The same picture is apparent for accessing *industry associations*, namely, the only significant difference in survival prospects is between those firms that never accessed *industry associations* and those that accessed *industry associations* more than three times during the year. In terms of networking with *others in the industry*, however, it seems that investing too many resources (time and effort) in this network activity could be counter-productive and might not result in 'asset parsimony'. For example, compared to accessing *others in the industry* on more than three occasions during the year, male SME owners that accessed *others in the industry* on between one and three occasions only (category 2) were over 1.5 times *more* likely to have survived. There is no difference in the survival prospects for firms that either did not network with *others in the industry* or those firms that accessed this source on more than three occasions during the year. In other words, it seems that not networking with *others in the industry* is equally as detrimental as spending too much time networking with *others in the industry*. This result might help to explain the finding by Bates (1994, p.671) that the heavy use of social

support networks typified ‘the less profitable, more failure-prone businesses’. That is, it might be important for SME owners to regularly assess the *range* and *intensity* of their network access to ensure they are accessing appropriate networks without devoting too many resources to this activity relative to the benefits they receive. ‘Through a process of expanding and culling the network, the entrepreneur identifies a set of relationships that merits continued development and future investment for the firm.’ (Larson and Starr 1993, p.6)

In summary, the final model for predicting the survival of male-owned SMEs incorporates (along with the age of the business) both *formal* (*external accountants* and *industry associations*) and *informal* networks (*others in the industry*). The final model had a Nagelkerke R Square of 0.36 and an overall predictive accuracy of 83.7%; with a predictive accuracy for surviving firms of 86.2% and a predictive accuracy for discontinuing firms of 68.4%. Accessing other networks (such as: the *Australian tax office*; *banks*; *business consultants*; *family and friends*; *local businesses*; the *SBDC*; and *solicitors*) did not add significantly to the explanatory power of the model and, therefore, these networks were not included in the final model presented in Table 4. It is worth noting that, with the exception of *industry associations*, the *formal* networks that were accessed significantly more often by the male SME owners compared to the female SME owners (*banks*; *business consultants*; and *solicitors* – see Table 2) had no apparent impact on the probability of survival for the male-owned SMEs.

Table 5 provides the results of undertaking a similar analysis for female-owned SMEs. As with the male-owned SMEs, age of the business is the only demographic variable that is significantly related to the prospects of survival for the female-owned SMEs. However, for the female-owned SMEs, it is only the youngest firms (those less than two years old) that were significantly (99%)

less likely to have survived. In terms of networking, it would appear that for female SME owners, networking with both *external accountants* (*formal* network) and with *family and friends* (*informal* network) improves the probability of firm survival. Female-owned SMEs that never accessed an *external accountant* were 91% (1-0.09) *less* likely to have survived than those that accessed an *external accountant* on more than three occasions during the year; there is no significant difference where *external accountants* were accessed between one and three times and more than three times during the year. It is interesting to note the similarity between the female-owners networking with *family and friends* and the male-owners networking with *others in the industry*. In both cases, too many resources devoted to these *informal* networks seems to be detrimental to the prospects of firm survival. Female owners who accessed *family and friends* on between one and three occasions during the year, rather than more often, were almost five times more like to have survived in business.

The final model for predicting the survival of female-owned SMEs had a Nagelkerke R Square of 0.62 and an overall predictive accuracy of 86.7%; with a predictive accuracy for surviving firms of 86.2% and a predictive accuracy for failed firms of 88.9%. It is worth noting that the model for predicting the survival prospects of female-owned SMEs appears considerably better than that for male-owned SMEs.

INSERT TABLE 5 ABOUT HERE

The results presented in Tables 4-5 provide some support for hypotheses 5 and 6 (network access is associated with increased firm survival for both male- and female-owned SMEs). The use of *external accountants* (*formal* network) was significantly associated with survival for both the male- and female-owned SMEs. Networking with *industry associations* (*formal* network) and

with *others in the industry* (*informal* network) was associated with the survival of male-owned SMEs. Networking with *family and friends* (*informal* network) was significantly associated with the survival of female-owned SMEs. While these results indicate that a variety of both *formal* and *informal* networks are associated with SME survival, they also indicate that SME owners need to monitor the resources they devote to networking to ensure that the benefits they receive from networking activities exceed the costs.

## CONCLUSIONS

‘The primary purpose of this study was to examine differences in the way male and female SME owners access both *formal* and *informal* networks, and to determine what impact this might have on SME survival. A significant advantage of this study (over many previous studies) is its use of a relatively large longitudinal database developed from surveys conducted on behalf of the Australian Federal Government and specifically aimed at providing a better understanding of the performances of Australian SMEs. As a result, the data was highly representative (with response rates typically over 90%) and allowed a number of potentially confounding demographic variables (owner education and experience; and the industry, age, and size of the firm) to be included in the analysis.

The results show that both male- and female-owned SMEs make extensive use of *formal* and *informal* networks. There is some evidence to suggest that females consult more frequently with *family and friends* while males are more likely to access *banks, business consultants, industry associations* and *solicitors*. However, although the types of networks accessed might vary, the number of different networks male- and female-owners consult is very similar. For example, there was no significant difference in the overall number of networks (both formal and informal)

accessed by the male and female SME owners; approximately half the SMEs in this study (52% of male-owned and 46% of female-owned) accessed more than four different networks during the year.

The results also indicate a significant association between accessing particular networks and firm survival for both the male- and female-owned SMEs. This finding is in contrast to Aldrich and Reese (1993) who were unable to find any evidence linking an entrepreneur's use of networks to business survival or performance. Also, contrary to the suggestions by Aldrich (1989) and Singh et al. (2001), there is no evidence that female SME owners are disadvantaged by any differences that might exist in their network access compared to their male counterparts. This result is consistent with a social feminist theory perspective (Fischer et al. 1993) in that, although men and women might access networks differently, they seem to be equally as effective. Indeed, the model for predicting firm survival was substantially stronger (in terms of the Nagelkerke R Square) for the female-owned SMEs than for the male-owned SMEs. This suggests that the relationship between networking and firm performance is clearer for females than males. One possible explanation for this might be that females, because of the time constraints they face balancing work and family commitments, are more strategic in the way they go about developing networking relationships.

In terms of *formal* networks, the results indicate that accessing *external accountants* was the only source of support significantly related to firm survival, for both the male- and female-owned SMEs. While this finding is consistent with Potts (1977, p.93) who found that 'successful companies rely more heavily on accountants' information and advice than do unsuccessful companies', it is in contrast to the results of Robson and Bennett (2000) and Cooper, Gimeno-

Gascon and Woo (1994). Robson and Bennett (2000) found no statistically significant relationship between accessing advice from accountants and any of their measures of firm performance. Similarly, Cooper et al. (1994) also found that the use of professional advisors (*formal* networks) had no significant effect on firm performance. The only other *formal* network to show up in the models was accessing *industry associations*, which was significantly associated with survival, but only for the male-owned SMEs.

In terms of *informal* networks, the results indicate that, for the male-owned SMEs, accessing *others in the industry* significantly improves the chances of survival. However, the results also indicate that too much time spent networking with *others in the industry* could be counter-productive. For the female SME owners, networking with *family and friends* significantly improves the chances of survival. Again, however, the results indicate that too many resources devoted to this networking activity could also be counter-productive.

Zhao and Aram (1995) noted that broad ranging networks cost more (financially, and in terms of the owner's time and effort) to develop and maintain. Starr and MacMillan (1990, p.80) argued that individuals 'invest their time and energy in social transactions based on their expectations of future profits and rewards' and Uzzi (1996) suggested that 'An organization's network position, network structure, and distribution of embedded exchange relationships shape performance such that performance reaches a threshold as embeddedness in a network increases.' Consistent with the comments above and the notion of 'asset parsimony', the results in this study suggest that too many resources devoted to networking might not be helpful to SME performance. For example, many networks appeared to be unrelated to firm survival (*banks; business consultants; local businesses; the Small Business Development Corporation (SBDC); solicitors; and the Australian*

*tax office*) and in some cases accessing a network on more than three occasions during the year appeared to be negatively associated with firm survival. This applied to males accessing *others in the industry*.

It seems that, despite the extensive use made of both *formal* and *informal* networks by SME owners (male and female), the majority of these networks (with the exception of *external accountants, industry associations, others in the industry, and family and friends*) do not appear to impact significantly on firm survival. This finding calls into question the conclusion by Davidsson and Honig (2003, p.303) that SME owners 'would be well advised to develop and promote networks of all sorts'. Indeed, given the cost of participating in networks, the results could be seen as providing support for Lerner et al. (1997) who found that participation in multiple networks was negatively related to firm performance. These results suggest that, given limited time for networking, SME owners should ensure that they at least maintain regular contact with an *external accountant*. This might be particularly important for female SME owners with family commitments and limited time available for networking. Further (and contrary to prior research), the results suggest that female-owned SMEs are not failing to make appropriate use of networks. Indeed, the model relating firm survival to network access was strongest (in terms of overall predictive accuracy and explanatory power – Nagelkerke R Square) for the female-owned SMEs.

Finally, the reader should be cautioned against interpreting the results as suggesting that networking with those groups not featured in the various models has no benefit. SME owners might get other benefits from networking, beyond the purely economic benefits that were the focus of this study. For example, by consulting with multiple sources, owners might draw more

comfort (reassurance) in their future plans, particularly if these multiple sources are essentially providing similar feedback. Also, the benefits from some network sources might be firm and/or situation specific and might, therefore, not show up in a large sample looking at average outcomes. For example, use of management consultants might be of substantial benefit in a limited number of very specific situations. An analysis of a large data set might mask, or make it difficult to detect, the benefits in such cases.

### **ENDNOTES**

- <sup>1</sup> Copies of the questionnaires can be obtained from the ABS.
- <sup>2</sup> Note that some of the firms could have had multiple owners (both male and female), however, if the major decision maker was male (female) the firm was classified as a male (female) owned firm for the purposes of this study.

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TABLE 1  
Number of Networks Accessed by Gender

| Networks Accessed | <u>Male</u> |      |       | <u>Female</u> |      |       |
|-------------------|-------------|------|-------|---------------|------|-------|
|                   | No.         | %    | Cum % | No.           | %    | Cum % |
| None              | 350         | 12%  | 12%   | 28            | 15%  | 15%   |
| One               | 166         | 6%   | 18%   | 13            | 7%   | 23%   |
| Two               | 214         | 7%   | 25%   | 19            | 10%  | 33%   |
| Three             | 316         | 11%  | 36%   | 16            | 9%   | 42%   |
| Four              | 344         | 12%  | 48%   | 22            | 12%  | 54%   |
| Five              | 396         | 14%  | 61%   | 22            | 12%  | 66%   |
| Six               | 333         | 11%  | 73%   | 26            | 14%  | 81%   |
| Seven             | 347         | 12%  | 84%   | 15            | 8%   | 89%   |
| Eight             | 229         | 8%   | 92%   | 9             | 5%   | 94%   |
| Nine              | 147         | 5%   | 97%   | 8             | 4%   | 98%   |
| Ten               | 77          | 3%   | 100%  | 3             | 2%   | 100%  |
| Totals            | 2,919       | 100% |       | 181           | 100% |       |

Note: Chi-Square not significant at 5%.

TABLE 2  
Type and Frequency of Networks Accessed by Gender

| <i>Range of Networks Accessed</i> | <i>Frequency (Intensity) of Access</i> |        |                  |        |                    |        |    |
|-----------------------------------|--|--------|------------------|--------|--------------------|--------|----|
|                                   | <u>Never</u>                           |        | <u>1-3 times</u> |        | <u>&gt;3 times</u> |        |    |
|                                   | Male                                   | Female | Male             | Female | Male               | Female |    |
| <i>Formal</i>                     |  |        |                  |        |                    |        |    |
| - Bank                            | 36%                                    | 44%    | 36%              | 39%    | 28%                | 18%    | ** |
| - Business Consultant             | 71%                                    | 82%    | 19%              | 13%    | 10%                | 5%     | ** |
| - External Accountant             | 19%                                    | 20%    | 34%              | 36%    | 47%                | 44%    |    |
| - Industry Associations           | 57%                                    | 75%    | 23%              | 15%    | 20%                | 10%    | ** |
| - SBDC                            | 84%                                    | 87%    | 13%              | 12%    | 3%                 | 1%     |    |
| - Solicitor                       | 41%                                    | 48%    | 35%              | 40%    | 24%                | 12%    | ** |
| - Tax Office                      | 58%                                    | 65%    | 32%              | 30%    | 10%                | 6%     |    |
| Average for Formal Networks       | 52%                                    | 60%    | 27%              | 26%    | 20%                | 13%    | *  |
| <i>Informal</i>                   |  |        |                  |        |                    |        |    |
| - Family & Friends                | 63%                                    | 52%    | 20%              | 23%    | 17%                | 25%    | ** |
| - Local Businesses                | 73%                                    | 75%    | 17%              | 15%    | 10%                | 9%     |    |
| - Others in the Industry          | 44%                                    | 48%    | 30%              | 26%    | 27%                | 27%    |    |
| Average for Informal Networks     | 60%                                    | 58%    | 22%              | 21%    | 18%                | 20%    |    |
| Average for All Networks          | 55%                                    | 60%    | 26%              | 25%    | 20%                | 16%    |    |

\* Significantly different for males and females at 5% using a Chi-Square test.

\*\* Significantly different for males and females at 1% using a Chi-Square test.

TABLE 3

Comparing the Performance and Demographics for Male- and Female-Owned SMEs

| Panel A                    |  | Male  |          | Female |          |    |
|----------------------------|--|-------|----------|--------|----------|----|
| Firm Performance           |  | No.   | (%)      | No.    | (%)      |    |
| <i>Survival Status</i>     |  |       |          |        |          |    |
| Survived                   |  | 2,508 | (85.9)   | 145    | (80.1)   | *  |
| Discontinued               |  | 411   | (14.1)   | 36     | (19.9)   | *  |
| Totals                     |  | 2,919 | (100)    | 181    | (100)    |    |
| Panel B                    |  | Male  |          | Female |          |    |
| Owner Demographics         |  | No.   | (%)      | No.    | (%)      |    |
| <i>Education of Owner</i>  |  |       |          |        |          |    |
| School                     |  | 1008  | (34.5)   | 89     | (49.2)   | ** |
| Trade                      |  | 692   | (23.7)   | 25     | (13.8)   | ** |
| Non-Business Degree        |  | 592   | (20.3)   | 49     | (27.1)   | *  |
| Business Degree            |  | 627   | (21.5)   | 18     | (9.9)    | ** |
| Totals                     |  | 2,919 | (100)    | 181    | (100)    |    |
| <i>Experience of Owner</i> |  |       |          |        |          |    |
| Number of years            |  | Mean  | (Median) | Mean   | (Median) | ** |
|                            |  | 15    | (13)     | 10     | (8)      |    |

TABLE 3 (cont.)

| Panel C<br>Firm Demographics      | Male  |          | Female |          |    |
|-----------------------------------|-------|----------|--------|----------|----|
|                                   | No.   | (%)      | No.    | (%)      |    |
| <i>Industry</i>                   |       |          |        |          |    |
| Mining                            | 19    | (0.7)    | 1      | (0.6)    |    |
| Manufacturing                     | 1,162 | (39.8)   | 43     | (23.8)   | ** |
| Construction                      | 199   | (6.8)    | 2      | (1.1)    | ** |
| Wholesale Trade                   | 449   | (15.4)   | 19     | (10.5)   |    |
| Retail Trade                      | 296   | (10.1)   | 33     | (18.2)   | ** |
| Accom, Cafes & Restaurants        | 68    | (2.3)    | 10     | (5.5)    | ** |
| Transport & Storage               | 104   | (3.6)    | 10     | (5.5)    |    |
| Finance & Insurance               | 126   | (4.3)    | 3      | (1.7)    |    |
| Property & Bus Services           | 402   | (13.8)   | 34     | (18.8)   |    |
| Cultural & Rec Services           | 51    | (1.7)    | 7      | (3.9)    |    |
| Personal & Other Services         | 43    | (1.5)    | 19     | (10.5)   | ** |
| Totals                            | 2,919 | (100)    | 181    | (100)    |    |
| <i>Age of Business (1995-96)</i>  |       |          |        |          |    |
| Less than 2 years old             | 375   | (12.8)   | 39     | (21.5)   | ** |
| 2 years to less than 5            | 425   | (14.6)   | 34     | (18.8)   |    |
| 5 years to less than 10           | 696   | (23.8)   | 50     | (27.6)   |    |
| 10 years to less than 20          | 793   | (27.2)   | 39     | (21.5)   |    |
| 20 or more years old              | 630   | (21.6)   | 19     | (10.5)   | ** |
| Totals                            | 2,919 | (100)    | 181    | (100)    |    |
| <i>Size of Business (1995-96)</i> |       |          |        |          |    |
| Number of Employees               | Mean  | (Median) | Mean   | (Median) | ** |
|                                   | 27    | (13)     | 13     | (5)      |    |

\* (\*\*) Significantly different at 5% (1%) level based on Mann-Whitney U test for years of experience and number of employees and Z scores for the remaining variables.

TABLE 4

Coefficients for Logistic Regression Model of Survival Against Networks Accessed and Demographic Variables for Male-Owned SMEs

| Variables in the Final Model    | B     | S.E. | Wald   | df | Sig. | Exp(B) |
|---------------------------------|-------|------|--------|----|------|--------|
| Age                             |       |      | 434.74 | 4  | 0.00 |        |
| - Less than 2 years old         | -2.96 | 0.20 | 212.94 | 1  | 0.00 | 0.05   |
| - 2 years to less than 5        | -0.41 | 0.23 | 3.10   | 1  | 0.08 | 0.66   |
| - 5 years to less than 10       | -0.06 | 0.22 | 0.07   | 1  | 0.80 | 0.95   |
| - 10 years to less than 20      | 0.19  | 0.23 | 0.69   | 1  | 0.41 | 1.21   |
| External Accountants            |       |      | 77.07  | 2  | 0.00 |        |
| - Never                         | -1.44 | 0.17 | 68.23  | 1  | 0.00 | 0.24   |
| - 1-3 times                     | -0.27 | 0.16 | 2.77   | 1  | 0.10 | 0.76   |
| Industry Associations           |       |      | 13.26  | 2  | 0.00 |        |
| - Never                         | -0.70 | 0.21 | 10.86  | 1  | 0.00 | 0.50   |
| - 1-3 times                     | -0.30 | 0.24 | 1.49   | 1  | 0.22 | 0.74   |
| Others in the Industry          |       |      | 9.48   | 2  | 0.01 |        |
| - Never                         | -0.04 | 0.18 | 0.06   | 1  | 0.81 | 0.96   |
| - 1-3 times                     | 0.46  | 0.20 | 5.42   | 1  | 0.02 | 1.58   |
| Constant                        | 3.47  | 0.24 | 201.84 | 1  | 0.00 | 32.25  |
| Percentage Predicted Correctly  |       |      |        |    |      |        |
| - Survived/Discontinued/Overall | 86.2  | 68.4 | 83.7   |    |      |        |
| Nagelkerke R Square             |       |      | 0.36   |    |      |        |

TABLE 5

Coefficients for Logistic Regression Model of Survival Against Networks Accessed and Demographic Variables for Female-Owned SMEs

| Variables in the Final Model    | B     | S.E. | Wald  | df | Sig. | Exp(B) |
|---------------------------------|-------|------|-------|----|------|--------|
| Age                             |       |      | 37.84 | 4  | 0.00 |        |
| - Less than 2 years old         | -4.75 | 1.25 | 14.55 | 1  | 0.00 | 0.01   |
| - 2 years to less than 5        | -0.52 | 1.34 | 0.15  | 1  | 0.70 | 0.59   |
| - 5 years to less than 10       | -0.83 | 1.20 | 0.48  | 1  | 0.49 | 0.44   |
| - 10 years to less than 20      | 0.86  | 1.50 | 0.33  | 1  | 0.56 | 2.37   |
| External Accountants            |       |      | 10.18 | 2  | 0.01 |        |
| - Never                         | -2.43 | 0.79 | 9.40  | 1  | 0.00 | 0.09   |
| - 1-3 times                     | -0.64 | 0.72 | 0.78  | 1  | 0.38 | 0.53   |
| Family & Friends                |       |      | 5.52  | 2  | 0.06 |        |
| - Never                         | -0.50 | 0.73 | 0.47  | 1  | 0.49 | 0.60   |
| - 1-3 times                     | 1.58  | 0.93 | 2.91  | 1  | 0.09 | 4.87   |
| Constant                        | 4.35  | 1.30 | 11.24 | 1  | 0.00 | 77.25  |
| Percentage Predicted Correctly  |       |      |       |    |      |        |
| - Survived/Discontinued/Overall | 86.2  | 88.9 | 86.7  |    |      |        |
| Nagelkerke R Square             |       |      | 0.62  |    |      |        |

“Smart training for the older entrepreneur”

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International Council for Small Business

World Conference June 15 – 18, 2005

ABSTRACT

The ageing of the Australian population is guaranteed and more significantly the number of years of employment and the economic consequences related to the risk of long term unemployment and premature retirement. Approximately one third of Australians between the ages of 50 and 64 rely on some form of social security payment and nearly one half of these do not have paid employment. As stated by the Federal Treasurer Peter Costello in February 2004 few older Australians have access to sufficient retirement funds placing a substantial burden on the economy. Considering the significant proportion of people in this group, the lack of participation in the labour force from this sector, either voluntary or forced, presents the Australian economy with significant financial and social challenges. Increasing the participation rate of older persons in the labour force makes clear economic sense and one strategic option is to encourage self-employment or small business ownership. Small business account for 96 percent of the Australian private sector, non-agricultural businesses and they employ 47 percent of people in this sector and hence small business is significant to the Australian economy. It is known from previous studies that older people are more likely to succeed in small business than other sectors of the business population however the eventual sustainment and possible growth is dependent on certain variables. This paper presents a conceptual framework for the participation of older persons in the labour force which includes those factors and interrelationships that influence the outcomes for self-employment through small business ownership.

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## INTRODUCTION

The ageing of the Australian population is guaranteed. Currently the proportion of the population over 65 is 12 per cent, by 2021 it will be 18 percent and by 2051 it will be 30 percent (Australian Bureau of Statistics, 2002). It is not just the ageing of the population that poses serious challenges to OECD countries (Curran & Blackburn, 2001; Morris & Mallier, 2003; Singh & Verma, 2001; Stanworth & Stanworth, 1995; Sterns & Miklos, 1995; Taylor & Walker, 1998; Walker, 2001), but the economic consequences related to the risk of long term unemployment and premature retirement (Department of Premier and Cabinet, 2002; Encel, 1999; Sheen, 1999). Around 33 percent of Australians between the ages of 50 to 64 rely on some form of social security payment and 46 percent do not have paid employment (Access Economics, 2001; Australian Bureau of Statistics, 2002; Sheen, 1999). Labour force participation rates for Australian 50 to 64 year olds is less than 50 percent, lower than the OECD average (OECD, 2002). Considering that there are over 30 percent of people in this group, the lack of participation in the labour force from this sector, either voluntary or forced, presents the Australian economy with significant financial and social challenges (Australian Bureau of Statistics, 2002; Blanchflower, 1998; Forum of Labour Market Ministers, 2002; Morris & Mallier, 2003; Platman, 2003; Singh & DeNoble, 2003). This research investigates the factors that will influence or deter participation in mainstream employment for longer and a significant outcome will be the development of a framework by which Australia can build sustainability through the option of self-employment and small business ownership for older people.

## BACKGROUND

Very few Australians over 50 years of age have significant personal savings that will allow them to have sufficient income available at early retirement (Australian Bureau of Statistics, 2002). In addition to the burden on the economy, one of the most significant implications of early retirement is its effect of a lower amount of disposable income subsequently available to individuals. As secure, full-time jobs that last until the statutory retirement age have dwindled, flexible forms of work have developed, such as job sharing, and are increasingly promoted as promising solutions to the problem of economic inactivity in later life (Platman, 2003).

Increasing the participation rate of older persons in the labour force makes clear economic sense and one option is to encourage self-employment or small business ownership (Baucus & Human, 1994; Blanchflower, 1998; Bruce, Holtz-Eakin, & Quinn, 2000; Curran & Blackburn, 2001; European Foundation for the Improvement of Living and Working Conditions, 2001; Greene & Storey, 2002; Singh & DeNoble, 2003; Weber & Schaper, 2003). Australia is in its infancy in relation to the issue of sustainable employment for older workers and there is no framework for encouraging and supporting continued participation in the workforce via options such as small business ownership for this sector of the population. The small business sector is vital for the economy in Australia, not only does it account for 96 percent of the Australian private sector, non-agricultural businesses but 47 percent of the private sector, non-agricultural workforce is employed in small business (Australian Bureau of Statistics, 2002). Small business has been said to be the 'engine room' of the Australian economy (Peter Reith, Minister for Employment, Workplace Relations and Small Business, 1997) and that the role of government is to create the right environment for business to grow and employ (Geoff Prosser, Minister for Small Business and Consumer Affairs, 1997). In addition the current opposition Labor party recognises that small business plays a central role in the Australian economy and that "through individual effort, small business owners provide employment for themselves and many thousands of employees" (Australian Labor Party Federal Platform 2000: Ch 6, Para 108). Even though both major political parties are in agreement in relation to the importance of small business and frequently acknowledge the aging population, neither party have developed a strategy to investigate the possibility of assisting or encouraging older workers lengthening their working lives by taking up the option of self employment.

## SELF EMPLOYMENT

Self-employment and small business ownership already exists amongst older people in most OECD countries (Curran & Blackburn, 2001; de Bruin & Firkin, 2001; Greene & Storey, 2002; Weber & Schaper, 2003). The proportion of people over 50 years of age who start a small business is increasing and it is known that older people are more likely to succeed in small business than their younger counterparts (Greene & Storey, 2002; Kennedy & Drennan, 2001; Morris & Mallier, 2003) but what is not known is what assistance is needed to encourage and support those who may not have considered self-employment as an employment alternative and further, what strategies would promote sustainability and

possible growth of businesses operated by older people. The key question being "is self-employment and small business ownership a viable employment alternative to early retirement for Australians?" If the answer to this question is yes (Greene & Storey, 2002; Kennedy & Drennan, 2001; Mallon, 1998; Platman, 2003; Quinn & Kozy, 1996; Singh & DeNoble, 2003; Singh & Verma, 2001; Stanworth & Stanworth, 1995; Weber & Schaper, 2003), then the further questions to be addressed regarding the early retiree and self-employment are:

- what type of potential early retiree is small business a viable employment option for?
- what are the inhibitors and facilitators of self-employment for this age sector?
- what are the indicators of business sustainability and growth for this age sector?
- what are the interrelationships of the provision of business assistance and advice, training, the background characteristics and experiences of people and the indicators of business success for this sector?
- how can we encourage and support business ownership as an employment option and an alternative to early retirement?

The theory of self-employment or small business ownership is well developed (Bygrave & Hofer, 1991; Casson, 1982; Chen, Greene, & Crick, 1998; De Noble, Jung, & Ehrlich, 1999) but there is little that refers to older people starting a small business as an employment alternative to early retirement in Australia. The theory behind this framework is innovative in developing new knowledge of the older entrepreneur, and building a framework of the distinctive interrelationships between the antecedents of self-employment, the skills and experience brought to the business, the assistance and information required to sustain the business and ultimately ensure the success of the venture. It is known that the economic impact of delaying retirement, for example, by 5 years, would mean that the superannuation savings available would last until the age of 95 as apposed to the age of 72 had retirement not been delayed and had been taken at the age of 58 (Access Economics, 2001).

## ANTICENTS TO SMALL BUSINESS OWNERSHIP

Much research has been conducted on the processes, paths and antecedents of starting a small business with a simplistic dichotomy being that the potential entrepreneur is either 'pulled' or 'pushed' into self-employment (Brockhous, 1987; Brodie & Stanworth, 1998; Buttner & Moore, 1997; Cooper & Dunkleberg, 1987; Gray, 1994; Hamilton, 1987). A 'pull' stimulus is associated with the individual having a reasonably strong positive internal desire to start a business venture. Internal 'pull' reasons for starting a small business centre around the potential new business owner wanting to take control and to change their current 'employee' work status. These reasons can be broadly segmented into personal and financial, which are not mutually exclusive categories. The most common personal reason cited in the literature is independence or wanting to be ones own boss (Birley & Westhead, 1994; Burke, FitzRoy, & Nolan, 2002; Mason & Pinch, 1991). The 'push' set of motivations are predominantly focused around aspects such as job frustration; perceived lack of opportunity for advancement; avoiding low-paid occupations; escaping supervision and constraints of subservient roles, and were traditionally cited by women who started their own businesses (Moore & Buttner, 1997; Roffey & Stanger, 1996). Few business operators cited forced self-employment, however today there is forced job loss through the contracting of the workforce via downsizing and also the change from standard employment towards part-time, casual or contract employment (Feldman & Bolino, 2000; Jurik, 1998; Preston, 2001).

All the available literature and the current state of the economy provides evidence that the group most at risk of these employment changes are older workers. Therefore as a cohort these older workers who become self-employed may well have more push motivations than pull. However enterprises which are started as an alternative to unemployment have a high failure rate (Smallbone, 1990; Smallbone, Baldock, & Bridge, 1998). A key hypothesis for this theoretical framework and future research is that failure may well be high amongst this sector and confirmation or contradiction of the likelihood and the characteristics of this is essential to provide targeted assistance and advice to business start ups for older people.

## TRAINING AND ASSISTANCE

One outcome of future proposed research in relation to the developed theoretical model will be the development of a framework for the support of targeted training and ongoing

professional development and business assistance for older self-employed people which will be specific to their unique circumstances and needs. Older people may not necessarily have the skill set required to become self-employed as they are known to be less able to cope with workplace changes (Hartmann, 1997) and this has clear implications for the training needs of this age group. The OECD has identified a number of principles for population ageing reforms including the need to ensure that training opportunities are available for older workers and included in the National Strategy for an Ageing Australia (1999) it is stated that "The Commonwealth Government's main priority in relation to lifelong learning is to ensure that Australians have the skills and flexibility needed to meet the challenges of continuing technological and structural change and to compete effectively in a globalised economic environment (Council on the Ageing & Committee for Economic Development of Australia, 2000; Department of Premier and Cabinet, 2002). For older workers, life long learning makes a key contribution to the capacity to remain active and independent and measures to support training of older workers are clearly needed in order to ensure that this sector has the required set of skills necessary to prepare them for continued employment opportunities whether in mainstream employment or self-employment (Kotlikoff, Smetterd, & Walliser, 2001). Presented below is the hypothesised theoretical framework of employment options for older workers developed from the available literature. The model does not include early retirement as an option as those who select that option are assumed to have sufficient funds to sustain them into their old age without employment income.

## THEORETICAL FRAMEWORK

The theoretical framework is based on current knowledge regarding the generalised antecedents of entrepreneurship, the facilitators and inhibitors to success and growth of small businesses, and the business advice and assistance and training needs of new entrepreneurs. In this model it is hypothesised that the relationships and interdependencies are unique for older people who select self-employment and small business ownership over early retirement and that older people have different business and assistant needs and different training needs, based on previous work and life experiences. Whereas that would be applicable for all age cohorts, older people may not initially see self employment as a viable option because of the perceived financial risk involved versus the perceived value.

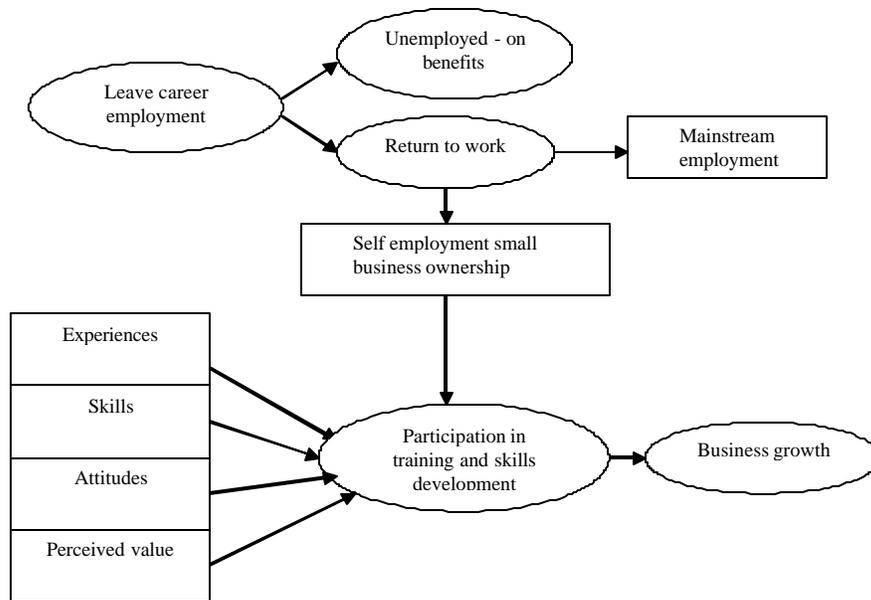


Figure 1: Theoretical framework of employment options for older workers

## SIGNIFICANCE OF THE FRAMEWORK

There are both economic and social benefits to encouraging older workers to consider self employment or business ownership as an alternative to unemployment or early retirement.

- *Firstly* for policy makers, self-employment extends a persons career and so reduces welfare benefit spending and increases both national and personal revenue and small businesses provide significant contributions to the economy of Australia.

The job-market status of older workers is becoming an increasingly important issue in our society. The older population continues to grow in both number and proportion; in part, because of a longer average life span and lower birth rates. The leading edge of the baby boomer cohorts are now in later years and in less than a decade will reach their 60's and Australia will begin a fundamental shift in the age distribution of its population and its workforce. As the proportion of the retired population increases relative to the labour force, pressures will continue to mount on the resources of the social security systems of the country. All OECD countries need people to extend their paid working lives and self-employment in small business is a viable option.

- *Secondly* for older individuals, self-employment promises to inject choice, control and independence into their working lives.

People who lose their jobs when aged in their 50's and 60's find it increasingly difficult to re-establish themselves in a career. Economic inactivity among this age group has grown, whether resulting from people taking early retirement or from people losing their jobs and getting discouraged in the search for a new one. It was identified in the UK that for older people who experience flexible working arrangements in the latter part of their paid employment years, these people found that self-employment offered job quality most comparable to that enjoyed by permanent full-time employees (Morris & Mallier, 2003; Singh & DeNoble, 2003; Weber & Schaper, 2003).

- *Thirdly* for organisations, where managers are forced to downsize older workers, the knowledge and experience of these retrenched workers could be retained in part if these workers become self-employed and subcontract themselves back to their original organisations.

If self-employment is promoted as a viable option for older workers then there could be less pressure placed on human resource managers in organisations who have the unenviable task of retrenching workers. It gives organisations more flexibility in staffing issues and allows workers to have portfolio careers, that is taking short term contracts, which utilise their considerable talents and experience gained over the years but does not bind them to one organisation (Weber & Schaper, 2003).

- *Fourthly* for society as a whole, self-employment promotes the idea of social 'inclusion' for marginal groups of older people in the labour market and retains social capital in the economy.

Self-employment offers choice, opportunity and control for individuals in the latter stages of a career. Self-employment also allows older people to bypass barriers to employment and negotiate their own transition into retirement but as yet very little research has examined the viability of self-employment later in life. In many organisations, older workers experience

discrimination and face voluntary or compulsory redundancy on the basis of age or costs (Encel, 2003; Greene & Storey, 2002). Previous research has described pervasive age discriminatory practices in recruitment, retention, promotion and training (Arrowsmith & McGoldrick, 1996; Burchell et al., 1999; Itzin & Phillipson, 1993; Taylor & Walker, 1998). One way of reducing welfare dependence and discrimination against older people in the workplace would then be for more of them to enter self-employment or small business ownership.

## CONCLUSION

This topic of older workers and the potential for them to become self employed as an alternative to unemployment or early retirement is a relatively new area of research. This paper presents a theoretical model of some of the antecedents that are necessary for the successful transition from mainstream employment to self employment. It should be said that self employment is not suitable for everyone and it is not the intention of the authors to infer that it is a viable option for all older workers who are at a career crossroads. However for some it may well be an extremely attractive and viable option, based on both the social and economic rewards. What is required is empirical research relating to this area to investigate the questions posed in the paper. This would then assist policy makers at all levels to develop appropriate training and assistance packages that are targeted at this age cohort, rather than making the assumption that older people have the same needs as other age cohorts. The ageing of the population is an issue that is only going to escalate and with it will come a plethora of economic and social challenges for the government, communities and individuals. Strategies that provide opportunities to address the labour force issues discussed in this paper are essential and self employment or small business ownership is one potential way to proactively address this particular challenge.

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DIRECT SELLING WORLDWIDE:  
THE MARY KAY COSMETICS STORY

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## **ABSTRACT**

This case is the story of one entrepreneur, Mary Kay Ash, and how she took her company, Mary Kay Cosmetics, international. Her basic guideposts on the human spirit and her belief in the abilities of women, in particular, have made her company's successes worldwide almost revolutionary. The case encompasses the history of the company, the strategy behind their expansion around the globe, and the beliefs, norms, values, and culture that has made Mary Kay, Inc. one of the strongest direct selling companies in history.

## INTRODUCTION

Mary Kay Inc. had achieved prominence as a U.S. cosmetics company and direct seller, but the company had not even reached its 10<sup>th</sup> year when international opportunities knocked on its Dallas door. The year was 1971 when a couple of Australian entrepreneurs – so impressed by what they had seen and read of the company – persisted to get Mary Kay’s first international outpost in this faraway land ‘down under.’ That’s how it came to be that Mary Kay was in Australia before it was anywhere else outside the U.S. The company now has a presence in more than 30 international markets on five continents and the focus for expansion is clearly on those places where the opportunity will be most appealing to entrepreneurial women.

What has transpired throughout the world is the creation of an interpersonal business model that seems to translate into a language women understand. Mary Kay’s history illustrates how an American company can expertly tailor its marketing plan to emphasize specific market strengths. In regions where women are even more under-employed than they were in the U.S. of the mid-60s, Mary Kay can be the great equalizer, the quintessential micro-entrepreneurial opportunity that has the potential to bring an entire family up from poverty or dire straits. Even in countries where infrastructures are far inferior to those of the United States, the company has experienced the great loyalty of women who – once they are exposed to the company philosophy and possibilities – will go to great lengths to make it work for their lives – in their market. According to Tom

Whatley, Mary Kay's President of Sales and Marketing, it is the culture that makes the most difference to Mary Kay's successful global development plan. When the culture is understood and acted upon, Mary Kay has seen success. Where it is not understood or embraced, the company has experienced difficulty.

The same year that Australia opened was coincidentally also the year that the company took another measure that would have far-reaching effects on the culture and the company's success. In 1971, it named the first two Mary Kay Independent National Sales Directors – establishing an extremely prophetic leadership role that would come to be viewed as one of the smartest succession plans in the business world. It has come to be viewed as a strategic move – instigated by Mary Kay Ash herself -- that has fostered female entrepreneurs like few others. It has been generally accepted that no one would ever replace the dynamic and charismatic company Founder, but the Founder had embarked –in establishing this position— upon a program where she could encourage leaders to create new leaders. The prospect of achieving this pinnacle has greatly enhanced the appeal of the organization worldwide to entrepreneurial women aspiring to leadership.

Texas entrepreneur Mary Kay Ash had founded her company on a shoestring in a small Dallas office center after vowing to create a company where women were provided opportunities long denied them in the workplace. She always said that she never imagined her cosmetics company would make it much outside Dallas city limits, let alone to nearly every time zone in the world. What the illustrious company Founder did realize

was that – just like in the America of the 1960s – the carving out of opportunity reverberates extremely well throughout every culture and language. “We discovered that all women want the same thing,” Mary Kay Ash once said. “They want a better life for themselves, their families and their countries. And they are willing to work for that.”

Perhaps it is that common thread – paired with Mary Kay’s 1963 founding belief that she wanted to create opportunities for women – that has contributed most to the company’s fame as well as its growth as a company whose mission is to “enrich women’s lives.” Corporate employees of Mary Kay Inc. attest that seeing this mission to fruition in the U.S. is exhilarating. However, it is in the witnessing of this phenomenon outside the U.S. that they come to understand the strength, stability and long term possibilities of the Company’s mission. After a 41-year run, the potential for Mary Kay remains huge.

## **The Americas**

By 1976, when the Company’s stock was first listed on the New York Stock Exchange, it had significantly enhanced its product line and already opened three U.S. distribution centers in the South and on the East and West coasts when a major opportunity arose. That was Canada, where in 1978; Mary Kay Ash answered repeated requests from its neighbor to the north. Canadians love to relate the cosmetic icon’s first visit to their country. It was in the midst of a deadly winter storm that the petite dynamo came, sans boots, to meet and rally the Canadian independent sales force. Despite radio safety warnings to stay at home because of difficulty traveling, Canadian women came out to

meet and greet Mary Kay in a hotel ballroom. It was said to be so cold there was ice forming inside the ballroom windows, yet Mary Kay's magnetism warmed the crowd. They definitely warmed to her message. That began a lifelong mutual admiration between the Texan and her Canadian operation. One employee who traveled with Mary Kay Ash on several subsequent visits said, "She was the consummate hands-on leader and that made a real impression with the women of Canada." Mary Kay never hesitated to get out from behind her desk and go up close and personal to disseminate her caring leadership style.

A *Reader's Digest* article, "Mary Kay's Sweet Smell of Success," appeared in late 1978, and just one year later the Company and its Founder were profiled on television's "60 Minutes." This latter 1970s media attention would – coincidentally – set the stage for a continued bright future for the company, both domestically and globally.

Mary Kay expanded to Argentina in 1980. In 1986 – shortly after the company was returned to private ownership – the first European operation, Mary Kay Germany was established. Expansion to Asia didn't begin in earnest until the 1990s.

Argentina and Mexico offer two great examples in the Americas region that validate and provide insight into how closely the Company's global success is aligned to its culture. Both countries have weathered economic crises that – rather than rocking them -- only solidified Mary Kay's position in those markets. Argentina came on board in 1980 but it wasn't until 2001 that its staying power was proved. There was an economic crisis that year that saw a blistering 300 percent devaluation as well as a financial collapse.

According to Mary Kay Latin America President Jose Smeke, even amidst these dire straits, “Our sales force count nearly doubled from 12,000 Independent Beauty Consultants to 20,000. There was a 28 percent sales increase in local currency.” Why? How? Smeke says Mary Kay Argentina knew what to do in 2001 during this economic crisis because one of its most successful sister subsidiaries, Mary Kay Mexico – founded in 1988 – had survived and thrived through a similar economic crisis in 1994. In Mexico that year, there was a currency devaluation of more than 150 percent in one day, a 20 percent unemployment rate, political uncertainty, and price increases of up to 60 percent.

“We faced daunting obstacles, but we had a commitment to our independent sales force and their families, and so we took some risks for them,” says Smeke, who believes the appreciation and support of Mary Kay Inc. to Mary Kay Mexico at that time (and to Argentina seven years later) provided the trust and confidence that would see sales increase by 80 percent by the end of 1995, as well as a 35 percent increase in Consultant count. “We had,” Smeke recalls, “a sales force in very high spirits. Their accomplishments proved that during a crisis a direct selling company can be a very good option for women who need to help support their families.” In Mexico and elsewhere in the Mary Kay world, one key most certainly makes a huge difference. “We always said to these small business owners, ‘you are in business *for* yourself, but not *alone*,’” explains one corporate veteran.

The Company’s fortunes are closely tied to the performance of its independent sales force. Mary Kay Mexico had opened in 1988 when the U.S. parent company was 25

years old. By 2004, Mexico had grown to be Mary Kay's second largest subsidiary in numbers, with an independent sales force of more than 120,000. Among those legions are dramatic and life-changing stories of triumph over illiteracy, poverty and even war. Who are the women of this sales force? Throughout the world, their backgrounds and lifestyles are as varied as they are in the U.S. Their stories portray the Mary Kay mission to enrich women's lives extremely poignantly. When Mary Kay Mexico published a call for stories to celebrate its 15th anniversary in 2003, hundreds of stories poured in. The best of those stories would be published in *Reader's Digest Mexico*. Among them were numerous stories like that of the fruit store merchant who had worked long hours with little to show. Without a car, but with the mentoring of her Independent National Sales Director, she decided to devote as much time to her Mary Kay business as she had to her fruit stand. She is now a successful Mary Kay Independent Sales Director in Mexico, planting many more fruitful seeds for growth than her produce stand ever would or could have provided. Even husbands of sales force members, on occasion, will testify to the life-changing potential they have seen this opportunity offers their wives and their families. One of the things they always express appreciation for is the Mary Kay emphasis on family and balance, which resonates particularly well in these cultures.

Mary Kay Ash saw the huge potential of changing women's lives in Mexico very early on. Not only did she enroll in Spanish classes, she often spoke to Spanish-speaking leaders in their native language. Even though in Mexico she was known to have ordered "a grandfather" once in a restaurant when she wanted a glass of milk, Mary Kay's love for the language and the culture was always a source of great pride to her Spanish-

speaking “daughters” as she called them. The first Independent National Sales Director in the U.S. of Spanish descent was an immigrant who had been airlifted from Cuba to the U.S. with parental consent in 1961 to prevent her indoctrination into communism. By 1975, she was enamored with the thought that she could earn the use of a pink Cadillac like the one she had seen in Mary Kay literature. By 1977, she had her first of many pink Cadillacs, and in 1991 was named a Mary Kay Independent National Sales Director.

The seeds of entrepreneurship exist today in Brazil, where an American woman of Brazilian descent decided to take her knowledge and skills as a Mary Kay Independent Sales Director and start over in the land of her forebears. With 18 years of Mary Kay business experience in the U.S., she knew the huge potential Brazil would have for this company and its mission to enrich women’s lives. She took a giant leap of faith, returning to Brazil to begin a new Mary Kay chapter in her life. It paid off. Only four years after starting over, this woman became Brazil’s first Independent National Sales Director in August 2003 – just five years following Mary Kay’s opening in Brazil.

Mary Kay’s General Manager in Brazil says that this woman’s successful journey represents a true milestone. “Other women have started to see everything that’s possible. She is, they reasoned, ‘just like me’ and so they came to understand how they could do the same.”

## **Mary Kay Europe**

The company had celebrated its 30<sup>th</sup> anniversary and had crossed the threshold as a billion dollar business at retail by the time Mary Kay Russia opened in 1993. Russia has become a pillar of strength and it is clearly among the best places on the globe to see the power of success potential that results from entrepreneurs with a penchant for hard work. Looking at Russia and the surrounding nations, it's apparent that the principles, career path and the products of this Dallas Company have made the transition into an international opportunity that transcends generations, language and culture. Mary Kay Russia also symbolizes that it is possible to transcend weather and wartime.

The story of one Independent National Sales Director from a region in the Far East of Russia illustrates how enterprising women can overcome economic woes and a severe climate. For this woman, building her business often necessitated month-long waits for products to arrive when inclement weather would prohibit air travel to and from the area. She built it anyway. So intent was another woman to get her products to her market that she would routinely fly in the cargo hold of an airplane in order to make the nine hour trek to the distribution center.

Another Independent National Sales Director hails from Chechnya, a region torn by wars since the time of the czars through the Soviet period and even today. This former music teacher left Chechnya for Moscow to discover the only work she could find was cleaning floors. Her Mary Kay business brought a radical lifestyle change -- affording her the luxury of owning her first car in the mid-1990s and the financial ability to unite her family, long separated by poverty and unrest at home.

Mary Kay has also been an important phenomenon during the second phase of “perestroika” – the end of the USSR and the start of privatization and reform.

The president of Mary Kay’s Europe Region, Tara Eustace, resides in Russia where she says she has seen Mary Kay contribute to a better way of life, a change of thinking and many positive influences. She recalls how Mary Kay Ash was overjoyed and proud to bring the Mary Kay opportunity to the former Eastern Bloc countries. Many in the Mary Kay world fondly recall the Founder’s visit to Germany shortly after the fall of the Berlin Wall. Germany had come on board in 1986 but shortly after reunification of East and West Germany, a newly free East German Independent Beauty Consultant just couldn’t contain her enthusiasm when she walked across the stage to shake the hand of Mary Kay Ash. She grabbed the microphone and proclaimed, “First we get freedom, and then we get Mary Kay!”

Eustace says Europe has followed the Mary Kay model very closely. Russia in particular has adapted to the lack of infrastructure (post, delivery, poor phone lines, emerging bank infrastructure, lack of personal check or credit card systems) by developing a Customer Service operation center where placement and payment for orders as well as education can take place. Some of the largest recognition meetings for Mary Kay Russia have been held at the Kremlin, which at one time was one of the few venues large enough.

Eustace believes that oftentimes the most effective way to deal with a less than positive impression of the direct selling model is by careful attention to teaching and focusing first on quality rather than quantity. “A great Mary Kay staff,” she concludes, “helps the new

market attract and teach those very first vital Independent Beauty Consultants. Together they will build the opportunity in their country.”

Eustace recalls hearing the poignant story of a woman from Odessa who is an Independent National Sales Director in the Ukraine. The home she lived in had no plumbing and no water. Today the woman recounts how one hot summer day she and her young son were dust-covered from hitchhiking along the motorway. “I was angry at myself and my miserable life,” she writes, “when suddenly in the row of dusty cars, I see a white, clean Mercedes. That Mercedes became my dream.” Today the woman drives a pink Mercedes courtesy of Mary Kay. She and her family vacation at the best international seaside resorts and her son studies at the most prestigious school and attends the finest sports club. “And owing to Mary Kay, I managed to make my dreams real,” she says.

The entire region is filled with stories of dreams come true and lives changed. Not only did Mary Kay Russia survive the economic crisis of 1998, but the company’s Independent Beauty Consultant count had almost doubled by the end of 2002 and nearly doubled again at the end of 2003. Currently there are some 100,000 Independent Beauty Consultants – third largest of the international markets behind Mexico and China.

Another place where numbers were significant was in sales force leadership. By 2005, Eustace estimates that some 70 women in Russia alone will be Independent National Sales Directors.

## Asia

If the prospect of a recognition and rally meeting of a U.S.-based capitalist company taking place at the Kremlin isn't enough of a contrast, imagine then that kind of a rally taking place in China. It is in this ancient land that Mary Kay has seen wonderful success. China, today the eighth largest consumer of cosmetics, is Mary Kay's most profitable subsidiary. It is also recognized by the business community. *Fortune China* named Mary Kay one of the top ten companies to work for in China. Not only is the marketing plan successful, Mary Kay manufactures its products at its facility in Hangzhou, and was the first cosmetics company that China granted a quality control and guarantee system certificate in 1998, just three short years after Mary Kay opened for business in China. Perhaps even more significant is the impact that the venerable culture of this American company has had on the historic land and its people. K.K. Chua, president of Mary Kay Asia, says he knew from the beginning that Mary Kay principles would transfer well into Chinese culture. "Confucius taught if you want others to treat you well, you must first treat others the same." As we examine the various components of what constitutes the Mary Kay culture, it is closely aligned with the Asian culture.

The region has not been an easy one to excel in. Mary Kay China faced daunting obstacles including a government ban on direct selling shortly after it opened. During the six months of the ban, more than 4,000 Mary Kay Independent Sales Force says Chua, "refused to go away." By the time Mary Kay was back in business, these faithful sales force members were ready to carry China to its current status as the company's largest

subsidiary. Mary Kay looks forward to expanding well beyond its 18 branch offices, as well as set operations in 29 additional cities. A new manufacturing plant is planned for 2006.

In addition to many inspiring stories, Chua points out that Mary Kay has made its way in China by following yet another of the founding principles. The belief in giving back to the communities has taken root in re-investing part of its profits into the lives of the country's women. There is a micro credit fund for female workers, schools in mountain regions where female children have been too poor to attend school, scholarships for female students at two prominent universities, and youth projects emphasizing skills training. The most telling of the impact of Mary Kay Ash on a culture so far removed from her own is the small rose garden outside a maternity hospital in Shanghai. It commemorates Mary Kay's life and philosophy and this Mary Kay garden honors the fact that this American woman's legacy is firmly established in China.

Equally heartwarming is a painting that hangs in the Mary Kay Museum at the world headquarters in Dallas. The Chinese street scene was painted by a renowned Chinese artist as a thank you to Mary Kay Ash. The artist paid tribute to this American businesswoman who had provided her a first chance at developing her personality. In the tribute letter, she poured out the heartwarming story of never having spoken until her teens. Although recognized as an artist she was extremely uncomfortable around people until her own Mary Kay network gave her the confidence among people that had eluded her for her entire adult life.

Another strong testament comes from the woman who ranks first among Independent National Sales Directors in international operations. In China, she was one of the 15 pioneers in the Mary Kay Independent Sales Force – one whose fierce determination to excel at her Mary Kay business could not be dampened. By her late 20s, she had attained the prestigious Independent National Sales Director position and in her mid-30s, ascended to first place among international Independent National Sales Directors. A medical doctor and National Sales Director told of never having worn makeup before she was 30 years old. Her mother believed only bad girls wore cosmetics. She came to know the company through its products and eventually left the medical profession to pursue a Mary Kay business. She says today, “In my mind, Mary Kay is a footstone. On this base, women’s dreams could come true: beautiful appearance, harmonious family, bright life.”

Another National Sales Director in China today has difficulty believing how her life has changed since she first began her Mary Kay business. She fondly recalls how she would regale her skin care class participants by telling them about the Texas-based legend and those infamous pink cars of the Mary Kay world. She went on to qualify, in 2000, for the first pink car in China. Having gone from being a jobless, homeless and poverty stricken divorced mother to becoming an international success story is indeed a powerful journey. It is a journey that breathes belief into other women aspiring for their own brand of Mary Kay success. It is a confidence-inspiring journey that Mary Kay’s history has proven others will emulate.

## **Conclusion**

It is the culture of Mary Kay that seems to shape the heart of the Company, no matter its location worldwide. Mary Kay is intent upon transforming itself to achieve an internal corporate challenge by the Company's 50<sup>th</sup> anniversary in 2013- that the international independent sales force will exceed that of the United States. By 2004, the international business sales projection was expected to exceed what the entire U.S. did in the year 2001.

The number one corporate strategy is to "amplify the soul" of the company. Mary Kay has not only "let the culture be," the Company has gone to extra lengths to make the heart of the Company the focus of international education and development. While the lucrative nature of the Mary Kay marketing plan would seemingly be sufficient, that's not enough. It's not enough, Whatley says, that a woman can earn potentially at 100 times the average per capita income of her country. This success works so much better and lasts longer when it is applied according to Mary Kay's founding principles. In 1963 when Mary Kay Ash stressed her Golden Rule style of doing business, it was a foreign concept to even a U.S.-based company. Today, that style is so celebrated that a recent newsletter took the time to spell out how the Golden Rule translates into all the major cultures and faiths of the world. There is always the emphasis on what Mary Kay saw as, "belief in the beautiful potential of women" that also drives Mary Kay's global success. Once the sales force understands the Mary Kay culture, adapting business systems to the customs and mores of each new country becomes a much simpler process. But it is never simple.

Mary Kay's International staff will talk of a starter kit designed for the tastes of Western women who drive their cars everywhere and how its size wreaked havoc on women in Asia who typically walk and take bicycles or buses everywhere. They will allude to how much more 'global' the color palette and formulas of Mary Kay brands are today as they routinely conduct product focus groups on a multitude of skin tones and in nine languages. Even a recent new Independent Sales Director education session in Dallas featured fully one tenth of the attendees needing translation into languages such as Polish, French, Cantonese and Spanish. But more important than the language is the common and shared experience all women relate to. That will, in summary, make the difference for this American company. When accepting the posthumous award given Mary Kay Ash as "Greatest Female Entrepreneur in American History," her grandson Ryan Rogers said, "Mary Kay tapped into one of the greatest under-used natural resources this nation had to offer – the hearts and minds of its women." It is much the same today throughout the more than 30 markets where Mary Kay has a presence, and in those parts of the world that women have even fewer opportunities.

Direct selling is one of the only forms of retailing that can adapt to virtually any conditions or circumstances and Mary Kay Cosmetics is a great example of this. Entrepreneurs and capitalists alike have come to see that when direct selling operates by the highest of standards, it can make amazing strides in contributing toward solid world economies. Mary Kay, Inc. follows the ethical standards set by the Direct Selling Association (DSA), and was instrumental in seeing the document to fruition in the 1970s

and strengthening it in the 1990s when one of its corporate officers was serving as DSA Chair. The DSA is the industry trade organization comprised of 150 direct selling member companies worldwide and has been an advocate of ethical business practices and consumer services. The DSA Code of Ethics has served the industry well, an industry now comprised of 49,937,719 sales people as of February, 2004 (R. Diamond, personal correspondence, March 10, 2005).

The culture of Mary Kay, Inc. reflects today the caring attitude its founder, Mary Kay Ash, established at the outset. David Holl, President and Chief Operating Officer believes that, "A fiscally sound company can also be a nurturing and caring company. We have a larger goal than selling a product. I have seen firsthand the stories of self esteem and personal growth that abound throughout the Mary Kay world. I know nothing would please our Founder more." Holl continues, "We have experienced in more than four decades that the businesses that succeed the most in Mary Kay are those built and based on the number of lives touched. Having someone in your market break a belief barrier is extremely important. Having them succeed by following Mary Kay principles is even more important."

Mary Kay Ash was a role model that truly believed in the human potential, encouraging others through positive reinforcement, such as praise, recognition, and respect. To instill her point, she insisted her own board of directors table have round seating with no head. These principles have greatly enhanced the appeal of the organization to aspiring entrepreneurial women. Today, there are more than 400 Mary Kay Independent National Sales Directors on five continents that serve as inspirational leaders for more than 1.3 million women in the Mary Kay independent sales force.

# **Who's The Boss? A Look at How Stakeholders Influence the Investment Decisions of Bankers, Venture Capitalists and Angels**

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## **ABSTRACT**

Investors in startup ventures face the problem of information asymmetry when assessing the potential for return from their investments. In general, investors have imperfect information and as a rule, the less information an investor secures, the more uncertain the outcome from a particular investment. Investors attempt to reduce the risk of funding the wrong businesses by seeking information regarding the founder, new venture teams (NVT) and the new venture concept and strategic plan. This paper argues that investors have become more organized (e.g., affiliation in an organization) in an effort to reduce risk. The result has been greater reliance on formal communication, more complex due diligence processes with more stringent criteria and higher expected returns on investments. This tendency toward increased organization has been a result of market and political uncertainty and instability, increased access to data and expanding global markets. One result of this trend among investors has been more stakeholders with a vested interest in the outcome of the average investment. In this paper, the authors suggest that this increase in stakeholders and the resulting orientation toward a lower risk tolerance may contribute to the trend toward less funding at the seed stage and increased funding in expansion and later stage companies by equity investors who have traditionally provided capital for startups. Questions regarding the impact of these trends on investment returns and new firm startups are posed. A market failures model is used to explain these trends and a model and hypotheses for future research are presented.

## **Introduction**

Investors in startup ventures face the problem of information asymmetry when assessing the potential for return from their investments (Binks et al., 1996, 1997). This is due in part to the fact that new businesses, and often the firm founders, do not have a prior track record that investors can use in their decision-making process (Berger and Udell, 1998). In general, the less information an investor secures, the more uncertain the outcome from a particular investment. Investors attempt to reduce the risk of funding the wrong businesses – either by investing in unsuccessful firms or failing to invest in high potential and profitable ones (Parker, 2002) - by

seeking information regarding the founder, new venture teams (NVTs) and the new venture concept and strategic plan.

The authors argue that investment trends over the past 10 years reflect an increased amount of formal organization among the investors that are the focus of this paper, namely banks, venture capitalists and angels. Moreover, we suggest that the criteria used by each of these groups and the amount and type of information necessary prior to making an investment decision is moderated by the stakeholders that come about as a result of the increased formal organization. Furthermore, we argue that the communication needs and criteria required for investment in new ventures by each of these three categories of investors can be modeled on Williamson's (1975) Market Failures Framework. In other words, investors organize to the extent they need to reduce uncertainty and increase information processing capabilities. Of the three groups, banks tend to be the most organized and constrained by stakeholders and angels the least constrained.

This research examines the proposed trend and offers a model for understanding the changes that have occurred and poses the following question. Has equity investing become more formalized over the past 10 years?

### **Williamson's Market Failures Theory**

The emergence of the organization as we know it today has been explained by numerous theorists (Eisenstadt (1958), Stinchcombe (1965), Parsons (1966), and others – see Scott, 2003 for a comprehensive overview of this literature. However, one well known approach to understanding this phenomenon focuses on the need to reduce transaction costs associated with reaching and policing agreements about the exchange of goods and services. This approach was developed most fully by Williamson (1975). He argued that in a market system, buyers and sellers transact exchanges based on contracts and negotiated agreements. This model assumes that all parties make decisions in these exchanges based upon self interest. According to this model, simple market transactions work well in conditions where all obligations can be fulfilled in the short term or on the "spot" as with *spot contracts* (Scott, 2003). However, when a good or service is not delivered until some later date a "*contingent contract*" is required. In this case, the longer the time frame and the more uncertain the circumstances surrounding the delivery of the contracted good or service, the more difficult it becomes for market systems to provide the necessary structure for an effective and efficient transaction to occur.

According to Arrow (1974: 33), "...organizations are a means of achieving the benefit of collective action in situations in which the price system fails." Both Arrow and Williamson concluded that organizations are superior to markets because they reduce transaction costs in uncertain economic transactions. Williamson's organizational solution to the failure of markets is illustrated in Figure 1. In his model, Williamson suggests that in complex and uncertain environments where there are limited exchange partners, organizations can provide a means to overcome the problems associated with limitations on human cognitive abilities and the human tendency to act in opportunistic ways. The attributes of organizations that help overcome these problems include increased support for decision-making, incomplete contracts, increased auditing and control systems, and the ability to provide agents within the organization with

incentives for contributions to the welfare of the organization and cooperation with the goals of the organization.

[Insert Figure 1 about here]

The conditions surrounding exchanges of money for equity in new ventures pose an excellent example of the circumstances described by Williamson. Individual investors are making decisions – either for themselves or their stakeholders – and are constrained by the limits of bounded rationality. Bounded rationality and cognitive limitations of individuals, emphasized by Simon (1997), simply refer to “the limitations of individuals as information processors” (Scott, 2003: 157).

According to Williamson (1975), the issues associated with bounded rationality become even more pronounced as complexity and uncertainty increase. It is widely understood that market and political environments today are increasingly becoming more and more complex and uncertain. Enhanced and changing technology delivers more and more data, but the sheer amount of data available today makes it even more difficult to sift through and find relevant and meaningful information. Emerging and growing global markets have added to the level of complexity as global expansion is a possibility for even the smallest of new ventures and most large organizations exploit international labor. Moreover, political instability and worldwide terrorism has added a new dimension of uncertainty to the marketplace. In sum, it could be argued that the need to create or associate with existing organizations, as a way to reduce uncertainty and complexity, has never been greater.

In his model, Williamson (1975) acknowledges what might be known as a dark side of human behavior. He evokes the possibility that people may operate dishonestly – especially when they have the luxury of being in high demand. In other words, when there are only a few partners for exchange and especially when the stakes are high, individuals may place self interest over honesty. This also suggests a power difference among exchange partners with the most powerful exchange partner being in a position to manipulate the weaker party.

In exchanges of money for equity, the partners for exchange are often limited. Investors are looking for the few new venture proposals that are likely to succeed while entrepreneurs and NVTs are highly dependent upon funding to pursue the opportunities they have identified. This dynamic provides an excellent example of the conditions cited by Williamson in his market failures model.

According to Williamson (1975), when these circumstances exist, the outcome is the emergence of organizations in an effort to reduce the costs associated with the transaction and improve the likelihood that the desired good or service will be provided. Institutional equity investors – investment banks and venture capitalists - have existed for some time. However, we suggest that more and more individual investors are banding together or investing through institutional investors and fewer wealthy investors are independently entering into equity investment exchanges.

## Dominant Coalition Theory

If "...organizations are a means of achieving the benefit of collective action" (Arrow, 1974: 33), issues associated with goals, power and control gain relevance. Questions about who determines goals and strategy lead to issues of power and control.

Simon (1964, 1997) distinguishes between individual goals, or *motives*, that govern the choices and behavior of the individual within an organization and organizational goals and strategy that serve to guide decision-making and measure the outcomes of organizational actions. One of the most commonly accepted definitions of the latter is "the determination of long term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals" (Chandler, 1962: 13). Only in a few organizations, which may be referred to as *purposive organizations*, do individual motives and organizational goals coincide. More often, individual motives differ from organizational goals and strategy. Consequently, it makes no sense to aggregate the goals of the individuals to obtain a description of the organizations goals (Scott, 2003) and instead, researchers have more typically attempted to understand who is responsible for establishing organizational goals.

Goal-setting in organizations may be conceptualized on a spectrum ranging from a classic economics theory on one end - where it is expected that the goals of the organization are determined by the owner or organizational founder - to the other end of the spectrum, where one might explain goal setting as a consensual process whereby all parties share equally in the process. Cyert and March (1963) provide an alternative explanation by suggesting that goals are set by members of the *dominant coalition*. In this conceptualization, organizations are viewed as entities comprised of groups of individuals who are seeking similar goals. Each group has some influence on the outcome, but no one group can fully determine the goals for the organization.

Scott (2003) adds that the dominant coalition as an explanation of shared goal-setting, must include all *stakeholders* of the organization. Stakeholders may be defined as "...any group or individual who can affect or is affected by the achievement of an organization's objective" (Freeman, 1984: 25). An individual who has a "stake" in an organization has the capacity to affect an organization's "behavior, direction, process or outcomes." (Mitchell, Agle and Wood, 1997: 858).

### *The role of power in equity investments*

Power, both inside and outside of organizations, resides in capital ownership and control. Capital is typically categorized in three groups: *financial capital*, *human capital* and *social capital* (Scott, 2003). In an equity exchange, investors and the organizations they represent tend to hold most of the power associated with the financial capital piece of the equation. An entrepreneur may be able to garner some financial power if he has an excellent credit history and holds collateral.

Human capital typically refers to attributes, skills, education and experience possessed by people. Entrepreneurs may hold significant human capital and may develop strong NVTs in order to gain leverage in equity investment exchanges. On the other hand, when investors

organize they increase their own human capital by hiring talented employees to assist with the due diligence and negotiation processes.

Social capital refers to power obtained through “networks, norms and trust that facilitate coordination and cooperation for mutual benefit” (Putnam, 1993: 36). Organizations can build increased opportunities for social capital and thus again provide a power advantage for organized equity investors.

### *Challenges of the organization in equity exchange*

Taken together, it can be argued that as uncertainty and complexity have increased and investors have moved toward more formal organizational investing, there have been increasing numbers of stakeholders in any equity investment exchange. Furthermore, those investors have had the opportunity to gain more power in the exchange process. Thus, given the benefits of an organization over the individual, the outcome of this trend should be toward improved investments and better return for shareholders.

One might conversely argue that using organizations to address issues of uncertainty and complexity introduce problems associated with conflicting goals and power struggles among the dominant coalition. Specifically, in new venture funding, the stakeholders must include the investor and the entrepreneur. In this type of exchange, the investor and the entrepreneur typically form a team and work together to encourage the growth of the new entity until one or more of the parties cash out their equity. However, as investing becomes more organized, the partnership is likely to be made up of an “agent” for the other stakeholders on one “side” and the entrepreneur and NVT on the other.. In this case, the agent has more power based in the organization she/he represents, and the new venture leadership less. This may lead to less optimal decision-making since NVTs are likely to hold more information regarding the prospects for the new entity (Amit, Glosten & Muller, 1990; Prasad, Bruton & Vozikis, 2000).

Thus, while the trend towards increased organization among equity investors may enhance the power held by investors by improving communication flows and enhancing decision-making regarding equity exchanges, it may also increase the number of stakeholders for an investment, lead to the potential for power struggles and compromised goals based on the need to seek consensus among the dominant coalition. It may also ultimately serve to slow down the investment process and lead to less investment in seed and early stage companies. These resulting effects may undermine the ability of entrepreneurs and NVTs to create value for the marketplace.

### **Model**

An increase in organized investing has a number of dimensions. Specially, we suggest that as investors become more organized, *the number of stakeholders increases, investors rely on more formal communication, the due diligence process involves more complex criteria and investors require higher expected ROIs.* These changes can be modeled as shown in Figure 2.

[Insert Figure 2 about here]

Via Williamson's model of market failures (1975), the authors suggest a trend towards more formalization in exchanges of equity for investment money that result from increased tendency toward organization, across the spectrum of investors – namely investment bankers, venture capitalist and angel investors. Institutional investors are even more organized and formalized and private investors are creating networks and obtaining the benefits of organization over pure market exchanges. Furthermore, this paper suggests the presence of an equity exchange organization can be measured by examining stakeholders in an equity exchange, formalization of communication used to acquire information for due diligence, criteria used in the due diligence process and the expected returns from investors.

## **Hypotheses**

Information can be defined as “any element in a system that provides understanding of an observed relationship” (Busenitz, et.al., 2004). While technology has increased our ability to obtain data, its effect on information, which requires organization and interpretation, has often been to render it more obtuse and hidden by “noise” in the communication process.

Investors obtain information in two broad ways. First, the founders of a new venture send information about themselves and the new venture via formal and informal methods. Second, investors seek out additional information in both formal and informal ways.

Formal communication from the founders to the investor typically includes a business plan, investor presentations and both brief and lengthy interviews and discussions about the new venture concept. In addition, new venture teams also send more informal “signals” regarding their commitment and their assessment of the value of the new venture through their own level of personal investment in the new venture (Busenitz, Fiet and Moesel, 2005).

Likewise, once investors are interested in the new venture prospect, they will seek out supporting information through industry, market and technology research. Informal information is also frequently sought through casual conversations with friends, colleagues, neighbors and even family members who are in a decision-makers network.

Therefore, in order to gain access to information, investors may wish to engage in more expanded informal networks or they may organize in order to create better flows of information. Similarly, as investors become more organized and have to respond to increasing numbers of stakeholders, they will establish more stringent investment criteria and set higher return expectations in order to meet the goals of the dominant coalition. Thus, we propose the following hypotheses.

**Hypothesis 1:** From 1995 to 2005 the number of stakeholders has increased in new venture investments.

**Hypothesis 2:** From 1995 to 2005 there has been an increase in formalized communication processes in new venture investments.

**Hypothesis 3:** From 1995 to 2005 there has been an increase in the complexity of due diligence criteria in new venture investments.

**Hypothesis 4:** From 1995 to 2005 investors have expected higher returns on investment in new venture investments.

### **Proposed Research**

We propose a two-stage study of angel investors, venture capitalists (VCs) and banks in a Midwestern city where the investment in seed stage ventures has shown a decline from 1995-2005 that is typical of the trend seen across the United States. Data for the Midwest region of the U.S. compiled by PricewaterhouseCoopers, Thomson Venture Economics and the National Venture Capital Association (Table 1) indicate a decrease in the number of seed stage deals from 1995 (437) to 2004 (171). A representation of the data in Graph 1 illustrates that equity investments in seed stage companies was lower in 2004 than in 1995, while investments in later stage and expansion companies was higher in 2004 than in 1995.

[Insert Table 1 about here]

[Insert Graph 1 about here)

Stage 1: We will conduct exploratory research including focus group research and content analysis of due diligence processes to refine our model.

Stage 2: We propose a survey of angel investors in one Midwestern city who have invested in new ventures from 1995 – 2005 to determine the number of stakeholders, reliance on formal communication, due diligence criteria, and expected returns in investments. We will conduct in-depth interviews with 20 angels in the community where at least 10 of those angel investors are affiliated with a well-organized network that has been in existence for more than 5 years.

### **Implications**

Research has shown that entrepreneurship plays an important role in contributing to economic growth (Baumol, 1993; Birch, 1979). Specifically, economists have suggested that the economic performance of an economy is driven by investment in physical capital (Solow, 1956), the accumulation of knowledge capital (Romer, 1986, 1990) and the presence of social capital (Putnam, 1993; Coleman, 1988). More recently, Andretsch and Keilbach (2004) have examined entrepreneurship capital and found evidence that it is positively linked to regional economic performance. They define entrepreneurship capital as “those factors influencing and shaping an economy’s milieu of agents in such a way as to be conducive to economic growth “(Andretsch and Keilbach, 2004: 419).

On the other hand, entrepreneurship only exists when there are entrepreneurs. Economists have directly linked wealth creation to entrepreneurs and entrepreneurial processes (Schumpeter, 1934, 1950), viewing the entrepreneur as the creator of new enterprises (Low and McMillian, 1988; Rumelt, 1987; Schumpeter, 1934).

It can be argued that a trend towards more formalization and organization in equity investment exchanges has and will increase the amount of dollars available for entrepreneurs, minimize investment in organizations that will not succeed and increase investment dollars flowing to the most successful new and growing ventures. Investors and all stakeholders in the exchange will benefit from the trend.

However, an alternative argument is that increased organization in a regional investment community may lead to more focus on the goals of the investor and less on the needs and goals of the entrepreneur. The investor typically does not have the same passion and willingness to overcome any obstacle that is present in someone with an entrepreneurial mindset. For example, in urban and rural Kentucky, where venture capital firms are rejecting nearly every entrepreneurial proposal to come their way (Sekula, 2005) angel investors are providing dollars and giving a “second wind to ideas that otherwise would not see the light of day” (Sekula, 2005).

However, as angels become more organized and create networks, will their investing become more like VCs? Are VCs gravitating toward “bank-like” decision-making? If so, will this gravitation toward more organization in equity investing affect the entrepreneurial capital in communities and the United States?

Specifically, if our research indicates a trend toward more organized equity exchange, we pose the following questions for future research:

- What impact has the trend toward more organized investing had on the quality of investments? In other words, has it led to better returns for investors? Has it improved the likelihood that investors will be able to reduce the chance of investing in unsuccessful firms or failing to invest in high potential and profitable ones?
- What impact has the trend toward more organized investing had on the development of entrepreneurship capital? In other words, has this has any effect on the number of successful start-ups and the growth in entrepreneurial firms and the resulting economic development of the regions in which these firms locate?

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**Figure 1**

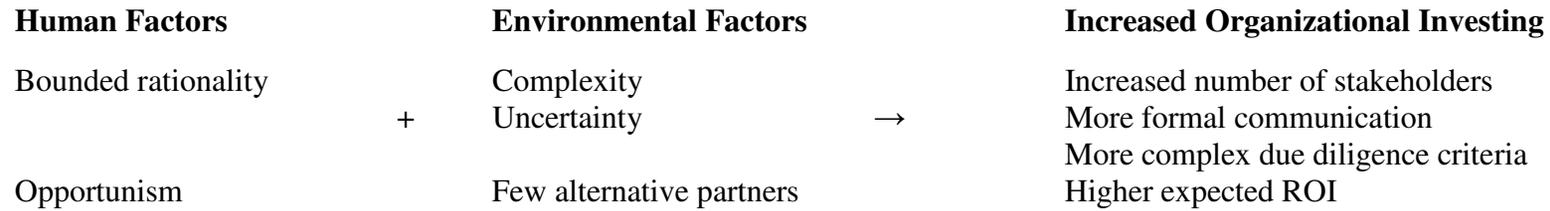
**WILLIAMSON'S MARKET FAILURES THEORY**

| <b>Human Factors</b> | <b>Environmental Factors</b> | <b>Organizational Solutions</b>   |
|----------------------|------------------------------|---|
| Bounded rationality  | Complexity<br>Uncertainty    | Support for decision making<br>Incomplete contracts                         |
| Opportunism          | Few alternative partners     | Auditing and control systems<br>Incentives for contributing and cooperating |

From Scott (2003), Organizational Solutions to Market Failures. Source: Adapted from Williamson (1975), Figure 3, p 40.

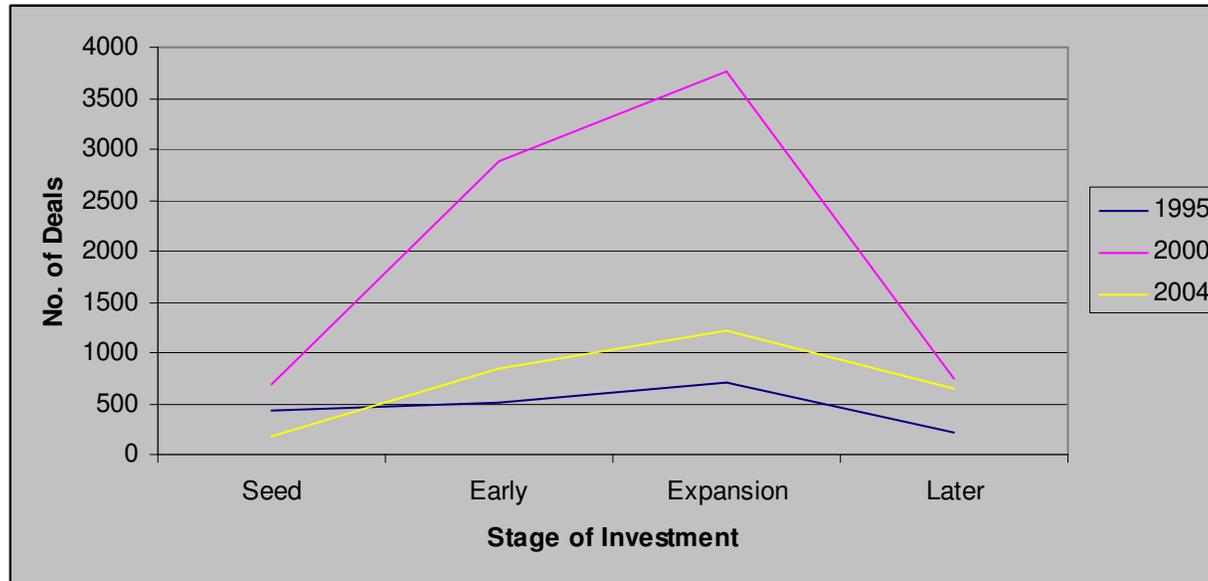
**Figure 2**

**MODELING TRENDS IN EQUITY INVESTING**



Adapted from Scott (2003), Organizational Solutions to Market Failures. Source: Adapted from Williamson (1975), Figure 3, p 40.

Graph 1<sup>1</sup>



<sup>1</sup> Data from [www.pwcmoneytree.com](http://www.pwcmoneytree.com)

**Table 1<sup>2</sup>**

| No. of Deals per Investment Stage |             |              |                  |              |
|-----------------------------------|-------------|--------------|------------------|--------------|
| <b>Year</b>                       | <b>Seed</b> | <b>Early</b> | <b>Expansion</b> | <b>Later</b> |
| <b>1995</b>                       | 437         | 512          | 708              | 214          |
| <b>1996</b>                       | 505         | 769          | 1039             | 298          |
| <b>1997</b>                       | 521         | 891          | 1422             | 348          |
| <b>1998</b>                       | 676         | 1004         | 1586             | 416          |
| <b>1999</b>                       | 819         | 1718         | 2503             | 572          |
| <b>2000</b>                       | 677         | 2881         | 3773             | 740          |
| <b>2001</b>                       | 258         | 1299         | 2450             | 612          |
| <b>2002</b>                       | 156         | 860          | 1605             | 429          |
| <b>2003</b>                       | 193         | 770          | 1354             | 530          |
| <b>2004</b>                       | 171         | 841          | 1217             | 647          |

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<sup>2</sup> Data from [www.pwcmoneytree.com](http://www.pwcmoneytree.com)

# DEMAND OF MENTORING AMONG NEW STARTERS

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## Abstract

Mentoring is considered of crucial importance to the survival and growth of small and medium sized companies (SME's), and that provision of new firm support can yield positive and worthwhile returns to the public sector investment. From a Swedish perspective there is a need for further action to become as competitive within business start-ups as the rest of the EU as well as the USA. The purpose of this paper is to get an indication of the extent to which new starters are interested in taking part as an adept in mentoring and their attitudes towards mentoring. The results are based on a questionnaire going out to 1 022 new starters in different branches located all over Sweden, with a reply frequency of 48,53%. Our research is a contribution within the field of supply and demand of mentors for new starters. Furthermore this could give new directions for governmental and other supporting agencies and indicate new directions for cost-effective business development programmes within EU to SME's and entrepreneurial firms.

Keywords: *mentor, mentoring, mentoring program, adept, start-up, new starter*

## **Introduction**

Mentoring is proved to be beneficial to the survival and growth for new businesses. But sadly in Sweden and many other countries we can not offer any extensive mentoring program to our new starters. We should work to be able to offer a mentor to any new starter that would like to have a mentor. From that perspective we need to know how many new starters that would like to have a mentor if they could decide. If we know this information and the amount of mentors that we can offer to new starters it will be possible to see the potential with mentoring programs.

## **Problem and purpose**

In a previous study we focused on entrepreneurs who retired and the possibility to keep this population for a longer time in the job market. We examined senior management from a survey with 406 answering respondents. This led to the paper "*Mentoring New Entrepreneurs - a Course of Action to Retain Knowledge and Experience in Society*", which was presented at the ICSB World Conference in Johannesburg 2004. The question researched was senior management's interest to act as mentors when they become pensioners, due to emotional bonds to their profession, identity and the satisfaction to pass on accumulated knowledge and experiences, which they have built up during a lifetime. For the above mentioned survey constructed a questionnaire, consisting 61 questions, going out to 1269 respondents, with a response rate of 32%. According to this survey there was an unambiguous result. 97% of the respondents were willing to act as mentors after retirement. These results indicate a promising alternative by keeping senior management active in the market for a longer period of time and thereby helping new entrepreneurs succeed by decreasing the risk of failure. [Henningson, Hultman & Wikholm, 2004]

Starting a new business is demanding and there are many complexities that may serve as barriers to entry for new ventures. We have identified through research and practice, an example being the SCORE (Service Corps of Retired Executives) program in USA, a positive correlation between the mentorship of new starters and the success of these very same ventures. It is therefore of great importance to investigate further. Only small shares of the total amount of new starters have access to mentoring programs. Our earlier study revealed a potentially high number of mentors, which would go far towards filling the supply gap for our new start-ups, granted sufficient demand exists for such services, hence:

*The purpose of this paper is to get an indication of the extent to which new starters are interested in taking part as an adept in mentoring and their attitudes towards mentoring.*

## **The Swedish issue**

In Sweden the total amount of SME's are 99,8%, that is those enterprises with less than 250 employees according to the definition by EU. The privately owned companies occupy 2,6 millions Swedes. [Företagarna & SIFO, 2003]

From a Swedish perspective there is a need for further action to become as competitive within business start-ups as the rest of the EU as well as the USA. This issue has been much discussed in the media and is constantly researched.

It is a demanding mission to start a new business. This is a matter, which many times work as a barrier for new ventures. The total entrepreneurial activity, i.e. share of the population who

either are actively engaged in the start-up process or managing a business, in 2002, was low in the European Union (EU) with only 6% and even lower in Sweden with 4% [GEM, 2002].

This should be compared to the United States of America (USA) with almost 11% [GEM, 2002]. The interest in the EU to be self-employed instead for an employee has decreased to 45% and in Sweden to 32% but the interest in the USA has increased to 67% [EOS GALLUP EUROPE, 2002].

According to table 1 below, Swedish people do not, in general, consider starting a business; more do however in the rest of the EU and in the USA. The same survey also reveals what scares potentially new entrepreneurs the most and that is the possibility of going bankrupt, uncertain income and a risk of losing ones property. What is positive is that more than half (55%) of the EU respondents are willing to take classes on how to set up and manage a business. [EOS GALLUP EUROPE, 2002]

|                | Never came to his/her mind | Is thinking about it | Gave up | Currently taking steps to start |
|----------------|----------------------------|----------------------|---------|---------------------------------|
| European Union | 59                         | 11                   | 9       | 2                               |
| United States  | 41                         | 20                   | 4       | 10                              |
| Sweden         | 73                         | 9                    | 3       | 2                               |

Table 1. Individuals taking steps to start a business, 2002, in% [EOS GALLUP EUROPE, 2002]

Potentially new entrepreneurs have good reason to be afraid, as business insolvencies in Europe have increased with 10.7% in 2002, compared to the previous year. The situation in Sweden as well with an increase of 5.2% the same period, but in the USA the bankruptcies fell and had a decline of 3,9% [CERU, 2003]. Bankruptcies do not only strike SME's, also large companies as the retail chain K-Mart, Philipp Holzmann in the construction sector and the Frankfurt bank Gontard & Metallbank amongst a lot of other companies went bankrupt in 2002. Only 55% of the new enterprises who set off their business in Sweden 1998 survived and were still running three years after start [SCB/ITPS, 2003a]. However there are people who conquer the barriers and start their own business and in Sweden there was an increase of 5.4%, in 2002, in the establishment of new enterprises. This is the secondly highest increase for 10 years. Then again the newly registered companies, excluding existing enterprises that expand, have decreased 15% in Sweden 2002. [SCB/ITPS, 2003b]. The same survey reveals that only 20% of the newly started companies have received support when they started their business.

When you put these figures together it could be said that Sweden is not in the optimal situation but it is improving. More needs to be done and mentoring programs are one measure toward becoming more equal with the rest of EU and the USA.

## Methodology

Our targets are new starters in different branches located all over Sweden. The definition we use for a new starter is a business that is within the period of 0 to 3 years since the start up.

We decided to use an online questionnaire, which is very effective; however it has two major weaknesses. Firstly it demands that respondents have access to and computer/Internet use knowledge. We assumed the target population was likely to have access and knowledge as

a result and condition of their profession and the fact that they have an e-mail address. Secondly Internet correspondence, in contrast to ordinary tangible mail correspondence for answering the questionnaire, is less likely to be answered. Reason for that being is that there is no envelope lying on the desk to remind the respondent to fill in the questionnaire every time she sees it; instead an e-mail is easily lost among all new e-mails that arrive to her mail box. For that reason it is of great importance to send out reminding e-mails more frequently and totally compared to tangible correspondence. It is however much cheaper, faster and more effective than tangible correspondence. We received the respondents from the Statistic Central Office of Sweden which is the most respectable provider of statistics in Sweden. The target population is a new started business that has been registered as a start-up year 2001 or later. When filtered this gave us a population of 1 022 respondents of which 496 answered, giving us a response frequency of 48,53%. To be able to receive a high participation rate from the respondents we followed up with three e-mails that reminded our respondents to answer the questionnaire. The reason for this being is that we assume that a survey e-mail is not of instantly importances in a business and as a result without difficulty get lost due to all new e-mails that arrive.

Table 2 shows some background variables of the respondents, almost a third of these being females. The age is structured in accordance with which decade the respondents were born, for example the interval 26–35 was born in the 1970:s et cetera. The mean age is within the interval of 36-45 years of, which are persons born in the 60's. Education can be of importance when you start business due to better knowledge if you start a business within your expertise. Among the respondents more than half, 51%, have obtained a university exam and 7% have only finished compulsory school. Before the respondents started their business they have at the moment, most of them, 62%, were an employee in a company, 21% managed a different company and 6% studied. The main product for the companies studied is for 26% goods and for 74% services in a wide spread of branches. The size of the respondents companies differ were 64% are micro- (0-9 employees), 30% small- (10-49 employees), 5% medium- (50-249 employees) and 1% from large ( $\geq 250$  employees) companies.

### Background of the respondents

| <i>Gender:</i>    | <i>Share:</i> | <i>Branch:</i>                         | <i>Share:</i> |
|-------------------|---------------|--|---------------|
| Female            | 29%           | Manufacturing sector                   | 21%           |
| Male              | 71%           | Energy sector                          | 3%            |
| <i>Age:</i>       |               | Construction sector                    | 13%           |
| < 25              | 2%            | Service sector                         | 31%           |
| 26 - 35           | 25%           | Trade, hotel and restaurant            | 18%           |
| 36 - 45           | 37%           | Transport sector                       | 6%            |
| 46 - 55           | 22%           | Communication sector                   | 10%           |
| 56 - 65           | 13%           | Finance sector                         | 5%            |
| > 65              | 1%            | Business services                      | 17%           |
| <i>Employees:</i> |               | Movie-, video-, radio- and TV-activity | 7%            |
| 0                 | 14%           | <i>Education:</i>                      |               |
| 1-4               | 32%           | Compulsory school                      | 7%            |
| 5-9               | 18%           | Upper secondary school                 | 42%           |
| 10-49             | 30%           | College/University                     | 51%           |
| 50-249            | 5%            |  |               |
| > 250             | 1%            |  |               |

Table 2. Background of the respondents

## **Definitions used in this paper**

The following are abbreviated definitions or frequently used terms in this paper:

*Mentors* are retired or active senior management with a background as self-employed or top management position and are willing to provide mentoring to start-ups free of charge.

*Adepts* also referred as *new starters*, *start-ups* and *protégés*. These are defined as any small or medium sized business owner that has not been in business for more than three years.

*Mentoring* is a relationship process between an adept and a mentor, independent from age and gender, where the mentor motivate and guide the adept forwards an contracted given goal based on the mentors accumulated knowledge and experiences. Although in this paper we se mentors as retired senior management with the background as self-employed or top management position.

*Mentoring programs* in this paper refers to formal mentoring programs for new starters, where a third part engages in pairing mentors and adepts.

*New starters* also written as *Start-ups* is a business that is within the period of 0 to 3 years since the start up.

## **Mentoring**

Mentoring is understood as a journey that describes a unique relationship between mentor and student teacher [Awaya *et al*, 2003]. "Mentors function as teachers and coaches to create learning opportunities and to challenge their protégés to develop to full potential [Vincent & Seymour, 1995]." There are many other definitions regarding mentoring: "The process in which an experienced veteran helps to shape or guide a newcomer...true mentoring is an extended, confidential relationship between two people who have a mutual personal growth and corporate success as common goal...a protected relationship in which learning and experimentation can occur, potential skills can be developed, and in which results can be measured in terms of competencies gained" [Sullivan, 2000]. We would like in general to define mentoring as a relationship process between an adept and a mentor, independent from age and gender, where the mentor motivate and guide the adept forwards a given goal based on the mentors accumulated knowledge and experiences. Although in this paper we se mentors as retired senior management with the background as self-employed or top management position.

## **History**

These definitions are just a small amount of those existing and there seems hard to declare a definition that is suitable for each and every one within mentoring for start-ups. The history of mentoring starts in the old Greece and mythology. When the king Odysseus of the island of Ithaka is forced to go out in war against Troy, he have to leave his beloved wife Penelope and son Telemachos back home. To insure himself that they will be safe and everything will workout at home without him he wanted a guardian. For the assignment he selected his childhood friend Mentor to run the household and the bringing up of Telemachos, and that is

the origin of mentoring. Similarly actions have been present in to our time and will probably always exist. To take care of knowledge and experiences and pass them on were practiced in earlier days in the fields of trade, handicraft- and art profession et cetera. Mentoring was distinguished as a master and apprentice system, of which the master is familiar these days as a mentor and the apprentice as an adept.

The industrial revolution put an end to the master and apprentice system to the favour of an employer and employee relation. What was beneficial for the master were no longer beneficial for the apprentice, instead profitability was in centre of attention. Mentor has from this background developed to be a person for adepts to model themselves on, with the purpose to make the adept competent in her profession.

### **Comprehensive areas**

In business mentoring there is two comprehensive areas. These are (1) mentoring for career development [See Roche, 1979; Whitely & Coetsier, 1993; Aryee *et al*, 1996] and (2) mentoring for self-employed [See Deakins *et al*, 2002; Waters *et al*, 2002; Smailes, 2002]. The first-mentioned is the area most written about. On the basis of these areas new ones have developed and these are (a) mentoring for women [ See Berry, 1983] and (b) mentoring through Internet [See Bierema & Merriam, 2002; Perren, 2003] that have grown big. There have also arisen combinations of female and Internet mentoring [See Headlam-Wells, 2004].

### **Meaning of mentoring**

Regarding the meaning of mentoring two perspectives is most common. Firstly, (1) it is the adept that should develop, not he mentor [Murray & Owen, 1992; Annerstedt, 1998; Steinberg, 2004]. Secondly (2) it is a dialog and the exchange of knowledge and experiences that occurs between the mentor and the adept take place on an equal footing were the mentor and adept learn from each other [Franzén & Jonsson, 1994; Franzén *et al*, 1999]. Although the most common is, the first mentioned, that mentoring is a deliberate merger of two persons was one of them have less knowledge and experience and opposite. The common goal is that the person with less knowledge and experience should learn and develop certain skills [Murray & Owen, 1992; Annerstedt, 1998; Steinberg, 2004].

### **Informal and formal**

Mentoring can be arranged in two different forms as informal and formal mentoring. Informal mentoring is when the mentor and the adept find each other without arrangement from a third part in the background. Formal mentoring take place when third parts arrange a match and meeting between a mentor and an adept. [Clutterbuck, 2004]

It is argued that a large share of the mentoring relationships develop informally within an organisation because of the physical nearness and regular interaction that occurs between mentors and adepts [Kram, 1985]. However, in the small business environment the mentor is external to the adepts business and there is limited physical nearness and interaction. Consequently, being a mentor to a person who is starting up a business is more likely to occur through a formalised program rather than an informal connection [Hofman, 1998].

## **Purpose for mentors**

There are two fundamental types of purposes for mentors. First, they provide career development behaviours, which involve coaching, sponsoring advancement, providing challenging assignments, protecting protégés from adverse forces, and fostering positive visibility. Second, they provide psychosocial roles, which include such functions as personal support, friendship, acceptance, counselling, and role modelling. [Ragins, 1997]

## **The mentor role**

Finding or becoming a mentor may seem like a huge responsibility, but it is actually rather easy [Call, 2003]. The mentor plays five key roles (1) coach, (2) co-ordinator, (3) supporter, (4) monitor and (5) organiser, where the roles are changing dependent on the needs of the protégé [Clutterbuck, 1991]. Assigned relationships through formal programmes have, however, been found to be problematical [Kram, 1986].

## **Developing adepts**

To be able to develop an effective adept the mentor should remember five standing points. First, the mentor should not assume that the relationships she has developed successfully will work for the adept. Second, the mentor should ensure that the adept is not confused by the mentor's influence. Third, the mentor should not try to hard to shield the adept from mistakes that are bound to happen. Fourth, the mentor should not burden the adept with to great a burden of gratitude. Finally fifth, the mentor should avoid confining the adepts growing potential to her own limitations. [Bensahel, 1977]

## **The adept's selection of mentors**

Before an adept get involved in a mentoring relationship the adept should ask them self questions when looking for a mentor, such as is this someone I admire, am I comfortable with this persons values, is the person in a position to offer me opportunities, does this person have strengths and skills that I want to acquire and finally is this person someone who can increase my visibility, that is, do people respect this person [McCune, 2000]?

## **Mentoring efficacy**

There are theoretical arguments suggesting that support for new ventures should be provided on a mentoring basis, where mentorship should have an impact on the management ability and confidence of such new start-up [Deakins *et al*, 1998]. It is also considered that mentoring is of crucial importance to the survival and growth of SME's [Sullivan, 2000], and that provision of new firm support can yield positive and worthwhile returns to the public sector investment [Deakins *et al*, 1998].

## **Mentoring programs**

National, regional and local economic development agencies use entrepreneurial mentoring as one ingredient in a wide assortment of assistance programs to entrepreneurs and small business owners. In Scandinavia, mentoring programs, where the involved offer their services free of charge to new and young entrepreneurs, are to be found in Sweden with the "Mentoring - Experience agency for new self-employees" at ALMI Business Partner; in

Finland at Yrityskummit ry and in Denmark with the “Sparring med erfaring” project. Other countries in Europe that offer similar services are the Professional Business Advisor (PBA) program in the U.K., ECTI and EGEE in France, SES in Germany and the “Saturno” project in Italy. In the USA there is the SCORE program.

### **Match mentor and adept**

It is recognized, that assigned mentoring relationships are not usually as beneficial as those that develop informally [Armstrong *et al*, 2002]. There appears, therefore, to be a need to match partners in some way. It has been suggested that a better understanding of psychological factors is necessary if this is to be achieved [ibid] and try to match the mentors to clients based on the mentors sector experience [Deakins *et al*, 1997] et cetera. On the other hand a study shows that perceived attitudinal similarity was a better predictor of adept's satisfaction with and support received from their mentors than was demographic similarity [Ensher et al, 2002].

### **Female or male mentor**

A study reveals that gender composition found to have a significant impact on the mentoring process [Armstrong *et al*, 2002]. Combinations with female mentors and male protégés were found to be the least favourable combination [ibid]. But regarding the issue of whether to have a man or woman as a mentor another study reveals that gender was not considered much of importance. But in the end mentoring can offer no guarantee of success. The mentors themselves can often be a bad influence for some people, men and women alike. Individuals must choose their mentors carefully and make sure the chemistry of the relationship "fits" both personalities and situations involved. [Simonetti & Aris, 1999]

### **Mentor supply**

In a research regarding senior management's interest to act as mentors when they become pensioners, interesting results came forward. Senior management want to become mentors due to emotional bonds to their profession, identity and the satisfaction to pass on accumulated knowledge and experiences, which they have built up during a lifetime. According to this survey there was an unambiguous result. 97% of the respondents were willing to act as mentors after retirement. These results indicate a promising alternative by keeping senior management active in the market for a longer period of time and thereby helping new entrepreneurs succeed by decreasing the risk of failure. The same survey also stated that more than 90% were interested to become mentors even before retirement, but for fewer hours. [Henningson, Hultman & Wikholm, 2004]

## Empirical data and discussion

### Have a mentor

According to a study made in New Zealand about small business uncover that 20% of the male respondent have a mentor and that another 33% wished for having a mentor [McGregor & Tweed, 2002]. This should be compared to the female respondents in the same study were 26% having a mentor and another 41% wanting a mentor. So you could say that females experience that they are in a more extensive need of a mentor than males to be successful. This should be compared to our study in Sweden were less persons have a mentor have a mentor than in New Zealand. About 13% of the start-up owners have a mentor. There is a small difference between the genders for having a mentor were 14% of the males having a mentor and 11% of the females having a mentor.

The reasons for the difference between the results in New Zealand compared to Sweden could be due to different atmospheres and attitudes towards mentoring between the two countries. But still the difference is not to extensive for making to drastic conclusions. According to our study it is start-ups that been in business for 2-3 years that have the largest share of mentors with 27%, for start-ups that been in business for 1-2 years it is 23% and the smallest is 12% and that is start-ups that been in business for less than one year.

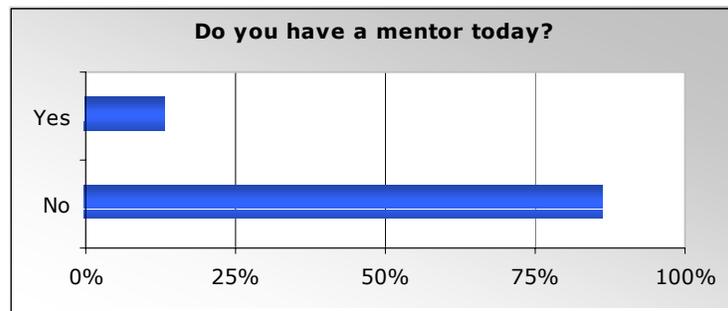


Figure 1. Start-ups that have a mentor

### Have had a mentor

Regarding those who do not have a mentor today there is 16% of the respondents who have had a mentor before. These figures are changing between the genders were 26% of the females and 13% of the males have had a mentor. The difference is too widespread to be ignored. So it seems that females seems to need a mentor more than males and according to the study made in New Zealand more females than males wished for having a mentor.

### Tried to get a mentor

If you not have or had a mentor it is of interest to find out how many there is who have tried to get a mentor but not succeeded, and according to our results that is 7%. As before there is a larger share females, 9%, who have tried to get a mentor compared to the males with 6%. It is first when you been in the business for 1-2 to years when you try to get a mentor. In this group 12% claims that they have tried to get a mentor compared to 6% for those who have been in business for less than one year and 2% for those that been in business for more than two years.

## Reflection towards mentoring

In general start-ups have a positive reflection towards mentoring, and as before there are more female respondents in favour for mentoring. According to our study 41% of the females are very positive compared to 28% of the male respondents. Further on it is the start-ups that been in business for less than two years that are most positive to mentoring for new starters were 78% are positive or more.

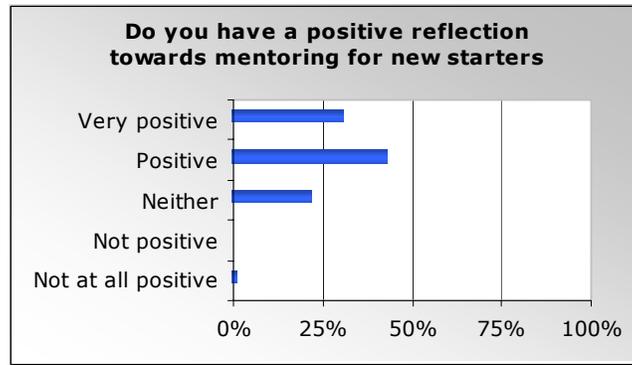


Figure 2. Start-ups reflection towards mentoring

## To have or not to have a mentor

If you could choose between having a mentor or not 85% of the female respondents and 75% of the male respondents would want to have a mentor compared to an average of 78%. And again it is those who have been in business for less than one year that would like to have a mentor. In this group 87% would like to have a mentor compared to 82% for 1-2 years and 78% for 2-3 years in the business.

## Take contact with a mentoring program

On the question if the respondents can imagine themselves taking contact with a mentoring program in their region if there was such a program, the results show that most of them, 63%, would. As we seen before there has been a difference between the genders towards different issues regarding mentoring. But not regarding taking contact with a mentoring program were the answers are fairly equal with 65% of the females and 62% of the male respondents. Respondents in the age of 25 or younger differ from the rest with 38% that can imagine themselves taking contact with a mentoring program.

Start-ups that have been in business for less than one year are most interested in taking contact with a mentoring program. In this group 78% are in favour for such behaviour and start-ups that have been in business for 1-2 years have 71% and 2-3 years have 56% that are interested.

## **E-mentoring**

Mentoring does not necessarily have to be arranged so that a mentor and an adept meet face to face. Mentoring can also, due to computer technology, be arranged over Internet and e-mails. Near half, or 49%, could see it as possible to have a mentoring relationship over internet. Females are considerable more in favour for internet than the male respondents, almost half as much. In figures that corresponds to 62% of the females and 45% of the males. The age factor does not seem to have too much of an impact, but it is the respondents in the age of 65 and more that are most positive, with 60%. Whether how long you have been in business there are the respondents who's been in business for less than one year that is least in favour for mentoring over internet, with 46%. Among those who could consider mentoring over Internet 25% finds mentoring over Internet as a better alternative than actually meeting a mentor. Those most in favour for this is respondents older than 65 years of age were 67% find mentoring over Internet as a better alternative than actually meeting a mentor. Finally when asking all the start-ups if they could consider not meeting a mentor and only has contact through e-mail and telephone 11% of the respondents were in favour.

## **Mentoring contributions**

In our population that we studied there were those who have and have had a mentor and their opinion of the contribution with having a mentor altered as one of the respondents proclaim:

*"A mentor can substantiate the 'truth' "*

But most of them, that is 96%, agrees totally or more that the most important contribution is a mentors support and tip-offs. Further the sharing of knowledge and experiences were 95% agrees totally or more. Receiving feedback from mentors (87%), develop the adepts knowledge (88%) and help to avoid mistakes (89%) of the respondents seeing as a contribution. Network is repeatedly mentioned within the field of mentoring and 84% of the respondents agree almost totally or more that a mentor helps the adepts networks to increase. The respondents experiences is that 76% of them agree almost totally or more that a mentor can help the adept's self-confidence and the motivation for 77% of the respondents. Further on 74% of the respondents believed that mentors can help put ideas into effect and 76% believed that a mentor can help adepts with how you lead a company. Finally 56% of the respondents agree totally or more that a mentor can help them to set up at international markets for their business.

These figures should be compared with those of the respondents that do not have or have had a mentor. Also these answers differed and as two of the respondents who have not had mentor proclaim:

*"A mentor can help me to get a structure and order in the different phases of my business."*

*"A mentor could be a good support when it comes periods of less good times."*

The majority, 89%, believe that sharing of knowledge and experiences are contributions from mentors. They are also united regarding that mentors can help avoid mistaken and give support and tip-offs, according to 88% of the respondents. When it comes to personal

development 83% believe that a mentor can help them to develop their own knowledge. 78% believed that mentors can help them put ideas to effect. 79% believed that a mentor can help them how to lead a company and 78% that a mentor can bring them a larger network. According 78% of the respondents they believe that feedback is a contribution from a mentor and 68% believed that a mentor can increase the adept's self-confidence and for 67% the motivation. Finally 66% of the respondents agree totally or more that a mentor can help them to set up at international markets for their business.

The figures are quite interesting between the two groups. The first group who have or have had a mentor express them selves from experience. The other group who have not had a mentor express them selves from what they expect and believe. Common for almost every answer is that group one, which expresses them selves from experience, have a higher opinion about the contribution of a mentor than group two who have no experience with a mentor. This tells us that mentoring have a higher impact on start-ups efficacy than what start-ups without mentoring experience expects. This gives implications that those start-ups who joins a mentoring program, for the most part, will experience immense satisfaction due to exceed of expectation.

### **Reasons for wanting a mentor**

Reasons for wanting to have a mentor for the group that have not had a mentor are many but there are a few that stands out. As a couple of the respondents say:

*"I want to choose the persons in my surroundings as I already respects."*

*"My business is to narrow."*

The main reason for not having a mentor, for those who answered that they did not want to have a mentor, is that they would like to succeed on their own without help according to 70%. Another reason is that do not believe that mentoring would help there company and 60% are sceptical and 67% believe that do not have time over to get engaged in such a commitment. Other reasons are for 57% that they believe that the difference is to big between the size of the adepts business and the business that the mentor used to have. 38% do not know what a mentor can contribute with. 32% feel that they do not want to "open up" for unknown person. 30% do not have any knowledge about mentoring. 39% do not want to share info about their business with a person they do not know. 43% do not want to get involved in new projects. 37% believe that it would cost too much. Finally 11% are afraid that the mentor could become a competitive to the adepts business.

Contrary to those who did not want to have a mentor we have the respondents who would like to have a mentor. The reasons for this are several and two of the respondents express them selves as follows:

*"My needs of a mentor are totally dependent of my competence and my weaknesses."*

*"To be told from a mentor if I am going to the right direction."*

To be able to have someone to exchange ideas with is the main reason for 98% of the respondents for having a mentor. Supplementary knowledge from another person is a reason for 95% of the respondents. 92% wants mentor for the reason that they believe it is worth a

try. Concerning network 85% believe that mentoring could expand their contacts. 79% believes that mentoring can teach them more about running a business. 81% believe that mentoring can help them with strategies and concrete solutions. Finally, 62% believes that mentoring can help them with issues regarding the change of lifestyle when you start a business.

### **Mentoring program fees**

Start-ups do not in general have extensive funds and mentoring programs require large funds to finance. The advantage of charging start-ups for involvement in a mentoring program and not offer the service free of charge are two. Firstly, you will only receive participators that are serious with their business. These start-ups see a future in their business and honestly want to succeed. By only receiving seriously start-ups you will not invest capital in start-ups that do not believe in their business up to 100%. Secondly, a fee would bring some money into the mentoring program that can be used to finance the expenses voluntarily mentors receive when they meet their adepts.

According to our study 48% can imagine them self to pay for a mentoring program. These figures would increase or decrease depending on the size of the fee and their knowledge about the efficacy impact mentoring can have on a start-up. There are more females, 54%, that could imagine them selves to pay a fee for joining a mentoring program compared to 45% of the male respondents. What is more interesting is that the willingness to pay a fee for participate a mentoring program increase with the age of the respondent. This result in that 33% of the respondents age 25 or younger and 61% of the respondents older than 55 years of age could imagine them selves to pay a fee for joining a mentoring program.

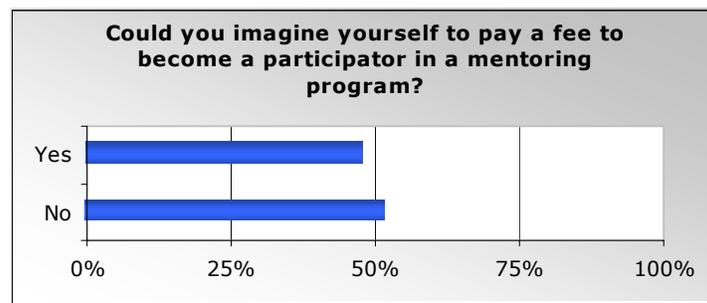


Figure 3. Start-ups reflection towards paying a fee to become part of a mentoring program

### **Meeting the mentor**

Our respondents state that they would like to meet their mentor approximately once a month according to 49%. Another 34% would like to meet their mentor less than once a month, 12% would like to meet their mentor every two weeks and 4% would like to meet their mentor every week.

### **Practical issues within mentoring**

Some practical issues regarding mentoring for start-ups are that they want the mentor to have extensive experience from being self-employed, 85%, and extensive experience from a top management position, 69%. Among the respondents 71% find it as important that a

mentor have experience from the same branch as them. The mentor should be able to meet the adept in the local community according to 57% of the respondents and this should be on regularly basis according 72%. Of the respondents 68% would like to also meet other mentors than their own for ideas and feedback. More than a third, 36%, of the respondents would like to have a central meeting point were mentors and adept can meet up. It is of importance for 45% of the start-ups that there is a working plan to follow in a mentoring relationship and courses to follow about the subject according to 34%.

### **Demand and supply of mentoring**

There is a remarkable possibility within mentoring in Sweden. Today only one of five start-ups has a mentor. It seems like start-ups do not know about the efficacy and benefits of taking part of a mentoring program. We know from research that mentoring have positive on impact new starters. Therefore there is of great importance that mentoring effects will be informed to start-ups and that there is mentoring programs available to join without costing to much.

Mentoring programs in Sweden are in general very small and have approximately 20 mentors or less available in every assembly, which are not many. We know from this research have input that makes it possible to see in which extent mentoring programs could be build up so that the mentoring programs could reach out and be accessible to all start-ups that would like to have their own mentor.

In our research we found that eight out of ten start-ups would like to have a mentor. Among start-ups in business for the first year almost nine out of ten would like to have a mentor. In Sweden we get 49 500 new businesses each year. The consequences would be that 31 680 start-ups would like to have a mentor during the first three years and could consider contacting a mentoring program. The figure 31 680 times three years will be 95 040 start-ups that demand a mentor if they could decide. That is a lot of start-ups that potentially needs a mentor and would require about 60 000 mentors.

A realistic perspective is that there will never be that many start-ups, but still. Not all of them could consider pay a fee for entering a program. After taking the fee in to consideration this would give 68 310 start-ups wanting mentor, start-ups that will contact and pay a fee to participate. This is a figure that will correspond to approximately 45 000 mentors that will be needed in Sweden.

If these figures would be put in to context of a region like Orebro, located in the middle of Sweden between Stockholm and Oslo, that would correspond to how many start-ups and mentors an average mentoring program would require. Orebro gets about 850 new starters each year. But only 46% are willing to pay a fee for mentoring giving us 391 start-ups left for possible mentoring. This figure times three gives us the total amount of new starters, which is 1 173, that needs to be matched against a mentor. The total amount of mentors that will be needed if all would contact a mentoring program would be about 780 mentors.

The truth often is that not that many start-ups or mentors will contact a mentoring program even if they say they would. Real figures would probably be a third of our calculations, which are 391 start-ups and 260 mentors.

We do have the start-ups and we do have mentors according to our studies, the only thing that is needed to be done is to bring them all together.

## Conclusion

We do know that mentorship have a positive impact on society. There is for that reason of great importance that mentorship is being implemented in wider scale in our society than ever before. This could be done in if can arrange an arena for both mentors and adepts to get together. For this to be promising interests need to act on a regional and local level within the nation. It would also be favourable if this could also be arranged over the nation borders if necessary, but have in mind that the mentors have a need in meeting the adepts on regularly basis.

Mentoring have great possibilities if handled correct and wisely. But it is not only positive. Mentoring can also fail due to the fact that it is not a guarantee for success. Many things can go wrong. The big issue is how to match the mentor with the adept, and the efficacy of doing so. Mentors can even have a bad influence on the adepts. So there is not only a problem with matching the mentor with an adept it also has to be a correct one. We discussed earlier that assigned mentoring relationships are less beneficial than those who develops informally. This gives us further complications regarding how to match informally. Further on the adept have to ask them self if this person have the skill and values that are acquired.

Even if the mentors are willing to offer their services free of charge and the demand from new starters extensive, there are plenty of barriers to triumph. The mentors want to share their knowledge and experiences. The mentors want to meet new and interesting people. The mentors want a new challenge in life. But sadly are not all of the mentors likely to be appropriate to become mentors. Not all qualify for such pedagogic assignment.

Most important is that we know the potentially supply of mentors and the potentially demand of mentors from the new starters. This gives an indication how extensive third party managed mentoring programs can be arranged to receive best possible efficacy and survival of start-ups.

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DETERMINANTS OF SUCCESS:  
SMALL AND MEDIUM SIZED ENTERPRISES SELLING GOODS AND SERVICES  
TO THE FEDERAL GOVERNMENT

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**ABSTRACT**

The purpose of the study is to discover the characteristics of successful small and medium sized enterprises (SME's) that sell goods and services to the federal government in order to develop a list of determinants of success (DoS). These factors can be used for a variety of purposes including as a self-check for aspiring business owners, a checklist for government or private sector purchasers, a way for determining assistance needs, and even for financiers. This, the first of a 4-part study, covers the rationale, prior research, and survey methodology. Parts two through four cover survey results of three populations—small and disadvantaged business utilization specialists, large government contractors, and successful small government contractors. This is the first study to solicit input from customers of small businesses to obtain their view of success to overlay what researchers view as significant success factors.

**INTRODUCTION**

Small businesses are one of the major engines that fuel the United States economy, and the government encourages small business ventures by maintaining low barriers to entry. According to the U.S. Small Business Administration, Office of Advocacy, there were 22.9M businesses in the United States in 2002. Because of the importance of small business to the U.S. economy, numerous scholars have parsed the entrepreneur in various ways in hopes of determining the theoretical entrepreneurial success formula. The underlying question is whether entrepreneurs have a common set of characteristics that can be used to determine who has the highest probability of success. This study tackles that question, but approaches it from a different direction. In addition to examining successful entrepreneurs to expose possible similarities that can be projected onto nascent entrepreneurs, this study starts from the customer perspective. Use of this approach helps obviate the self-serving attribution bias when entrepreneurs are asked to explain their success (Rogoff, Lee et al. 2004). It also creates an opportunity to overlay customer perspective upon researcher findings about success characteristics.

The purpose of this study is to discover the characteristics of successful small and medium sized enterprises (SME's) that sell goods and services to the federal government in order to develop determinants of success (DOS). These determinants can then be used for a variety of practical purposes including as a self-check for aspiring business owners, a checklist for government or private sector purchasers, a way for determining assistance needs, and as part of the decision-making matrix for venture capitalists or bankers. Another critical outcome of this study is to provide a tool that could help in reducing the

number of business failures, which are frequent and damaging to the efficient operation of a market economy (Storey, Keasey et al. 1987).

## **BACKGROUND**

Small businesses have been hailed and proclaimed as economic engines that make significant contributions to job creation, and the general health and welfare of the U.S. economy. They represent more than 99.7 percent of all employers, pay 44.5 percent of total U.S. private payroll, and generate 60 to 80 percent of net new jobs. A study by Birch was the first to shed a bright light on this magnificent engine (Birch 1979). Since Birch's results contrasted sharply with previous economic research, there was and continues to be debate among mainstream macro-economic researchers about the validity of his research findings. But statistical data from the U. S. Department of Commerce strongly supports his findings, and policy interest in the small business sector arises out of this proven capacity to generate and increase employment.

### **Small Business Advocacy**

Small business—this powerful economic and employment generating engine is shepherded by the U. S. Small Business Administration (SBA) whose mission is to “maintain and strengthen the nation’s economy by aiding, counseling, assisting and protecting the interests of small businesses and by helping families and businesses recover from national disasters (USSBA 2005). The SBA assists small businesses through grants, consulting, counseling, training, developmental programs, business information centers, financial assistance, outreach, women’s business centers, and other activities, which are available to all businesses regardless of size, ability, industry, or other factors.

The culture of the United States is built upon the belief that everyone regardless of background should have an opportunity to succeed, and entrepreneurial development systems are designed based upon that premise—service to all. It is almost heresy, and certainly politically incorrect, to suggest that resources be expended on those ‘most likely to succeed’, but business failure rates (53% over a 4 year period) and loan default rates of 2.5% for all businesses and a higher rate for small businesses provide data that cannot be ignored (Berger and Mester 1999; Boden 2000). Based upon the knowledge that new business creation is highly associated with economic growth around the world (Reynolds, Carter et al. 2002), coupled with rapid movement to a global economy absolutely requires that the United States become more diligent in optimizing its resources, stabilizing its economy, and therefore maintaining economic success.

SBA assistance to small business is threatened by shrinking dollars. The SBA’s 2006 budget request included \$115.8M<sup>1</sup> for assistance to small businesses, which represents a 37% reduction from fiscal year 2000, when they received \$185.6M.<sup>2</sup> If there were a means to identify the factors that drive small businesses to success, then the SBA and its agents could target and nurture those factors. Thus, making the best use of declining public sector funds.

In addition to providing general business assistance, the SBA is mandated to ensure that small businesses get their fair share of government contracts. The SBA negotiates annual procurement preference goals with each Federal agency and reviews each agency's results to ensure that the statutory government-wide goals are met "in the aggregate." Section 15g of the Small Business Act sets statutory goals for contract awards, called *goaling*. Goaling is one area where small businesses operating in the Federal marketplace differ from other businesses. Due to these 'contract goals', small businesses may be selected based upon agency goals or price, and not necessarily because they are the best business. There is another area where small businesses operating in the federal marketplace differ from the non-governmental sector, and that is associated with contract turnover. When a contract ends, federal acquisition regulations (FAR) require that the contract be re-competed.<sup>3</sup> During the re-compete process, another small business may be selected to perform the contract. The new firm often hires the employees and buys the equipment of the previous small business. Consequently, the selection is not necessarily based upon the best company, but is based upon employees.

### **Small Business Research**

Researchers have been investigating small business development and entrepreneurship since Cantillon coined the term entrepreneur (1755). For decades, researchers have been attempting to uncover the secret formula for entrepreneurial success. They have studied the entrepreneur by using different indicators, in different industries, by gender, by country, and most of them have come to the same conclusion—success in business highly correlates to certain personality traits, work experience, and education. Beyond this, there have been minute, incremental steps in our understanding of entrepreneurship.

Birch's seminal, and controversial work on small business job creation, sent researchers on a quest to confirm (or deny) his findings. In fact, some researchers now believe that most new jobs actually come from relatively few small businesses (Stanworth and Curran 1976; Burns and Dewhurst 1996; Glancey 1998). If that is true, then the U.S. Small Business Administration (SBA) and other small business advocates may be expending limited resources on firms with little chance of success. According to the SBA 2005 budget request, approximately 2.1 million entrepreneurs received business counseling and technical assistance through one or more of the Agency's advisory and training programs(SBA). This study asks whether those dollars would be better spent by targeting and nurturing entrepreneurs with the highest probability of success.

With all of the resources and training expended on entrepreneurs, this study suggests that it is now time to study entrepreneurship from a different perspective. Instead of microscopically examining the entrepreneur, maybe we should use a common industry technique, and ask the customer to define and identify successful small businesses. This will allow us to overlay what we believe about entrepreneurial success with the customer's perspective.

Obtaining the customer view of success allows us to confirm, expand, or reject research findings about success. This could be a daunting task due to the plethora of businesses, customers, products, services, geographic locations, etc, but there is one marketplace that

is relatively closed with a vast pool of data—the federal government, where over \$200B are expended each year (USGSA 2003). The federal government market is a perfect laboratory for discovery and testing of entrepreneurial activities, because it is a relatively closed system. All small businesses, must register in the Central Contractor Registration system and contract awards are recorded and tracked in the Federal Procurement Data System.<sup>4 5</sup> Consequently, information on entrepreneurs is available from birth (registration) through contract award to death (no more government contracts).

### **Federal Procurement**

An advantage of focusing on the federal marketplace is that all government agencies are required to have an Office of Small and Disadvantaged Utilization Specialists (OSDBU) (pronounced az-d-bu) whose role is to insure that their respective agencies promote the utilization of small, small disadvantaged, veteran-owned, hubzone, and women-owned business concerns in compliance with Federal laws, regulations, and policies. The OSDBU also assists such firms in obtaining contracts and subcontracts with large businesses.

Large businesses that sell goods and services to the federal government have a counterpart to the federal government OSDBU with a similar charge. The large business representative and the federal OSDBU represent an opportunity to gain direct access to their perceived ‘successful’ small businesses or to the buyers within their organizations who have first-hand knowledge of their small business vendors.

Information from the customer and the names of their successful small businesses is invaluable information for this study. Conversely, the output from this study can be used by those offices to help them assess small businesses desiring to do business with them.

There is one major area where the government is falling short of adopting a business model and that relates to an outcome orientation. Even with all the work being done in support of small businesses in the federal market, and the millions of dollars being expended, there is no way to measure and no definition of success. It is acknowledged that the definition varies depending on the definer, but it is wasteful to expend resources on an activity with no measurable outcomes other than the number of nascent entrepreneurs receiving counseling.

### **OBJECTIVE OF STUDY**

The objective of this study is to uncover the determinants of success (DOS) for small businesses selling goods and services to federal government agencies. A successful outcome of this study would provide: a practical roadmap for policymakers to allocate scarce and declining funds for small business development; the foundation for trainers and educators to develop training and curriculum that targets specific small business needs; a of success probability to be used by investors and financiers; and, most importantly, it would assist the nascent entrepreneur in assessing her own abilities. Finally, this study will be the first to consider customer input on small business success characteristics.

## THEORY

The focus of this study builds upon research pertaining to small business success. It is not necessary to rehash and re-review past research in order to create a bibliography, because others have done an excellent job of that. (See Timmons and Peacock for reviews and bibliographies of studies related to characteristics of small businesses (Timmons and Spinelli 2003; Peacock 2004)). Therefore, this study only provides an overview of pertinent studies.

This study concerns what Van Praag calls the “personspecific” determinants as opposed to the “businessspecific” determinants, because small business success and entrepreneurial success are intertwined (vanPraag 2003). The culture and characteristics of the small firm generally reflect that of the owner(s). Consequently, research on small business success often focuses on the owner characteristics.

Researchers have parsed the entrepreneur by considering a variety of factors. Reynolds and Newbert studied the characteristics of the nascent or gestational entrepreneur (Reynolds, Carter et al. 2002; Newbert 2005). Boden studied small businesses by industry and race (Boden 2000). D’Amboise and Muldowney looked at management and organizational structure (D’Amboise and Muldowney 1988). These studies and others focus on the small business in the earliest stages of development—one to five years. Whichever framework is adopted, researchers tend to focus on what Morrison and Breen has categorized as pro-growth factors, which include intention, ability, and opportunity (Morrison, Breen et al. 2003).

Due to the desire for quantification, several factors are excluded from the success equation—the unobservables or intangible assets such as corporate culture, access to scarce resources, management skill, corporate reputation, luck and social networks, which can be postulated to be principal determinants of business success (Aldrich and Zimmer 1986; Hall 1992; Freeman 1996). Freeman supports the inclusion of social networks as a factor by offering that an invaluable input of venture capitalists is access to their networks.

The underlying objective of entrepreneurial success studies is to develop a predictive model, but accurate models are not widely available (Lussier and Pfeider 2001; Reynolds, Carter et al. 2002). Even if a model existed, it would not be a replacement for existing decision-making techniques, but an adjunct. This study takes a qualitative approach to answer Birch’s question about why “gazelles” grow (a gazelle is a business establishment with at least 20% sales growth, starting with a base of at least \$100,000.) (Birch, Haggerty et al. 1993), and takes D’Amboise’s challenge to identify factors critical to above average growth by using customer input to sharpen vague generalizations about entrepreneurial success characteristics (D’Amboise and Muldowney 1988). The overall conclusion is that there is no one factor that is the lynchpin of success, but a combination of factors.

## **STUDY METHODOLOGY**

The study is conducted in four parts designed to capture determinants of success from those with firsthand knowledge of successful firms in the federal government contracting community—the customer and the small business. This first part of the study involves an explanation of the background, hypothesis, methodology, and establishes the framework for the overall study. The second through fourth parts of the study involve surveying small business customers and selected small businesses.

### **Definitions**

Three terms need to be defined for this study—small business, entrepreneur, and success.

#### **Small business**

Most researchers use the U.S. SBA definition of a small business “an independent business having fewer than 500 employees. <sup>6</sup> SBA further delineates small businesses by size standards—500 employees for most manufacturing and mining industries and \$6 million in average annual receipts for most non-manufacturing industries. This study is based upon these definitions.

#### **Entrepreneur**

The definition of an entrepreneur begins with the originator of the term and idea, Richard Cantillon, an economist who spoke of the entrepreneur as someone who organizes and assumes the risk of a business in return for the profits (Cantillon 1755). The term disappeared until J.B. Say’s *Treatise on Political Economy* (Say 1863). Say believed that the entrepreneur used their industry/labor to organize and direct the factors of production so as to achieve the satisfaction of human wants. These ideas were built upon by other economists and refined by Schumpeter who viewed the entrepreneur as one who engaged in ‘creative destruction’ as innovations caused old inventories, ideas, technologies, skills, and equipment to become obsolete (Schumpeter 1912/1934). A more recent definition comes from work done at Harvard Business School and is now generally accepted by authors: “Entrepreneurship is a way of thinking, reasoning, and acting that is opportunity obsessed, holistic in approach, and leadership balance” (Timmons and Spinelli 2003).”

This study rejects Schumpeter’s idea of innovation, because today’s entrepreneur is often more capitalist, imitator, or opportunist than innovator and may simply shift factors of production (i.e., business, employees, customers) from one venture to another. A combination of these previously formulated ideas forms the definition for this study an “entrepreneur is one who assumes the risk of business by creating or seizing an opportunity with no guarantee of profit”.

#### **Success**

Prior research has tended to focus on industry average profits, share of the market, return on investment, age of business, and other quantifiable elements to determine success. These are often difficult to calculate for small, non-public, businesses due to record keeping, organizational structure, owner/manager expenses, and other elements, but as Adaman and Devine state “...whatever the subjective motivation of the owners may be,

the ultimate criterion of survival and success is profitability” (Adaman and Devine 2002). Therefore, profit cannot be ignored and is included here in the success definition.

For the purpose of this study, success is refined to reflect the realities of the federal government contracting market. It has been found that having more than one contract is critical to survival of contractors with 10 or more employees (Fullenbaum and McNeill 1992) and that the average number of contracts awarded to minority-owned businesses in 1999 was 2.5 while the average number for non-minority-owned businesses was 1.7 (Wilson 2001). It was also found that the average dollars received per firm in 1999 was \$1M.<sup>7</sup> This leads to the following definition “a successful small government contractor has ten (10) or more employees, average annual revenues greater than \$1M, increasing or stable profits, and more than two contracts.”

### **Thesis and Hypotheses**

The thesis of this study is that successful, small government contractors have similar characteristics. Morrison and Breen’s pro-growth factors of intention, ability, and opportunity are used to test this thesis (Morrison, Breen et al. 2003). Not only do their factors encapsulate and categorize elements most often studied in the area of success and entrepreneurship, they dovetail with this study’s definition of the entrepreneur.

Most of the unobservable success factors (corporate culture, access to scarce resources, management skill, corporate reputation, luck and social networks) are covered in Morrison and Breen’s list with the exception of corporate reputation and luck so they have been added. Corporate reputation can be ascertained from customer interviews, and luck can be added as a survey question for small businesses. This lists of factors form the core of the surveys to be conducted in parts 2 thru 4 of this study.

The framework of this first part of the 4-part study consists of four elements: background, objective, thesis/hypothesis and study methodology. These elements represent the foundation upon which the surveys in parts 2 through 4 are based.

The second part of the study involves surveying the Office of Small and Disadvantaged Business (OSDBU, pronounced az-d-bu) officials who are the first-responders for small businesses selling or desiring to sell products and services to the federal agencies. According to the Small Business Act, all government agencies with contracting authority are required to have an OSDBU whose role is to insure that their respective agencies promote the utilization of small, small disadvantaged, and women-owned, Hub Zone and veteran-owned business concerns in compliance with Federal laws, regulations, and policies.

Part three of the study involves surveying federal government prime contractors who subcontract work to small businesses. The prime contractor counterpart to the federal agency SADBUs is asked for their input about their small business vendors and for a list of internal managers with direct relationships with small businesses. They are also asked to provide a list of their success small businesses to be surveyed in part 4 of this study. The conduct of surveys will be via email or in-person.

The fourth and final part of the study surveys small businesses identified by government agencies and prime contractors as successful. Survey conduct is by email and/or in-person. The survey questions are structured to utilize the pro-growth categories defined by Morrison and Breen, and the final analysis will incorporate the findings of all parts of the study.

## **Conclusion**

In order for the U.S. economy to capitalize on its gazelles, it is imperative that a system be developed to identify and nurture them at the early stages of their development. The rapidly increasing move to a global economy makes it incumbent on the research community to move rapidly in the development of success determinants. Researchers can take a lesson from the technology community and move toward standardization. It has been proven that standards speed development, because each individual firm does not have to spend time developing and maintaining their own standards.

Researchers should settle on the SBA definition of a small business, and this study suggests a standard definition of the entrepreneur as “one who assumes the risk of business by creating or seizing an opportunity with no guarantee of profit”. Whether this definition is accepted or not is not important. It is important that the community settle on a definition that everyone understands and agrees upon.

It is past time to include customer input in the determination of a successful small business. Researchers seem to be mired in a continuous loop review of the same personal entrepreneurial characteristics. In fact, some success criteria once thought to be significant are now being considered insignificant. Very little new knowledge is being developed in the area of success characteristics. The customer perspective is a way to validate research findings.

The fundamental question being asked by this research is whether small businesses operating in the federal government market and considered successful by their customers possess the characteristics that researchers have found to be significant. The federal market was chosen because it is a relatively closed system with vast stores of data. This first of a 4-part study is the framework to be implemented in study parts two through four.

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## Endnotes

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[http://www.sba.gov/cfo/2006\\_Budget\\_Request\\_and\\_Performance\\_Plan.pdf](http://www.sba.gov/cfo/2006_Budget_Request_and_Performance_Plan.pdf)
- <sup>2</sup> Percent change is unadjusted for inflation.
- <sup>3</sup> Federal Acquisition Regulations <http://www.arnet.gov/far/>.
- <sup>4</sup> The Central Contractor Registration (CCR) is the primary vendor database for the U.S. Federal Government. (<http://www.ccr.gov/handbook.pdf>).
- <sup>5</sup> The FPDS is the current central repository of information on Federal contracting. The system can identify who bought what, from whom, for how much, when and where.
- <sup>6</sup> In addition to this general definition, there are size standards designated by the U.S. Small Business Administration, Office of Size Standards. These standards vary by industry; see [www.sba.gov/size](http://www.sba.gov/size).
- <sup>7</sup> Minority-owned businesses received an average of \$1.5M and non-minority owned businesses received \$631,000(Wilson 2001).

**SMALL-FIRM PERFORMANCE:  
MODELING THE ROLE OF PRODUCT IMPROVEMENT AND PROCESS  
IMPROVEMENT**

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*Proceedings of the 50<sup>th</sup> World Conference of the International Council of Small Business  
(ICSB), Washington, DC -- June 2005*

## **ABSTRACT**

Entrepreneurial and small- and medium-sized (SME) firm performance is a complex; multi-faceted construct that researchers (e.g., Dvir, Segev & Shenhar, 1993) argue should be examined with an eye toward its complexity. Our research study seeks to accomplish this examination by proposing a conceptual model of SME performance with two distinct outcome dimensions—growth as one dimension and profitability as the second. We propose hypotheses for relationships between the four factors above and an SME's likelihood to pursue either product improvement or process improvement as their primary strategic orientation. Further we propose that an SME product improvement orientation likely has greater influence on growth and profit performance than will a process improvement orientation. The findings of the study suggest that internationalization and innovator position have a positive impact on new product and process improvements, while environmental uncertainty, internationalization, and product improvement have positive influences on growth as a performance dimension. In addition and as hypothesized, the product improvement orientation is positively associated with growth and in turn profitability whereas the process improvement orientation showed no statistical relationship to growth and ultimately profitability.

## **INTRODUCTION**

An important subset of the small- and medium-sized enterprise (SME) and entrepreneurship literature is that which examines venture related performance and the various antecedent factors proposed to affect performance (for example Chandler & Hanks, 1994; Covin & Covin, 1990; Qian & Li, 2003 Zahra & George, 1999). High firm performance can facilitate growth and subsequent profit performance, which in turn can yield employment and economic growth. Conversely, low-performance may lead to firm stagnation or failure and the negative economic ramifications of these outcomes. Given the resource constraints of small firms (Acs, 1999) and their susceptibility to distress, hardship, and outright failure with respect to environment change and uncertainty, a better understanding of the contributing factors and mechanisms for high growth is desirable. Therefore the goal of this research is to examine a set of conditions, factors and actions that we propose are of consequence to high SME performance.

This empirical research paper examines two characteristics of entrepreneurial SMEs (their innovator position and the propensity to internationalize) in conjunction with two contextual variables (environmental uncertainty and firm size). We propose hypotheses for relationships between the four factors above and an SME's likelihood to pursue either product improvement or process improvement as their primary strategic orientation. Further we propose that an SME product improvement orientation likely has greater influence on growth and profit performance than will a process improvement orientation. The hypothesized relationships are developed from much of the significant research conducted in entrepreneurship, small business management, and strategic management over the recent past. Our postulates are explained and illustrated using a structural equation model.

## **HYPOTHESIS DEVELOPMENT**

### **Environmental Uncertainty**

Uncertain, unstable, or hostile business environments generally result in difficulties of varying types for all business firms with the margin for error particularly thin for SMEs. Organizational

flexibility and entrepreneurial posture (i.e., innovation, proactiveness and risk taking) can mitigate the effects of hostile environments for SMEs (Covin & Slevin, 1989; Lau, Man & Chow, 2004). Small firms may also be aggressive in difficult environments (Covin & Covin, 1990).

*H1: Environmental uncertainty is positively related to product improvement.*

Second, innovation and proactiveness as a response to environmental uncertainty may lead to process improvements to lower costs and thereby preserve financial flexibility.

*H2: Environmental uncertainty is positively related to process improvement.*

In a recent study of market orientation, product innovation and small firm performance Verhees and Meulenber (2004) linked market orientation and market intelligence to performance. Information gathering, market understanding, environment understanding, and sense making are necessary for SME performance. Such a market orientation is likely to elicit development of the internal resources and capabilities commensurate with adequately meeting the market's needs with appropriate products. Chandler and Hanks found that "[f]irms with higher levels and broader varieties of resource-based capabilities grew faster and had higher levels of business volume" (1994: 343). With fewer degrees of freedom for survival, small firms will seek to derive the benefits attributable to size to more effectively fend off the undesirable consequences of environmental conditions.

*H3: Environmental uncertainty is positively related to growth.*

### **Internationalization**

Following Johansen and Vahlne's (1977) stage theory propositions, small firms develop their business activity in domestic home country markets. Success in domestic markets provides the capability to move into foreign markets at first primarily through export activity. From this limited exposure to foreign markets through exporting, firms can learn about customer's product needs, pricing needs, country distribution systems, culture, etc. Ultimately, such learning yields greater commitment to international markets and potentially enhanced performance for the firm. Logically, SMEs have two general strategic orientations from which they may pursue international activities—product improvement or process improvement.

*H4: Internationalization is positively related to product improvement;*

and

*H5: Internationalization is positively related to process improvement.*

Internationalization is a major strategic action for an SME. Under the stage theory premise, an SME operates from an established base of business activity. Research has reported internal conditions that impact SME internationalization to include special competitive advantages (Jaffe, Pasternak & Nebenzahl, 1988), the possession of a unique product, profit advantage, and technological competence (Koh, 1989), and underutilized production capacity (Kaynak, Ghauri, & OlofssonBredenlow, 1987).

*H6: Internationalization is positively related to growth.*

### **Innovation**

Typically SMEs are characterized as resource constrained when comparison is made to large-sized firms. What SMEs lack in resource endowments may be compensated for by flexibility, agility and innovation (Acs & Yeung, 1999; Buckley & Mirza, 1997; Qian & Li, 2003). SME innovation is generally manifested in the form of product modifications (Verhees & Meulenber,

2004). Romano (1990) revealed that the internal drivers for SME growth from innovation were technology, R&D and the ability to generate a competitive edge in the firm's product market. The ability to innovate and adapt new technology to make product modifications is likely due to the greater creativity and innovativeness of small-firm employees (Acs & Yeung, 1999).

*H7: Innovation is positively related to product improvement.*

Similar to the product improvement arguments presented above, firms may also pursue innovations in their organizational and manufacturing processes to become more productive and improve quality, reliability and efficiency.

*H8: Innovation is positively related to process improvement.*

### **Firm Size**

In discussion above we stated that small firms are typically characterized as resource constrained. Larger firms likely possess a greater array of resources to cope with corporate life-cycle changes (Miller & Friesen, 1984). Zahra and George (1999) report significant differences in the manufacturing strategies between corporate ventures (CV) and independent venture (IV) biotech firms. Many of these differences are directly attributed to the different resource endowments available to the ventures—CVs have the wherewithal to draw upon their corporate parent resources while IVs do not. McDougall, Deane, and D'Souza (1992) reported similar outcomes for computer and telecommunications equipment manufacturing ventures.

*H9: Firm size is positively related to product improvement;*

and

*H10: Firm size is positively related to process improvement.*

### **Product improvement and SME growth**

Growth is related to R&D, product innovation and the ability to gain competitive advantage in the product market (Romano, 1990). Product improvements and new products provide firms the momentum for market leadership and growth (Iansiti, 1995). Product innovation opens firms to market share growth and hence sales growth by increasing the customer base in current markets or attracting new customers by opening new markets to the firm (Zahra & Nielsen, 2002).

*H11: Product Improvement is positively related to growth.*

### **Process improvement and SME growth**

Covin (1991) contrasted the characteristics of what he termed entrepreneurial strategic posture versus conservative strategic posture firms. Several important differences emerged in Covin's (1991) analysis that distinguishes entrepreneurial from conservative firms. However, an interesting outcome of Covin's research is the lack of difference in emphasis on operating efficiency between the entrepreneurial and conservative SMEs. Possibly resource constrained firms must get maximum productivity from the resources they possess. We postulate that resources improvements and subsequent operational efficiencies positively impact SME growth.

*H12: Process Improvement is positively related to growth.*

### **Growth and profitability**

SME managers/owners may find it useful, necessary, or unavoidable to pursue strategies that sacrifice (short-term) profitability for growth. Such risky strategies may be due to environmental conditions (Covin and Slevin 1989; Lau, Man, & Chow 2004) or to a particular time in the firm's development (Oviatt & McDougall, 1994). Absent the ability to reach a "critical mass" in

revenue at some point in the early development of a firm, the issue of profitability in the traditional sense is moot. In similar fashion major organizational transformation stages (Miller & Friesen, 1984) in established firms may necessarily require the (albeit temporary) abdication of profit in favor of sales growth.

As performance dimensions growth and profitability are sometimes treated as contemporaneous constructs (e.g., Qian & Li, 2003). However, particularly with respect to small firms, there is a greater likelihood that growth may be antecedent to profitability. Therefore we put forth our final hypothesis:

*H13: Growth is positively related to profitability*

## **METHODOLOGY**

The research design employed the survey method for data gathering. A representative random sample of 855 small- and medium-sized manufacturing firms was identified. A cover letter and survey were addressed to the president or owner from each firm soliciting a response to the questionnaire. A total of 192 key-informants responded, with 182 providing complete information for an overall response rate of 21%. The means, standard deviations and intercorrelations for our data are presented in Table 1.

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Table 1 about here  
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Following the method of Anderson and Gerbing (1988) we employed a multistage process to verify construct validity. Both discriminant validity and convergent validity were determined satisfactory through a process of principle components and confirmatory factor analysis. Structural equation modeling was employed using the AMOS software package in SPSS to test all proposed hypotheses simultaneously. Again following the method of Anderson and Gerbing (1988) outcomes from the analysis show an adequate model based on fit indices provided (see Table 2).

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Tables 2 about here  
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## **RESULTS**

The results from the statistical analysis support most (but not all) of the major premises of the hypotheses developed (see Table 2). Briefly, we find support for the hypothesized positive relationships between innovator position and product improvement ( $p < .001$ ); innovator position and process improvement ( $p < .001$ ); internationalization and product improvement ( $p < .001$ ); internationalization and process improvement ( $p < .01$ ); internationalization and growth ( $p < .001$ ); environmental uncertainty and growth ( $p < .001$ ); product improvement and growth ( $p < .001$ ); and growth and profitability ( $p < .001$ ). Of note is the lack of a significant positive relationship between process improvement and growth which indicates that a process improvement orientation may not yield growth and, in turn, profitability. Conversely a product improvement orientation (as noted above) does yield higher growth, and in turn, higher profitability. Finally, the findings had no support for the hypotheses examining firm size on either product or process improvements.

## DISCUSSION AND CONCLUSION

The primary contribution this paper makes to the literature on small firm performance, namely SME growth is the distinction between product improvement and process improvement as an orientation for growth. Acs (1999: p12-13) stated:

*“The importance of the relationship between innovation and firm growth is also clear. The successful entrants that grow the most are those that develop some type of innovative activity either with new products, new technology or human resources.”*

The results of our research support this premise in part. Innovations (and internationalization) that works through new product and product improvement efforts appear to be successful drivers of growth. However, if new technology is interpreted to mean new processes and process improvements, our data does not support this element of the premise.

These findings reveal that among small businesses environmental uncertainty only has a direct affect on growth (H3), while the hypothesized indirect affects through either product (H1) or process improvements (H2) never materialized. In fact, contrary to the theory developed above, the negative relationships between environmental uncertainty and both product and process improvements were not at all what we expected. It could be that small businesses perceive the uncertainty in the environment more harshly than first thought (Covin & Slevin, 1989).

However, the findings reveal that internationalization has both a direct as well as indirect—through product improvement (H4)—affect on growth (H6). Although, internationalization had a significant influence on process improvement (H5), the relationship between process improvement and growth was not significant (H12). The results suggest that the internationalization construct is significant in explaining all of the above hypothesized relationships (H4, H5 and H6). It would seem that small business internationalization is important for product and process improvement orientations as well as growth of the businesses, it may represent some form of learning or capability development that enables leaping of the stages of internationalization by small firms (Johansen & Vahlne, 1977; Verhees & Meulenber, 2004).

The results of the study also suggest that innovation significantly impacts both product (H7) and process improvements (H8) for small businesses. The findings are not surprising, it seems that product and process improvements are likely due to the greater creativity and innovativeness of small businesses (Acs & Yeung, 1999). According to Romano's (1990) research a central driver of growth is from the innovation of small businesses. However, based on our findings we suggest that innovation impact growth but only product improvement mediates such a relationship (H11). Unexpectedly, firm size had no apparent effect on either product (H9) or process improvement (H10) for this sample of small businesses. Although other researchers have found significant relationships between the size of a firm and manufacturing approaches, clearly this study found no relationships (Zahra & George, 1999).

Finally, we found that product improvements (H11) lead to greater growth of the firm, process improvement (H12) did not, and growth is significantly related to profitability (H13). These findings support the research of Acs and Yeung's (1999) work, which suggested that the ability to innovate and adapt to make product improvements is likely due to the greater innovativeness of small businesses. In addition though, we suggest that profitability will also improve as a result of growth achieved by new product development.

Intuitively the relationship between innovation and growth may seem to be clear. The results from our research indicate that the causal effects from innovation are more complex than such a general statement might indicate.

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**Table 1**  
**Correlations, Means and Standard Deviations of Study Variables**

| Variable                   | Mean | SD   | 1      | 2     | 3      | 4      | 5      | 6      | 7      | 8 |
|----------------------------|------|------|--------|-------|--------|--------|--------|--------|--------|---|
| 1. Growth                  | 3.44 | .99  |        |       |        |        |        |        |        |   |
| 2. Profitability           | 3.42 | .93  | .531** |       |        |        |        |        |        |   |
| 3. Product Improvement     | 3.82 | .75  | .373** | .142  |        |        |        |        |        |   |
| 4. Process Improvement     | 3.35 | .76  | .250*  | .111  | .399** |        |        |        |        |   |
| 5. Environment Uncertainty | 3.32 | .56  | .431** | .283* | .149   | .070   |        |        |        |   |
| 6. Internationalization    | 3.33 | 1.01 | .392** | .290* | .346** | .239*  | .380** |        |        |   |
| 7. Firm Size               | 2.74 | 1.48 | .419** | .288* | .212*  | .207*  | .336*  | .352** |        |   |
| 8. Innovation              | 2.92 | 1.18 | .499** | .271* | .403** | .354** | .314** | .250*  | .334** |   |

\* $p < .01$ ; \*\* $p < .001$

**Table 2**  
**Structural Model Parameter Estimates and Goodness-of-Fit Statistics**

| Estimates and<br>Fit Statistics               | Standardized<br>Estimate | Critical<br>Ratios | R <sup>2</sup> |
|---|--------------------------|--------------------|----------------|
| <b><u>Model Parameters:</u></b>               |                          |                    |                |
| Environment Uncertainty → Product Improvement | -.098 <sup>ns</sup>      | -1.10              |                |
| Firm Size → Product Improvement               | .016 <sup>ns</sup>       | 0.47               |                |
| Innovation → Product Improvement              | .226                     | 5.34               |                |
| Internationalization → Product Improvement    | .205                     | 4.16               | .21            |
| Environment Uncertainty → Process Improvement | -.170 <sup>ns</sup>      | -1.86              |                |
| Firm Size → Process Improvement               | .044 <sup>ns</sup>       | 1.25               |                |
| Innovation → Process Improvement              | .209                     | 4.76               |                |
| Internationalization → Process Improvement    | .131                     | 2.57               | .16            |
| Environment Uncertainty → Growth              | .592                     | 5.30               |                |
| Internationalization → Growth                 | .161                     | 2.50               |                |
| Product Improvement → Growth                  | .313                     | 3.57               |                |
| Process Improvement → Growth                  | .127 <sup>ns</sup>       | 1.50               | .24            |
| Growth → Returns                              | .509                     | 7.83               | .26            |
| <b><u>Goodness-of-Fit Statistics:</u></b>     |                          |                    |                |
| $\chi^2/df = 8.86$                            |                          |                    |                |
| RMSEA = 0.177                                 |                          |                    |                |
| ECVI = 0.883                                  |                          |                    |                |
| NFI = 0.96                                    |                          |                    |                |
| NNFI = 0.93                                   |                          |                    |                |
| CFI = 0.97                                    |                          |                    |                |

Note: All parameters are significant except for the impact of firm size, macro environment on product improvement and process improvement on returns; the R<sup>2</sup> for Returns is non-significant. R<sup>2</sup> indicates the proportion of variance accounted for each of the four endogenous constructs (product improvement, process improvement, growth and returns)

# **THE IMPACT OF ENTREPRENEURSHIP UPON TOWNSHIP, VILLAGE ENTERPRISES OF THE PEOPLE'S REPUBLIC OF CHINA**

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## **ABSTRACT**

The purposes of this paper are: (1) to show the development of Township, Village Enterprises (TVEs) in China; and (2) to discuss the possible impact of entrepreneurship on TVEs. The paper has several sections which discuss: (1) a brief introduction of the TVEs' history, development and position in the national economy; (2) the rationale behind TVEs' rapid growth despite the ambiguous ownership structure and seemingly insufficient incentives; (3) the ambiguous ownership structure and the involvement of community governance as the appropriate responses to an unfavorable economic environment during the transition from a command economy to a market economy; (4) the cultivation of entrepreneurship in an unfavorable environment; (5) the emergence and development of entrepreneurs in China; and (6) the impacts of entrepreneurship upon TVEs.

## **INTRODUCTION**

Many people are amazed by the dramatic change in Communist China during the past 25 years. Yet not many understand the locomotive of the national economy: Township, Village Enterprises (TVEs). From the early 1980s to mid 1990s, the rapid development of TVEs in rural China has caught the attention of the entire world. In less than two decades, TVEs have grown from a stepchild of the national economy into a giant adult which contributes more than one third of the total national industrial output. By 1998, there were more than 20 million TVEs nationwide, with a total employment population of 125 million, compared with 12 million TVEs and a total employment of 75 million in 1985 (see Table 1). Their contribution was tremendous, especially

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Place Table 1 About Here

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during a period while most State-Owned Enterprises (SOEs) stagnated and the population was dislocated by reform.

The rapid growth of TVEs is fascinating; yet it can hardly be explained by existent economic theories. Unlike SOEs and private enterprises, TVEs have ambiguous ownership. Therefore, they may seem to lack a strong stimulant towards entrepreneurship. However, the ambiguous ownership and the involvement of community governance are appropriate responses to an imperfect economic and political environment in China. Given the unique political and cultural contexts, the incentives are strong enough to cultivate entrepreneurship, but the culture may also cast a negative impact on entrepreneurship. In general, two types of managers are more likely to transform into modern entrepreneurs: cadres who have service records at various levels of government and have been appointed to managerial positions, and people with experience of long-time apprenticeship in the commune-brigade enterprises in Mao Tse-tung's era. As reforms

deepen, entrepreneurs face great challenges in terms of human capital and enterprise management knowledge and skills. Hence, appropriate training and development become most important.

Despite the growth of TVEs during the early 1980s and mid 1990s, their development has slowed down after the mid 1990s. This can be attributed to the general economic slowdown, unfavorable external environment (Southeastern Asian Financial Crisis) and sluggish exports at the same time. With the development of a market-oriented economy, the costs of ambiguous ownership and community governance have gradually offset the benefits, and the advantages of TVEs over other types of organization have diminished. TVEs face two choices: either privatization or stock-ownership by employees. In either choice, TVEs are non-national enterprises. Will TVEs become *standardized* (more like Western enterprises) or *characterized* (maintain Chinese characteristics)?

### **TRENDS IN THE GROWTH OF TOWNSHIP, VILLAGE ENTERPRISES**

After the mid 1990s, TVE development has slowed down, with deteriorating enterprise performance and diminishing contribution to national economy. According to Fewsmith (2001), the annual growth rate of TVEs has dropped from an average of 42 per cent during the Eighth Five-Year Plan period (1991-1995) to about 17 per cent in the latter part of the Ninth Five-Year Plan period (1997, 1998, and 1999). These decreases have occurred primarily due to the negative effects of ambiguous ownership structure and community governance which began to offset the benefits as the deepening reforms and the strengthening of the market economy occurred.

Given the fact that the uniqueness of TVEs (ambiguous ownership and community governance) is an appropriate response to an imperfect economic environment, it is reasonable to regard TVEs as expedient during transitional period, rather than a perfect organizational type. As the Communist Party becomes more positive about the market economy, the effects of cultural factors diminish and the ideal-typical versions of enterprises become more appropriate in China. The management styles of TVEs must be changed, or TVEs will become history. In fact, several changes concerning TVEs have emerged since the mid 1990s: privatization and joint-stock co-operatives, both of which are based on well-defined property rights.

#### **Privatizing TVEs**

The rapid privatization occurred during the mid 1990s, with variance in different regions. TVEs are sold to individuals and become private firms. TVE managers, who have rich experience and broad networks, are more likely to take over the new private enterprises. Academics have different explanations for the striking trend of privatization in rural China. One holds that the trend is due to poor performance of TVEs and a shift in government policy. Peng (1998) argued that there was nothing fundamentally wrong with the rural industrial sector and the recent slump in performance might be mostly as a result of the economy-wide recession. Looking back to the development of rural enterprises, TVEs are rather flexible in an imperfect economic and political context and have a tendency to adapt to newly emerging changes in the economic environment.

Privatization occurs when agent costs outweigh the benefits from ambiguous ownership and community governance. The recent wave of privatization is just an extension of the evolutionary process that has seen continual improvement in the property rights bestowed on the manager since the early reform. As privatization becomes more widespread and adjustment costs are sunk, there is no reason to believe that this new private sector cannot lead rural China in another drive to rapid growth (Li & Rozelle, 1998).

First, the central government gradually recognized the contribution of private firms, and thus granted more favorable policies and regulations. The government realized that private firms had become a dynamic enterprise type and an indispensable part of market economy. Due to well-defined ownership and straight-forward incentive system, private firms are more flexible, nimble, and always set on the pulse of the market. Moreover, private firms create a huge number of jobs for urban laid-off workers as well as for rural saturated laborers. Second, a changing attitude of banks accompanied by favorable government policies also accelerated the privatization of TVEs. In 1994, nearly all bank managers favored lending to collective firms. By 1997, only 14 percent favored collective firms while 58 percent favored private firms (Park & Shen, 2002). It is partly due to fierce competition and diminishing profit margin of TVEs. Park (2000) argued that poor TVE performance had led to a collapse in confidence in the ability of whole townships and villages to remain solvent. Third, Gabriel (1999) discussed a trend among the TVEs towards the “individualization of ownership”: ownership shares are increasingly being distributed from the local governments to firm management due to a keen interest in expanding their authority over TVEs by managers. From managers’ perspectives, privatization would provide stronger incentives to focus on creating share owner value and improve business performance. Fourth, with increasing exposure to the outside world, especially after the entry into WTO, the costs of community governance have become increasingly significant. On one hand, foreign companies are attracted by the TVEs’ low labor and land costs and eager to establish cooperative relationships. On the other hand, foreign companies hesitate when taking ambiguous ownership and community governance into consideration. In other words, they do not want to work with companies that have much interference and distraction from outside.

Although massive privatization of TVEs has become a striking trend in recent years, it also has brought negative effects. Undoubtedly, unambiguous ownership should improve managerial incentives, and should come with increasing productivity and profitability. However, such ownership reform does not happen in a vacuum. Effective private sector development requires supporting financial, legal, and government institutions. If appropriate reforms in these supporting institutions are not implemented, private firms may struggle (Park, 2000).

### **Joint-Stock Cooperatives**

Meanwhile, there is another trend of TVEs in rural China. According to Sun, Gu and McIntyre (1999), many of the existing TVEs themselves have changed their legal form during the 1990s, becoming joint-stock co-operatives. Under this form, shares of TVEs are sold or distributed to TVE employees and managers or community residents in the form of both “collective shares” (one-person-one-vote) and conventional individual shares (one-share-one-vote) (Che & Qian, 1998). In this way, ownership becomes straight-forward. Owners can influence the enterprise operation by stock transaction. Once the property rights and control are well-defined, owners usually become more responsive to incentives. Che and Qian (1998) also discussed the partial

privatization of TVEs, mainly in the form of sales of control rights to managers and employees or to foreign investors. The two main features of this change from community collective ownership to joint stock ownership are: quantifying employees and community's equity stakes; and reallocating control rights to the board of directors from the local government (Chang, McCall, & Wang, 2000). Although community government still plays a role after partial privatization of TVEs, its role primarily focuses on investment in infrastructure and public works. Under joint-stock cooperatives form, there is a mixture of local government ownership and employee share ownership. It is a type in between TVEs' community governance and complete privatization, revealing the fact that main Chinese institutional innovation is much like a multi-member partnership. If privatization of TVEs is an adaptation for the increasingly market-oriented economy, joint-stock cooperatives are more like a Chinese characteristic experiment to set up a socialist enterprise type, rather than a pure capitalist one.

### **DEVELOPMENT OF TOWNSHIP-VILLAGE ENTERPRISES IN CHINA**

Despite the fact that TVEs have become privatized or joint-stocked, they were contributive to national economy, especially to rural economy. In rural China, farmers had been depending upon agriculture for thousands of years. It was not uncommon to end up with nothing at the end of the crop year because of bad weather. To avoid merely relying on agriculture and to diversify risks, many farmers set up small-scale family businesses, which formed traditional industry in rural China. In the early 1950s, the central government put the management of rural industrial firms on its agenda, and tried to guide rural development. During the *Great Leap Forward* era in 1958, the communes established many small industrial enterprises. None of them lasted very long, but they turned out to be valuable in terms of experience involving community governance in enterprise management.

During the national agricultural mechanization drive of the early 1970s, rural small-scale industrial enterprises rapidly started to re-emerge (Modderman, Gorter, Dalhuisen, and Nijkamp, 2001). Due to the low wage rates and land costs, many SOEs gradually subcontracted or outsourced operations to small industrial enterprises in nearby rural areas. Such community enterprises were then known as so-called commune and brigade enterprises (CBEs), the predecessors of TVEs and eventually changed their names to TVEs with the termination of the commune system in 1984. The central government adopted a few favorable policies and regulations towards TVEs so that they could improve in terms of economic scale, management, specialization, and cooperation. In many provinces (similar to states in the U.S.), TVEs contributed to one-third, or even one-half of their industrial output.

A TVE is neither a state-owned, cooperative, nor a private enterprise. A TVE is small-medium-sized enterprise owned by all the residents living in a rural community. Theoretically, only the rural residents can claim ownership. Thus, they make the final major decisions, such as appointing managers and allocating revenues and profits. Such collective ownership is so vague that it is inefficient in the real business world. If everyone has ownership, no one can really claim it. Therefore, various levels of local government, township and village government in particular, execute the control of the enterprise on behalf of rural residents.

At the township (formerly the Commune) level, community government not only takes charge of routine administrative duties, but also supervises the running of TVEs. The township government is not necessarily in charge of daily operations. The government appoints a manager to manage the enterprise. Similarly, the village (formerly the Brigade) enterprise is controlled by the village government, but run by the manager. Hence, a TVE is more like an economic co-operative in which rural residents, community governments, and managers are involved. Although community government does not have the real ownership of a TVE, it takes an active part by offering not only the necessary infrastructure, but also its financial support, given its close relationship with rural banks.

The period between the early 1980s and the mid 1990s was a golden era. TVEs enjoyed a rapid growth and gradually replaced the dominant position of SOEs in certain industries. In terms of the total number, TVEs achieved their apogee in 1993, with a total of 34.53 million enterprises. Although the number decreased thereafter, the population of employees, the revenues and profits, as well as assets have increased steadily, indicating that the development of TVEs were becoming more quality-oriented. TVEs are still the dominant component of the rural industrial sector (Yep Kin-man, 2001).

The reasons for the rapid growth of TVEs vary. First, the growth occurred during the second stage of reform, and thus benefited from the fruits of first-stage reform. The Chinese reform is significant, yet it is rather a step-by-step transformation, so that the later reforms can borrow both successful and failure experience from the previous ones. Understanding that agriculture is the foundation of national economy, the central government decided to start the reform within that sector. By the time TVEs began to develop, the agricultural sector was able to provide sufficient resources, including foods, materials, and surplus labor. In fact, TVEs did not start from scratch. Second, TVEs had competitive advantages over other types of enterprises, given their unique economic and political environment. Thanks to community governance, it was easier for TVEs to get loans from local banks or governments. Compared with TVEs, private firms did not have such access because they had neither collateral nor close relationship/network (guanxi) with banks. Therefore, an absence of funding has never become a serious bottleneck to TVEs as to most private firms. Third, limited access to financial services pushed TVEs to maintain a closer look at their financial situation and adopt harder budget constraints. Unlike SOEs, TVEs' access to financial services was limited due to the relatively weak influence of community governments on banking systems. Hence, TVEs were more cautious in enterprise management to make sure that they stay solvent and continue to get funding from banks. Last, Stern (2001) pointed out that TVEs seek social support from state enterprises. Many families received income or other forms of social benefits from SOEs, which provided a sense of security and encouraged risk-taking activities.

Throughout the 1980s and the early 1990s, the employment gap between country and urban areas was partially offset by the growth of TVEs. This not only increased rural incomes, but also absorbed over 100 million workers who were transferred out of agricultural labor (Fewsmith, 2001). However, the growth of TVEs apparently slowed down after the mid-1990s: the number of TVEs decreased, their performance deteriorated, and the ability to absorb surplus labor was reduced. The explanations for such a trend vary. Fewsmith (2001) noted that the TVE sector has entered a new phase of development; where intensive growth has begun to replace extensive

growth. Such a trend may partly be due to the general unfavorable economic environment. Woo (2001) argued that the slowdown of TVE growth perhaps is the result of a general economic slowdown since 1994. At the mid-1990s, the growth rate has slowed down with the concomitant slowdown of the national economy. Since then, the economy has been experiencing deflation. Moreover, the external environment deteriorated with the explosion of the Southeastern Asian Financial Crisis. Since most TVEs have been export-oriented, the crisis inevitably cast negative impacts on their production and sales. Another explanation is that massive privatization of TVE sector occurred at the same time, which significantly decreased the number of TVEs as well as employment. As private entrepreneurs have taken over, they have no doubt felt freer to lay off excessive or unproductive workers and not to take on new staff (Park, 2000). As the Chinese market matured with economic reforms, the disadvantages of community governance became more obvious. TVEs may be replaced by different types of organization.

### **RATIONALE BEHIND TOWNSHIP-VILLAGE ENTERPRISES' RAPID GROWTH**

This section discusses the rationale behind the rapid TVE development during the reform era. The rapid growth of TVEs is most fascinating, yet it can hardly be explained by existent Western economic theories. Theoretically, well-defined property rights are absolutely essential to the well-functioning of enterprise in that it is directly related to incentives. According to Weitzman and Xu (1994), the Chinese model, with a central role being played by TVEs as the major form of non-State enterprises, is much more successful than any actual applications of the standard property rights model, where the existence of well-defined private property rights seems an absolutely essential precondition to the proper functioning of a market economy. There are two interesting paradoxes in rapid TVE development: ambiguous ownership versus rapid growth, and community governance vs. management.

#### **Ownership Structure**

What makes vaguely defined TVEs outperform such well-defined counterparts as SOEs and private firms? It is partly due to a unique ownership structure. It is mentioned above that the ownership of TVEs lies in local residents, but in fact, the township, village governments represent the nominal owners to control the enterprises. Moreover, with explicit rules specified by the center regarding profit distribution, residual benefits of the TVEs are shared between the local citizens and the township, village governments (Chang & Wang, 1994).

The ambiguity in ownership reveals a balance between maintaining the present political system and providing economic incentives. The reform that China has been undertaking is gradual, with many debates and suspicions of the central government and academics about the application of market economy to the country. Therefore, the dominant position of public-owned enterprises could not be changed radically during the transitional era. TVEs happened to act as a successful model of public-owned enterprise type, especially when SOEs suffered from stagnation. TVE is not quasi-governmental, yet it is not private. In general, TVE is still a collectively-owned enterprise type, with a group of local residents as property owners. In addition, part of TVE profits go to infrastructure and benefits local residents, indicating a superiority to private firms.

Yet, assigning the control rights to local residents is inefficient. It is more difficult for individuals to get government support or bank loans, which are of critical importance to TVE operations. Due to the fact that township, village governments are more accessible to bank loans, getting them involved in operation and allocating part of residual benefits provide strong incentives to exert positive influence on TVEs. Of course, the number of TVE owners in a given TVE is much smaller than the number of owners in SOEs so that TVE owners can be directly involved in operations. Hence, a sense of commitment provides them with strong incentives to make sure TVE is running well.

Although township, village governments have more resources to operate TVEs, control rights cannot be assigned to them. First, it is against the public-owned philosophy of the government. If township, village governments own TVEs, their roles move to business from governance. In this case, economic incentives are so strong that township, village governments may retain more profits and ignore their commitment to the central government: tax revenue demands. Local residents lose their ownership and rights to claim for residual benefits, and thereby lose incentives to safeguard the well-being of TVEs.

In a perfect market environment, well-defined ownership is the foundation of a well-functioning enterprise. Li (1996) claims that the immature market environment in China makes ambiguous property rights often more efficient than unambiguously defined private property rights. Compared with private firms, TVEs are more accessible to credit from banks and capital markets. In the meantime, TVEs are relatively immune to excessive and irregular charges placed by local governments. Given the dual roles of community government in governance and business, it is efficient to get township, village government involved in TVE operations.

### **Community Governance**

Involving community government in enterprise operations is certainly shown as Chinese Characteristics in transitional economies. It is the rationale behind balancing the costs and benefits of community governance under unique cultural and economic contexts. Given the imperfect market environment during transitional era, community governance is rational in terms of joint liability lending. Until recently bank loans to TVEs exhibited the key features of joint liability leading, which facilitated the provision of formal credit to finance the rapid expansion of TVEs (Park & Shen, 2002).

In rural China, local residents are not sufficiently well off to collateralize loans and it is very difficult to get funding from outside organizations. Under a joint liability lending system, all people involved hold responsibility of repaying bank loans. Since township, village governments control the enterprise and share residual benefits; they could use their own assets as collateral or equity to seek funding from local banks. In addition, community governments provide loan guarantees and assume final responsibility of repaying loans. Meanwhile, banks give more credit to community governments because governments have more resources and lower default risks.

Joint liability lending relies on local information and the monitoring and sanctioning abilities of borrowers to overcome problems of adverse selection, moral hazards, and strategic defaults that

frequently plague bank lending when collateral is absent (Park & Shen, 2002). Given the fact that Chinese culture emphasized collective interests, financial institutions have more solid trusts in community governments than individual rural residents. Additionally, township, village governments have control over many TVEs within its territory. Even if one TVE fails to repay bank loans, it is always possible for community governments to arrange for other TVEs to pay back money. In this way, community governments are able to maintain a clean record and a good reputation. Moreover, the relationship between government officials and bank managers are somehow intertwined. It is possible for local leaders to exert political influence on bankers. The effect of “one good turn deserves another” is not uncommon in Chinese society. By offering bank loans to TVEs, government officials owe bank managers big favors (renqing), and try to pay these favors back in other ways. That explains why the total rural lending by state financial institutions to TVEs increased steadily during the rapid growth of TVEs even though the nominal owners lacked collateral and credits.

Township, village governments that share residual benefits and take charge of allocating profits have vested interests in TVEs. Under such circumstances, community government is not likely to bother TVEs with excessive and irregular charges, which are common and harmful to individuals and private firms in rural China. Over interference and imposition are more likely to incur when interests of government and individuals diversify or clash. Again, it has partly resulted from government’s dual roles in business and governance, which is one of the Chinese characteristics during transitional era. Through community governance, the interests of rural residents and those of community governments are somehow aligned, avoiding direct interest conflicts. In this sense, community governance can be interpreted as a rational adjustment to an imperfect economic and political environment.

Another benefit of community governance is hard budget constraints due to limited influence of township, village governments on local banks. Limited access to bank loans provide financial support to TVE operations which restrains TVEs from unnecessary spending and bad business decisions. If the access to funding is all good for enterprise management, it is hard to explain the stagnating performance of SOEs. Compared with SOEs, TVEs have harder budget constraints, which lead to better business performance.

Both TVEs and SOEs are government-controlled; the difference is that the former are controlled by community governments, whereas the latter are controlled by the central government. SOEs suffer from a soft budget constraint problem (Kornai, 1980). Banks are not independent entities making decisions on lending to SOEs because both banks and SOEs are controlled by the central government. If the government considers it necessary to refinance SOEs, banks can do nothing but make loans, regardless of profitability. In most cases, the central government makes decisions in refinancing SOEs not only from an economic perspective, but also from political and social perspectives. Perotti, Sun, and Zou (1999) pointed out that SOEs may not have performed so badly if their broad social contributions other than reported profits are also taken into account. Unlike their counterparts in foreign countries, SOEs in China have too many political hues. Once SOEs go bankrupt, laid-off employees lose their “iron rice bowls” (tiefanwan), and thereafter lose their sense of security and trust in socialism. Because the society cannot create sufficient jobs to absorb unemployed and the social security system is not developed, a large population dislocated by reform may put social and political stability in

jeopardy. Even if the SOEs are losing money, the central government continues pouring money into the SOES, for fear of a large population of unemployed and social instability.

Soft budget constraints do not happen to TVE because community governments have no controls over local banks. This separation of control over enterprises and banks may allow banks to refuse refinancing when the benefits of refinancing are small (Dewatripont & Maskin, 1995). Although community government does have some influence over bank managers, such influence is so limited that it does not ensure unconditional financial support. In other words, refinancing by local banks is virtually based on the ability to repay loans, rather than the liability to provide financial services. Without assurance of continual funding, TVEs tend to be more cautious in business decisions and enterprise management.

In summary, the major benefits of community governance come from two aspects: fund raising and hard budget constraints. Che and Qian (1998) pointed out that the community government's basic features help TVEs reduce State predation, raise capital in an imperfect capital market, and cause harder budget constraints for TVEs than for SOEs.

## **ENTREPRENEURSHIP IN TRANSITIONAL CHINA**

Township, village governments control TVEs on behalf of rural residents, yet they are not necessarily involved in daily operations. Instead, community governments execute control by appointing (renming) managers to TVEs and letting them run the enterprises through contracts.

### **TVE Managers as Entrepreneurs**

As the agents take charge of enterprise management, TVE managers must be nominated by community governments and approved by the township, village Economic and Trade Commission. Generally, two types of people are more likely to be appointed as TVE managers: those who have service records at various levels of governments, and those who have rich experience of long-time apprenticeships in commune-brigade enterprises in Mao Tse-tung's era. There are several ways of obtaining managerial positions in TVEs, including internal promotion, contract, or administrative transfer. For those who have been serving in community governments for a long time, it is more likely to be a transfer from an administrative position to a managerial position. This kind of appointment is based on mutual contact and solid trust. In contrast, for those who have long-time experience in business, they are more likely to achieve managerial posts by winning contracts or internal promotion. Due to long-time service and thorough understanding of the enterprises, TVE managers arise from an internal contact, usually with the recommendation of outgoing or retiring managers. It is not uncommon that a TVE has several candidate managers available, and the one with the highest vote in an election always secures the position. In addition, achieving managerial posts through contracts is another option: people who are interested bid for the contracts, and those who make the best bid beat the competitors and sign the contracts. In this case, previous service records in business, rich management knowledge, as well as a willingness to take risks are of critical importance in winning the contracts. People who have previous work experience in communes, brigade enterprises, such as purchasing staffs, accountants, sales clerks, have competitive edges in bidding for the contracts because they have accumulated a great deal of experience and

established broad relationship networks. By putting the enterprises in their leadership, TVEs are more likely to flourish.

There is something in common about TVE managers: most of them were not highly educated, but they have acquired management knowledge and skills in a unique economic environment. Due to the fact that TVE managers lack higher education and formal training, their ways of enterprise management are based on business instinct and their experience. In addition, sensitive political sense and thorough understanding of market environments are essential to business management.

### **Distinct Incentives for Entrepreneurs**

Appointed by community governments, TVE managers manage daily operation on behalf of the governments. Their daily routine includes setting manufacturing objectives, allocating resources, hiring labors, boosting morale in workplace, dealing with upstream and downstream suppliers, as well as evaluating business performance. In other words, TVE managers have multiple roles in a rural enterprise: accounting, marketing, engineering, human resources, and decision makers.

However, managing daily operations does not entitle TVE managers to the title of “entrepreneurs”. Entrepreneurs should be more than managers: the latter is like a steward of the business, whereas the former is an innovator, bringing fresh air to the TVEs and transforming entrepreneurial talents into marvelous ideas, critical strategies, and eventually large market shares and handsome profits. As Schumpeter (1943) argued, the function of entrepreneur is to reform or revolutionize the pattern of production by exploiting an invention or, more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way, by opening up a new source of supply of materials or a new outlet for products, by reorganizing an industry and so on. According to Western economic theories, entrepreneurship is closely related to private ownership and strong incentive mechanism. In Western market economies, most entrepreneurs own the entire enterprise or part of the enterprises; and thus, the risks and benefits are very straight-forward. When the owners of the business make bad decisions, their property or assets shrink, or they may even go bankrupt. Even if they are only hired to run the business by the real owners, they lose salaries and stock options by making bad decisions. A loss of the companies indicates that the managers have to leave with a severance package. Such overwhelming benefits and risks seem to be foreign to TVE managers; however, there is a set of distinct motivational mechanism in rural enterprises.

For TVE managers, there is a broader definition of incentive mechanisms given the unique economic and cultural environment in China. Brus and Laski (1989) pointed out that the adoption of various forms of performance-related remuneration methods in collective enterprises in the post-Mao period have strengthened the linkage between personal losses by the manager and business failure. First, like their counterparts in foreign countries, TVE managers’ financial well-being has been closely related to the business performance of the enterprises, which is always made explicit in contracts. Under the contract responsibility system, TVE managers sign contracts (hetong) with community governments, setting business goals and various performance-related remuneration methods. In most cases, TVE managers secure minimum wages. Bottom-line wages are meager compared with handsome bonuses if the enterprise

performance is good. TVE managers receive monthly wages, and by the end of business cycle, they get bonuses according to the enterprise performance as well as the fulfillment of original business goals. TVE managers always strive for the maximum bonus: the minimum wages make them only slightly different from common laborers; but handsome bonuses help them achieve comfortable lives.

In rural China, the implications of managerial failure go beyond the loss of tangible capital (Yep Kin-man, 2001). A sense of loss and humiliation can be as important as financial loss, if not more so. Situations can always be worse in township, village communities where people know one another and have close communication. In Chinese culture, people tend to make judgments primarily based on success. It is revealed by a famous Chinese saying that those who win are somebody (wanghou), while those who lose are nobody (zei). People tend to look down upon a “loser”, regardless of the reasons for losing. Once you lose, you lose forever. If the enterprise performance is not as good as expected, the manager gets fired and becomes a “gossip” topic for the local people. Behind-the-back talks always go beyond the talents and capabilities of TVE managers; they can go as far as to the character and the integrity of the human being.

In China, it is always more comfortable and beneficial to be government officials than business managers in that the latter have a sense of insecurity. It is not uncommon that government officials are appointed to other posts (sometimes even higher up the political ladder) even if they have failed in previous positions. Relationships with higher-ranking officials are more important than administrative positions and service records. This does not apply to rural business world. Poor business performance not only terminates one’s business life, but also closes the door to the political world. Looking back to ancient Chinese culture, there was a tendency to emphasize politics while slighting business. It is still true in modern China in that politicians can exert influence on businessmen, but it does not always work the other way around. Therefore, the ultimate goal of many TVE managers is to pursue political positions at various levels of government. At least, they may obtain honorable positions in local or higher-level congress. In this case, a sense of humiliation and a loss of business and political future can be more detrimental to TVE managers than financial loss.

Similarly, good enterprise performance rewards TVE managers in various ways, including a sense of fulfillment, promotion by community government, a climb up the political ladder, and nominal positions at various levels of Congress

### **The Influence of Chinese Culture on Entrepreneurship**

The Chinese culture (Confucian) plays an important role in the motivational mechanism in organizations. The question whether the Chinese culture is conducive to the cultivation and flourishing of entrepreneurship has long been an interesting topic for both Chinese and Western academics. According to Kirby and Fan (1995), some entrepreneurial attributes---a positive response to change, initiative, and profit-orientation---appeared to be in conflict with Chinese values. For thousands of years, Chinese have been deeply influenced by Confucian values, which emphasize ideology and human relationships despise profit-seeking behaviors. People who have high rankings in government are seldom poor, and those who achieve business success strive for penetration to the political world. It is true that some entrepreneurial attributes are

foreign to Chinese values though; political incentives mentioned above may have a few offsetting effects: it encourages and promotes innovation, creativity, and flexibility. Traditional Chinese culture seems to be only partially conducive to entrepreneurship; however, the newly modified culture is more favorable. With accelerating reform and increased openness to the outside world, Chinese values keep changing. Nowadays, pursuing business interests is no longer shameful as long as it is done in appropriate ways. Successful entrepreneurs are viewed as role models by people of every walk of life, and they are awarded with various political titles. In this way, the barriers to business decrease since entrepreneurs have various sources through which to complain or report. It is expected that Chinese entrepreneurs will make haste in pursuing their goals and make use of their talents in a more favorable economic environment fraught with business opportunities.

### **THE IMPACTS OF ENTREPRENEURSHIP ON TVEs**

TVE managers were not the same as real entrepreneurs since they were involved in the contract system and did not own the businesses, yet they demonstrated some entrepreneurial characteristics. They decided the product line, sought their own sources of funding, bore risks, reacted to price and cost to maximize profits, and reaped the benefits. This flexibility stands in stark contrast to the constrained and unimaginative behavior of SOE managers. TVEs can be seen as the beginnings of modern Chinese Entrepreneurship. (Liao & Sohmen, 2001)

Given the distinct motivational mechanism resulting from a unique cultural environment, entrepreneurship can be cultivated and flourish in China. Chinese entrepreneurs share something in common with their foreign counterparts, yet they have some entrepreneurial characteristics that are labeled “Made in China”. Such entrepreneurial characteristics may cast significant impacts on the development of TVEs.

First, political sense is always critically important to business performance. Due to a long history of human-governance, China lacks legal institutions, especially in rural areas where people have relatively less exposure to outside world. The fact that China is at least partly ruled by a group of elites increases the instability and unpredictability, which is unfavorable to business operations. Though China is transforming to market-oriented economy and a country ruled by law, it takes time to change the current imperfect economic and political environment. Hence, entrepreneurs still need to seek support from and establish harmonious relationships with government officials.

Second, business acumen is another oft-quoted characteristic universal to successful entrepreneurship (Liao & Sohmen, 2001). Despite the fact that most TVE entrepreneurs were not highly educated, they are still enormously successful in operating the enterprises. Their success depends on empirical experience accumulated by long-time service in previous commune-brigade enterprises and thorough understandings of economic and political climate, instead of formal education and trainings. Business acumen has offset the small amount of formal education of TVE managers and contributed tremendously to the development of TVEs. As the market economy becomes mature and Chinese enterprises operate as Western enterprises, lack of education and knowledge of managers will de-accelerate the growth of TVEs.

Third, Chinese entrepreneurs establish broad relationships networks with government officials, bank managers, and technical staffs in higher institutions. TVE managers clearly understand that successful performance relies on policy protection from various levels of government, financial services of local banks, and technical support from academic and research institutions. Therefore, TVE managers make friends with those people to seek support. In this sense, Chinese entrepreneurs have the characteristics of being flexible, sensitive, and respect for knowledge, which contribute to the well-being of TVEs.

Fourth, Liao and Sohmen (2001) have held that most Chinese entrepreneurs tend to emphasize short-term profits and opportunism. Such tendency is revealed by a lack of long-term strategies and clear market positions, and it is not good for the well-being of enterprises in the long run. Being opportunistic is an appropriate response to an unpredictable and imperfect economic environment. Due to community governance, TVE entrepreneurs do not have full control of the enterprises, and thereby are being restricted in large decisions. Planning for long-run strategies when things often go beyond their control is difficult. Clear market positions are hard to set and valuable customers are hard to target, because manufacturing can always be changed. It is not uncommon that TVEs are in A industry today, while switching to B industry tomorrow. To squeeze cash cows is more important than to make strategic plans. In addition, there is always pressure from community government, which expects revenues from TVE. It takes a long time for long-term strategies to take effect, and TVE entrepreneurs may miss the chance to claim the credits. Making short-term profits is directly related to financial rewards and promotions. Being nimble and opportunistic is a unique characteristic of entrepreneurship in China; it is expediency to the unstable political and economic environment. An absence of strategic plan is harmful to the long-term well-being of TVEs.

## CONCLUSION

The rapid growth and economic success of TVEs during the early 1980s and mid-1990s are remarkable, despite the fact that TVEs, as an enterprise type, seem to have disadvantageous structural and behavioral features. It is better to explain TVE success from an institutional perspective, rather than the aspect of economic entity. Ambiguous ownership and community governance have turned out to be appropriate responses to an imperfect economic environment during transitional era. With the acceleration of market economy and deepening of reforms, agent costs gradually outweigh the benefits of community governance, and ambiguous property rights have become a hurdle to TVE development. Hence, community governance is only an expediency to an imperfect market environment, and it does not deny the benefits of well-defined ownership.

The slowing down of TVE development since the mid-1990s makes people re-think ownership issues and consider changes in the legal form of TVEs. One way is privatization, which is close to the Western enterprise type. The other one is joint-stock cooperatives, a mixture of employee and local government ownership, in which employees and rural residents become more involved and the role of community government diminishes. It is more like a Chinese characteristic experiment to test a socialist enterprise type within a market-oriented context. With rapid privatization, China is moving rapidly to an economy that will be dominated by the private sector, with collective ownership representing an important, but clearly transitional phase (Park,

2000). It will be interesting to see whether TVEs will become more Western standardized or continue to carry on a Chinese characteristic during the continuing reform.

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**TABLE 1. Township, Village Enterprises, 1990-1998**

| <b>Characteristics</b>                  | <b>Year</b> |       |        |        |        |        |        |        |        |
|---|-------------|-------|--------|--------|--------|--------|--------|--------|--------|
|   | 1990        | 1991  | 1992   | 1993   | 1994   | 1995   | 1996   | 1997   | 1998   |
| No. of TVEs (million)                   | 18.73       | 19.09 | 20.92  | 34.53  | 24.95  | 22.03  | 23.36  | 20.15  | 20.04  |
| No. of laborers<br>(million)            | 92.65       | 96.09 | 106.25 | 112.76 | 120.17 | 128.61 | 135.08 | 130.50 | 125.37 |
| Value added of TVEs<br>(RMB billions)*  | 250.4       | 297.2 | 448.5  | 800.7  | 1092.8 | 1459.5 | 1765.9 | 2074   | 2218.6 |
| Income of TVEs<br>(RMB billions)        | 728.4       | 902.7 | 1343.4 | 2443.4 | 3721.5 | 5729.9 | 6834.3 | 8182.7 | 8935.4 |
| Profit of TVEs<br>(RMB billions)        | 60.8        | 72.7  | 107.9  | 196.6  | 257.2  | 369.7  | 435.1  | 486.5  | 511.2  |
| Taxes paid by TVEs<br>(RMB billions)    | 34.4        | 41.9  | 60.5   | 105.8  | 159.3  | 205.9  | 236.6  | 254.1  | 286.7  |
| Fixed assets of TVEs<br>(RMB billions)  | 268.2       | 318.8 | 408.4  | 643.9  | 886.8  | 1284.1 | 1605   | 1942.7 | 2156.6 |
| Liquid assets of TVEs<br>(RMB billions) | 226.5       | 292.8 | 539    | 809.6  | 1056.6 | 1449.3 | 1698.9 | 1696.7 | 2070.6 |

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\* RMB is the initial of the Chinese Currency Ren Min Bi  
\$1 was equal to approximate 8 RMB in 1998

# **FUTURE PROSPECTS FOR ENTREPRENEURSHIP IN AZERBAIJAN**

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## **ABSTRACT**

This study attempts: (1) to show the trends on SMEs and toward entrepreneurship in Azerbaijan; (2) to determine the major challenges and solutions for the development of SMEs and entrepreneurship in the country; and (3) to discuss future prospects for entrepreneurship. The national economy is dominated by the petroleum industry. SMEs that have been developed are generally related to that industry. There are other SMEs in manufacturing, transportation, construction, and retail trade. Since 1992, new laws and regulations have been helpful in developing SMEs. The history and development of the petroleum industry has had a significant impact upon new SMEs. New SMEs are being developed outside of this relationship to the industry. To strengthen these new SMEs, encouraging legislation needs to be passed in efficiency and effectiveness and entrepreneurial ethics, strengthening entrepreneurial public organizations, providing information on the development of entrepreneurs, conceptualizing family businesses, and strengthening SME service centers.

## **INTRODUCTION**

During recent years, Azerbaijan has been implementing economic reforms that have boosted the development of entrepreneurship and that have strengthened the role of businesses in improving living conditions of population. However, entrepreneurship has not yet become a decisive factor in producing quality output in the country, development of competitive production and ensuring employment opportunities for the people.

The purposes of this paper are: (1) to show the entrepreneurship trends in Azerbaijan; (2) to determine the major challenges for entrepreneurship in Azerbaijan; and (3) to discuss the future prospects for entrepreneurship in Azerbaijan. Several sections discuss: (1) a brief introduction of the entrepreneurship history, development and position in the national economy; (2) entrepreneurship in the oil industry; (3) the challenges which entrepreneurs have in Azerbaijan and the possible solutions on the way which to protect the entrepreneurs.

## **SMALL AND MEDIUM ENTERPRISES IN AZERBAIJAN**

A strong market economy is impossible without a dynamic private sector, which is a major force for internal investment, technological change and economic growth. Azerbaijan is no exception. The more that there are internal funds available --- especially the fast-growing earnings from oil and gas exports --- the more the support for the energy sector will be reduced. Promotion of the private sector should strengthen the economy through targeting support for small and medium size enterprises (SMEs) and create new market economy structures.

The definition of SMEs in Azerbaijan depends upon the sector of economy in which this enterprise exists. The form of enterprise is determined by the number of the employees (see

Table 1).

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Table 1 about here

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The main measures of promotion for SMEs are the following:

1. SMEs may apply for tax credit through the National Fund for Small Enterprise Support.
2. SMEs are exempt from paying tax in the construction industry, reconstruction and updating of capital assets, utilizing new technology, educating and training human resources.

SMEs are exempt from paying tax during their first two years of operation in the fields of food processing, manufacturing household goods, construction materials, and small innovative enterprises.

The number of operating small enterprises by segments is illustrated by the primary direction of development of the whole economy (see Table 2). This table shows the strong increase of industrial enterprises after 1998.

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Table 2 about here

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The major pieces of legislation affecting the development of the SME sector are:

1. Law No. 405 on Entrepreneurial Activities, December 15, 1992.
2. Presidential Decree No. 269 on the National Fund for Support of Entrepreneurship, October 12, 1992.
3. State Policy Concerning the Development of Entrepreneurship and the State Program for the Development of Entrepreneurship in the Azerbaijan Republic for the years 1993-1995, adopted on January 26, 1993.
4. Presidential Decree on Urgent Measures for the Development of Small Businesses, June 20, 1993.
5. Law No. 847 on Enterprises, July 1, 1994.
6. Law No. 858 on Bankruptcy of Enterprises, July 22, 1994.
7. Law No. 931 on Leasing, November 29, 1994 and Law No. 952 on Investment Activities, January 13, 1995.
8. Project on Program of State Support for SMEs in the Azerbaijan Republic for the period 1996-1998.
9. Presidential Decree No. 610 on State Support Program for Small and Medium Entrepreneurship for the Period of 1997-2000, June 24, 1997

Private SMEs are innovative and flexible in the face of changing market requirements. They could help guarantee a balanced economic structure in Azerbaijan. However, the establishment of a broad corporate structure is impeded by high taxes and corruption as well as deficits in the legal system. The government has taken initial steps to improve overall institutional and legal conditions, including the introduction of a new insolvency law. The transformation of the tax legal system and the absence of practical applications render the process difficult. The majority

of the companies have their home in Baku. Frequently smaller commercial enterprises get involved in production.

In many countries, there are significant differences between small business and entrepreneurship. “Entrepreneurship is the creation of new organization that introduces a new product, serves or creates a new market, or utilizes a new technology regardless of whether that new organization is created independent of (entrepreneurship) or within (intrapreneurship) a corporate structure” (Wortman, 2005). In Azerbaijan, it is difficult to find differences between entrepreneurs and small businesses.

Yet, insufficient capitalization and liquidity problems as well as weak financial markets considerably restrict their ability to expand and diversify. For the most part, the banks limit their activities to granting short-term trade finance. Overall, lack of credit is a key constraint to the development of private business in Azerbaijan. The existing credit supply is far too small to provide a suitable environment for the development of even small enterprises in Azerbaijan, let alone medium-sized ones. Many enterprises have no access to affordable credit given collateral requirements and short payment terms. Long term trade and project finance are rare. Outside of donor-backed credit lines, there is essentially no bank credit exceeding 12-18 months. The existing donor-backed finance facilities, while helpful, simply are not large enough to accommodate the needs. The relative volatility of the Caucasus region, combined with the under-capitalization of Azeri banking sector, puts a further squeeze on availability and terms of trade and project finance. Azeri banks offer difficult lending terms, usually 15-25 percent interest in dollar-denominated loans with a maximum two year term. Many Azeri firms simply cannot afford such loans and turn to private sources for finance. Some Azeri banks have begun lending in the nascent private sector, including constructions, telecoms, and food processing and packaging.

## FINANCIAL SECTOR IN THE COUNTRY

Western businesses use a handful of local banks for their local business dealings. The International Bank of Azerbaijan (IBA), the healthiest majority state-owned bank, Unibank, an upstart private commercial bank, the Turkish Kocbank and Azerigasbank are more among the more popular. HSBC, the British Bank of the Middle East, a widely used bank for exports and by the Azeri community was downsized in Summer, 2002 but it closed its doors in Spring, 2003. Of the four state-owned banks, only IBA is a fully functioning commercial bank. The other three are technically bankrupt and currently going through a restructuring program. Consequently they are unable to lend money. The IBA is currently a candidate for privatization. The Azeri government has selected a financial consultant to assess the value of the bank’s assets and to advise them regarding all investments proposals received. EBRD is expected to take 20 percent of the available shares in this bank. Local private banks exist, but they account for about 15 percent of deposits in the commercial banking sector, which is dominated by the state-owned IBA. Several smaller Azeri private banks--- most notably Unibank, Arkobank, and Most Bank---are making good progress toward becoming viable, market oriented financial institutions (Country Commercial Guide Azerbaijan, 2004).

Therefore, building an efficient financial sector is a key to successful transition process. Very

few private banks are attempting to broaden the spectrum of their activities to cover the field of SMEs' finance. Owing to insufficient knowledge about assessment and monitoring small-scale loans, to a lack of funds to build this field of business and to the possible risks involved, the banks have been hesitant to move out of their target group.

To succeed in transforming itself into a stable, market-oriented nation, Azerbaijan, with the support of the international community, is focusing on developing SMEs.

## THE IMPACT OF THE PETROLEUM INDUSTRY

In the early 1990's, there was a collapse of Azerbaijan's economy as the result of political instability and a war with Armenia. Although the gradual return of political stability and a ceasefire with Armenia ended the general economic decline in 1995, the journey towards a strong market economy has been a long one for Azerbaijan. With every year of deadlock, the risk of a resumption of war has been growing, with its implications. As the result of aggression by the Republic of Armenia against the Republic of Azerbaijan, during the period 1988-1994, more than 10,563 sq. miles (approximately 20 percent of the territory) were occupied. Serious material damage has been inflicted, currently estimated at \$22 billion dollars. The number of internally displaced persons (IDP) from the occupied Azerbaijani lands and refugees from Armenia reached about 1 million people. In a country of 8.3 million people, this represents the highest per capita number of IDP in the world. (ATAA, 2005) This unsolved conflict is still the largest challenge not just for the growing SMEs, but also for the whole economy.

Azerbaijan has been linked with oil for centuries, even for millennia. Medieval travelers to the region remarked on its abundant supply of oil, noting that this resource was an integral part of daily life there. By the 19th century, Azerbaijan was by far the frontrunner in the world's oil and gas industry. In 1846---more than a decade before the Americans made their famous discovery of oil in Pennsylvania---Azerbaijan drilled its first oil well in Bibi-Heybat. By the beginning of the 20th century, Azerbaijan was producing more than one-half of the world's supply of oil.

The last century saw sharp rises and falls in Azerbaijan's economy. The oil boom at the start of the century transformed Baku into the `Black Gold Capital` of the world with a thriving market economy and buoyant entrepreneurship. In the 1920's, the Soviet regime introduced an inefficient centrally-planned economy. Oil production peaked at about 500,000 barrels per day (bbl/d) during World War II and then fell significantly after the 1950's as the Soviet Union redirected its resources elsewhere.

Azerbaijan has 1.2 billion barrels of proven oil reserves, as well as enormous possible reserves in undeveloped offshore Caspian fields. Over 80 percent of Azerbaijan's oil production currently comes from offshore, with a significant percentage coming from the shallow-water section of the Gunashli field, located 100 km off the Azeri coast.

## AZERI OIL COMPANIES AND SUBSIDIARIES

The State Oil Company of the Azerbaijan Republic (SOCAR) was established in September, 1992 with the merger of Azerbaijan's two state oil companies, Azerineft and Azneftkimiya.

SOCAR and its many subsidiaries are responsible for the production of oil and natural gas in Azerbaijan, for operation of the country's two refineries, for running the country's pipeline system, and for managing the country's oil and natural gas imports and exports. While government ministries handle exploration and production agreements with foreign companies, SOCAR is a party to all of the international consortia which develop new oil and gas projects in Azerbaijan. The company (not including subsidiaries) employs 70,000 people. In January, 2003, President Aliyev issued a decree calling for the reorganization of SOCAR. Under its new charter, SOCAR now owns the oil it produces. Previously, SOCAR relinquished ownership when the oil had been sent to processing facilities. The restructuring also involved transferring some of the non-oil-producing businesses to the Ministry for Economic Development. In June, 2004, reports indicated that SOCAR might change into a joint-stock company within the next three to four years. The European Bank for Reconstruction and Development (EBRD) and the U.S. Trade and Development Agency will underwrite this transformation.

Development of new fields through joint ventures and Production Sharing Agreements (PSA) in the Caspian Sea likely will boost Azerbaijan's oil production well beyond its earlier peak, with predictions that Azerbaijani oil exports could exceed 1 million bbl/d by 2010, and 2 million bbl/d within 20 years.

These huge oil contracts are all PSAs. The PSA are based on one common concept: they provide for the exploration and development of selected oil fields and allow for the sharing of the proceeds by the participants. Each PSA must be approved separately by the Azerbaijan Parliament. Parties to the PSA are consortia of international oil companies headquartered in many different countries, notably the United States, the United Kingdom, Turkey, Saudi Arabia, Norway, Japan, and Russia. They are always partnered with the Azerbaijan State Oil Company.

Over 21 PSAs have been signed in Azerbaijan alone between the state oil company SOCAR and various major oil companies. The biggest contract is named "Century Contract" and provided by Azerbaijan International Operating Company (AIOC), which is a consortium of 11 major international oil companies and SOCAR. According to this contract, the consortium is developing the Azeri, Chirag and deep-water portion of Gunashli fields in the Azerbaijan sector of the Caspian Sea. Their 30-year PSA was signed on September 20, 1994. The contract area has estimated reserves of more than 4 billion barrels of oil.

Azeri crude oil is refined domestically at two refineries: the Azerineftyag (Baku) refinery, with a capacity of 160,000 bbl/d; and the Azerneftyanajag (New Baku) refinery, which has a capacity of 202,830 bbl/d, with domestic production averaging about 328,000 bbl/d in 2003. With one-half of that exported as crude oil, Azerbaijan's refineries have been running well below capacity. Overall refinery utilization rates are as low as 40 percent. Heating oil accounts for roughly one-half of the output at Azeri refineries, followed by diesel fuel, gasoline, motor oil, kerosene, and other products. The U.S. Trade and Development Agency is financing a \$600,000 feasibility study to be conducted by ABB Lummus for upgrading the two refineries and the specialized oil port of Dubendi.

Currently, Azerbaijan's only export pipelines are the Baku-Novorossiysk pipeline ("northern route"), which sends Azeri (and exclusively SOCAR) oil to the Russian Black Sea, and the Baku-

Supsa pipeline ("western route"), which mainly carries AIOC's "early oil" from ACG to Georgia's Black Sea coast. The Baku-Novorossiysk pipeline closed briefly in late June, 2004 after oil thieves set off an explosion when they attempted to steal oil from the pipeline. Azerbaijan's options for increasing its oil exports depend to a large extent on the construction of new pipelines. Several oil export pipelines from the Caspian Sea region are under consideration, but Azerbaijan has not wavered in its support for the Baku-Tbilisi- Ceyhan (BTC) pipeline currently being constructed. This so-called "Main Export Pipeline" would export Azeri (and possibly Kazakhstan ) oil along a 1,040-mile route from Baku via Georgia to the Turkish Mediterranean port of Ceyhan. Such a pipeline would allow oil to bypass the increasingly crowded Bosphorus Straits. Construction of the 1-million-bbl/d pipeline, which is estimated to cost \$2.9 billion, is scheduled to be completed in early 2005, with oil to begin flowing in the summer of 2005.

Azerbaijan has proven natural gas reserves of roughly 30 trillion cubic feet (Tcf), and a potential for even larger reserves. However, because there is insufficient infrastructure to deliver the country's natural gas from offshore fields, natural gas has been flared off instead of being piped to markets. Azerbaijan's major natural gas production increases in the future are expected to come from the development of the Shah Deniz offshore natural gas and condensate field. Industry analysts estimate that Shah Deniz is one of the world's largest natural gas field discoveries of the last 20 years and contains "potential recoverable resources" of roughly 14 Tcf of natural gas. According to the project's operator, BP. Natural gas from Shah Deniz, as well as associated gas from ACG and the Bakhar-2 project, is expected to make Azerbaijan self-sufficient in natural gas as well as to generate significant export revenues.

#### DEVELOPMENT POTENTIAL OF OIL RESERVES

The State Oil Fund of the Republic of Azerbaijan (SOFAZ) has been established in accordance with the Decree of the President of the Republic of Azerbaijan in 1999. It is a mechanism whereby energy-related windfalls will be accumulated and efficiently managed. In so doing, the government is demonstrating its over-riding desire and determination to avoid the inherent risks for any nation in the midst of an oil and gas boom to spend excessively and create macroeconomic distortions. The State Oil Fund of the Republic of Azerbaijan has as its main objective the professional management of oil and gas related revenue for the benefit of the country and its future generations.

Earning from oil and natural gas exports are basically opening up good perspectives for development for the country of Azerbaijan. However, they are associated with the risk of one-sided focus of the economy, which would jeopardize the development of sectors outside of the oil industry. Azerbaijan is now at a crossroads. It needs to decide whether its quickly rising earnings from oil sale are to be used for broad-scale economic development or whether they will flow into pockets of only a handful of people who control that development. By establishing the oil fund---as recommended by the donor community---the government signaled that it is striving for structural change and the diversification of the economy that such change will bring about.

Business support centers (BSC), incubators and techno-parks all try to provide new SMEs with the resources necessary to improve their chances to success. Different entities emphasize

different mixes of space, training, capital, human and computer networking, and consulting. Several definitions have been proposed, but definitions have to be flexible to fit current usage. To cover all of these various entities, the term “Local Business Assistance Centers” (LBAC) has been suggested. Generally business support centers emphasize soft resources such as training, while techno-parks emphasize physical resources such as space. The best business incubators try to provide most resources for small business’ survival and growth. While techno-parks often focus on space and business support centers on consulting, but incubators identify the bottlenecks and try to overcome them. Depending on the environment, the bottleneck could be space, training, access to capital or markets, and infrastructure such as computer networks and many others (Hubner, 2001).

Business incubators in Azerbaijan are organizations, creating favorable environment for start up companies. Incubators offer space for start-ups and provide the necessary managerial, legislative and accounting backup. The government is trying to develop its own infrastructure policy in order to create a favorable environment. There is also a great need for more liberal legislation concerning taxation and investments policies. The first objective for Azerbaijan is the development of SMEs sector.

The business environment of an incubator consists of two crucial factors: the immediate environment near the incubator and a more general business environment in the region and the country. When selecting a site for the incubator, there are a number of success factors that need to be taken into account. Many local business centers focus on particular economic sectors, often naturally based on the resources and skills available in region concerned. Azerbaijan integration to the European Structures is a very important issue. One of the principal goals of Azerbaijan is to shift investors’ attention toward non oil sector of the economy and to develop franchising and cooperation of SMEs with transnational corporations.

The Enterprise Center in Baku is a very good example of supporting local business in Azerbaijan. This Center is a major new undertaking aimed at helping Azerbaijan-owned based companies develop their business to support oil and gas industry. The Center, opened in May, 2002, helps to build local supply capability, promote international standards and increase opportunities for local business. Specific services offered include: information on industry standards for health, safety and environment, as well as contracting and procurement processes; consultancy and business advice; and business skills training. The Center also maintains a register of local suppliers. Primarily oriented toward local SMEs, the center is intended to bring together national and international companies to increase mutual awareness of capabilities and needs. This facility has been established by foreign oil companies to increase business opportunities for local industry. Offering training, support and advice to small and medium-sized enterprises (SMEs), it reached its 2002 goal of expanding the commercial involvement of local companies in the projects by 25 per cent. Even more ambitious targets have been set for 2003.

## THEMATIC DEVELOPMENT OF OIL RESOURCES

Six themes were identified as critical to the peaceful development of Azerbaijan in the context of the exploitation of its oil reserves according to Killik(1998): (1) supporting the development of local business in order to diversify the economy; (2) meeting the needs of internally displaced

people and refugees; (3) strengthening civil society; (4) establishing democratic reforms and development; (5) stabilizing regional politics; and (6) strengthening oil industry co-operation;

The most progressive theme to date is business diversification. A new multi-sectoral body has been established to manage the evolving program---the Business Development Alliance (BDA) - with the Steering Committee comprised of British Petroleum (BP), Citizen's Democracy Corps, Azerbaijan Entrepreneur's Confederation, the Eurasia Foundation, and the American Chamber of Commerce.

Given the diversity of themes, some probably would progress faster than others. The most progressive is the work on supporting business diversification through the body known as Business Development Alliance (BDA). The rationale for the BDA is that if Azerbaijan is to reap the full social and economic benefits of its oil and gas wealth, it will need to invest heavily in strengthening and broadening its economic base.

The BDA is not a traditional business or trade organization; it is a network of international and local companies and business associations, government, international and local NGOs and international development agencies. The founding principles of the group are that partnership and co-ordination are the most effective means to achieving the goal of local business development. The objectives of BDA are: promote the growth of Azeri private sector; provide a unique multi-sectoral forum for information sharing, consultation and advise on issues related to private sector development in Azerbaijan; enhance co-ordination and coherence amongst different economic development initiatives (government, multilaterals, private companies, international NGOs, donors, IFIs, etc.); identify gaps in and obstacles to economic development in Azerbaijan and develop strategies and recommendations to address them; define and recommend policy and legislative changes that will enhance private sector growth; collectively and through individual members, implement initiatives drawing upon members' core competencies and constituencies; provide a comprehensive information resources for the local and international business on investment opportunities, potential business alliance partners, financing, capacity building services/programs available, etc.

The BDA is an entirely voluntary organization. In order to develop, expand and sustain its work, the BDA will establish a permanent Secretariat and set up an office within a local Enterprise Center supported by BP and its partners. To date, the BDA has established five Working groups focused on issues that are identified as joint priority and that match the expertise and capacity of its current members, namely: supplier database, training, oil industry needs assessment, policy development, credit and finance.

The SMEs in the oil industry in Azerbaijan have some specific characteristics. The registration of SMEs in Azerbaijan still has some bureaucratic challenges. Still, the companies lack access to broad information about the situation in the market and other significant financial data. In other words, information exchange is yet to be developed.

Licensing presents obstacles for some firms in Azerbaijan. However, a September, 2002 Presidential decree, "Activities Requiring Special Permission (Licenses)," reduced the number of activities subject to licensing from 270 to 30 with the term of all licenses increased to five years.

While this step has been welcomed by the business community, as of August,2004,it remains unclear as to what practical, day-to-day effect this decree will have on business.

As this industry needs large investments, the majority of SMEs are doing research or supporting the PSA. The main aim is to help local companies develop their business in support of major oil and gas developments in Azerbaijan. A centralized and simplified official registration system for legal entities would be the most effective way of addressing the problem. A few initial steps have been taken in this direction, including the launching of a state programme for SMEs, which aims to simplify registration and licensing procedures for SMEs and ensure protection of their rights.

## CONCLUSIONS

In addition to reducing bureaucratic roadblocks to the development of SMEs in Azerbaijan, there are a number of potential solutions which could be implemented such as:

1. Carry out control on efficiency of adopted legislations and other normative-legal acts.
2. Conduct explanatory studies relative to business-ethics among entrepreneurs in order to improve entrepreneurs' image.
3. Strengthen public control by attraction of entrepreneurs' public organizations in order to ensure clarity of the processes related to the entrepreneurial development
4. Improve the role of entrepreneurs' public organizations in organizing new SMEs.
5. Provide the entrepreneurs with information in all aspects of business activities--- through all basics of business,
6. Establish timely, complete information on entrepreneurship development in the Republic from entrepreneurs themselves;
7. Encourage the concept of family members in spin-offs;
8. Organize and provide management assistance from local and international small business development centers;

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## APPENDIX I

National Confederation of the Entrepreneurs (Employers') Organizations of Azerbaijan Republic (AEC) was established and officially registered according to the legislation of Azerbaijan Republic in Baku on March 5, 1999. AEC being a union of employers in Azerbaijan is non-commercial, non-government, self-managing organization coordinating activities of the juridical and physical persons dealing with the entrepreneurial activity not-dependent on their property and organization-legal form (excluding state-financed organizations) on voluntary basis, protecting their legal and economic rights, having public-effective objectives and considering not to get profit as the basic principle of its activity. The Confederation collaborates with BESO - British Executive Services Overseas (Great Britain), NMCP- Netherlands Management and Cooperation Program, EU TACIS - MTP (Managers Training Program), OACIS ASSN, UNDP, TACIS SME and other international programs. It has concluded cooperation agreements with its partners operating in more than 20 foreign countries. AEC is the member of International Industrialists and Entrepreneurs Congress, Azerbaijan-British Trade Industrial Council. Confederation works closely with the embassies of USA, Great Britain, Germany, France, Iran, Turkey, Egypt and Israel, international organizations, such as UNDP, CDC and participates in their various meetings. The governing and executive bodies of Confederation are as follows: General Assembly, Board of Directors, Presidium, Auditing Committee, the President of Confederation is the Chairman of Board of Directors and Presidium. The executive structure of Confederation is the Directorate. The Secretary General manages the Directorate. The Confederation has its representatives in 20 regions of Azerbaijan Republic. The modern conference-hall, training classes, business meeting rooms and library are always used by the members.

AEC renders the following services to its members:

- to analyze the activity of entrepreneurship enterprises and invite foreign experts through the international programs to assist in fund-raising;
- to assist in search of partners abroad;
- to organize business trips to foreign countries;
- to organize trainings covering various spheres of entrepreneurship, computer and language courses;
- to send the representatives abroad to promote entrepreneurial unions in the framework of the international program;
- to advise regarding the legal matters, legislative and other normative-legal documents;
- to provide review regarding the juridical examination of the documents and their correspondence to the current legislation;
- to assist in composing of statements, appeals, petitions and other juridical documents;
- to examine of the documents and their correspondence to the current legislation;
- to assist in composing of statements, appeals, petitions and other juridical documents;
- to clarify and advise regulation of the relations in Commercial and Labor legislation;
- to offer modern conference-hall, business-meeting rooms in the center of the city for various meetings;
- to render consulting services;

Table 1. Definition of SMS in Azerbaijan

|                           |                              |                              |                                  |   |
|---------------------------|------------------------------|------------------------------|----------------------------------|---|
| Small-sized enterprises:  | < 50 employees in industry   | < 15 employees in transport  | < 25 employees in construction   | < 10 employees in retail trade and servicing  |
| Medium-sized enterprises: | 51-250 employees in industry | 16-75 employees in transport | 26-150 employees in construction | 11-50 employees in retail trade and servicing |

Source: UN-ECE Operational Activities, Network of SME National Focal Points, 1998.

Table 2. Number of operating small enterprises by branches of economy, units

|  | 1997  | 1998  | 1999  | 2000  | 2001  | 2002  | 2003  |
|--|-------|-------|-------|-------|-------|-------|-------|
| Agriculture, hunting and forestry  | 1799  | 1217  | 1761  | 1402  | 1345  | 1753  | 1488  |
| Industry   | 1696  | 1460  | 1518  | 1414  | 1486  | 1809  | 1960  |
| Construction   | 940   | 1068  | 792   | 724   | 897   | 971   | 1129  |
| Wholesale and retail trade; repair of motor vehicles, motorcycles and personal household goods | 8313  | 8476  | 7105  | 11062 | 14224 | 13215 | 10351 |
| Rendering of services by hotels and restaurants  | 310   | 378   | 433   | 892   | 724   | 881   | 577   |
| Transport, storage and communication   | 200   | 277   | 206   | 279   | 338   | 396   | 386   |
| Real estate activities, lease and rendering of services to consumers                           | 1883  | 2459  | 6074  | 6743  | 2614  | 1859  | 1751  |
| Education  | 44    | 65    | 29    | 65    | 68    | 78    | 90    |
| Health and rendering of social services  | 71    | 90    | 140   | 168   | 126   | 143   | 171   |
| Other branches   | 771   | 1014  | 1005  | 1505  | 3299  | 3616  | 3275  |
| Total  | 16027 | 16504 | 19063 | 24254 | 25121 | 24721 | 21178 |

Source: The State Statistical Committee of Azerbaijan Republic, 2004.

# THE DETERMINANTS OF ENTREPRENEURSHIP DEVELOPMENT IN CHINA

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## **Abstract**

While studies of entrepreneurship development in China continue to debate on whether China as a socialism ruled country is compatible with an entrepreneurial environment, the economic prosperity in China's private sector and the Chinese government's serial policies to protect private property and ownership have made the pursuit of an entrepreneurial environment irresistible. Existing studies of entrepreneurship development in China, unfortunately, are inadequate to measure the breadth and scale of entrepreneurial activity and performance in China in an orderly and systematic way that enables benchmarking with other nations.

The purposes of this paper are, therefore, to provide an analytical framework so as to better define and measure entrepreneurship and to apply it in the context of China. The following questions are addressed from both a policy and scholarly perspective: 1) How and why has entrepreneurship developed in China? 2) What is the likely role of the Chinese government in the facilitation of entrepreneurial development? 3) What are the barriers that might impede the steps of China toward a more entrepreneurial society?

## Introduction

Although the investigation of entrepreneurship is not new in China, current studies seem to be trapped in a debate of compatibility between the country's market-oriented innovation strength and legacies from a central-planned economy (Crug, 2000; Crug and Hendrischke, 2001, 2002). On the other hand, gradual deregulation policies in the private sector and continuous economic growth during the past two decades have taken the edge off the debate because facts and data have demonstrated that an entrepreneurial environment has been established and is rapidly evolving (Global Entrepreneurship Monitor, GEM, 2003). Thus, potential conflicts in the study of entrepreneurship do not lie in whether it could be entrepreneurial or not, but in how it can be more entrepreneurial.

The purpose of this paper is to examine the development of entrepreneurship in China and the factors that have had a major impact on this development during the period 1979-2003. Three questions are important. First, how did entrepreneurship develop in China? This entails an examination of entrepreneurship in the past and the development that has led to its status today. Second, what are the factors that have impacted entrepreneurial activity in China? A distinction is made between demand and supply factors in responding to this question. Third, what is the contribution of government policy, institutions and culture to the evolution of entrepreneurship? To answer these questions and to contribute to the understanding of entrepreneurship as an economic action under particular social and cultural conditions, this paper begins with a short review of relevant literature. In part 2, mostly informed by the *Eclectic Theory of Entrepreneurship* (Verheul, Wennekers, Audretsch & Thurik, 2002), we investigate entrepreneurship in China. From a static perspective the state of entrepreneurship in China in 2003 is described and discussed, whereas from a dynamic perspective developments in

entrepreneurship between 1978 and 2003 are examined. Various demand and supply determinants of entrepreneurship in China are analyzed in part 3 while in part 4 and section 5 we examine the influence of government policy and culture on entrepreneurship in China, respectively. An empirically based conclusion is provided after the comparison of the different factors that influence the entrepreneurship development in China

## 1. Relevant Literatures

Approached from different theoretical perspectives, different analytical models have been constructed to describe, explain and predict entrepreneurial behavior (Kilby, 1971). Broadly speaking, studies of entrepreneurship tend to be carried out at one of three analytical levels: 1) societal, focusing on macroeconomic or cultural-institutional conditions; 2) structural, focusing on social relation factors; and 3) individual or organizational, focusing on psychological and behavioral factors.

At the societal level, *the mainstream economic* approach treats entrepreneurship as an outcome rather than a cause of social change, claiming that when commodity, capital and labor markets are developed, individuals, as rational actors, will follow market signals and take advantage of new opportunities. As put vividly by Schultz (1964, p.5), “once there are investment opportunities and efficient incentives, farmers will turn sand into gold”.

Instead of the simple explanation relying on the profit incentive, *institutional economists* trace favorable social and economic conditions for entrepreneurship to the institutional arrangement that provides incentives for entrepreneurial activities (Coase 1988; North 1981). While the provision of physical facilities is necessary to carry out routine market transactions, “an intricate system of rules and regulations would normally be needed” in order to reduce transaction costs and to increase the volume of trade (Coase 1988, p.9). With respect to completing the neoclassic

interpretation, North emphasized that “institutions are a set of rules, compliance procedures, and moral and ethical behavioral norms designed to constrain the behavior of individuals in the interests of maximizing the wealth or utility of principles”

Making significant modifications to mainstream economic analysis, the institutional school has been confronting a debate over the relative importance of formal vs. informal social rules, that is whether there is a linear relationship between the degree of institutionalization and the level of entrepreneurial opportunities. Demonstrated by Li (1997), entrepreneurship incentives, especially in a mixed economy, do not necessarily come solely or even primarily, from the market. The opportunity structure undergoes dramatic changes which pull and push different social groups to engage in entrepreneurial activities during different stages of institutionalization (Róna-Tas, 1994). Certain highly profitable opportunities such as brokering between the state and the market sectors only exist during the transition period, and certain types of entrepreneurs rise only in a mixed economy during transition to capitalize on their social and political resources. Knowing this, when the level of institutionalization is measured in terms of the amount of regulations codified rather than their effective implementation and wide observation, the correlation between institutionalization and entrepreneurial behavior becomes arbitrary and cloudy.

Another approach at the societal level is *the cultural approach*. Scholars in this orientation focus on how certain cultural scripts motivate entrepreneurship. Weber ([1930], 1991) suggested that the Calvinist doctrines about salvation through hard work provided a necessary motivation for industrial activities, which led to the development of early capitalism. His pioneering study has inspired a persistent search for cultural factors, or functional alternatives to Protestantism, in other societies to account for capitalist development. One of them is Berger’s argument that

“there can be no capitalist development without an entrepreneurial class; no entrepreneurial class without a moral charter; no moral charter without religious premises” (Berger 1991, p.12)

The soar of economic growth performance in East Asia during the late 20<sup>th</sup> century has aroused a great enthusiasm in Oriental culture, especially the Confucianism. The Confucian ethic of hard work, deference, and group-orientedness has been identified as a determinant of the dazzling economic success in East Asia, particularly among ethnic Chinese groups (Hamilton, 1991; Basu, 1991; Harrell 1985, 1987; Redding, 1991). Regarding these cultural arguments, their weakness is exposed when people point out that they are ahistorical and unable to account for the fact that the Confucian ideology has existed for thousands of years but did not spur much capitalist activity until the last few decades. As the cultural premise advocates have rightly acknowledged, the effect of culture is never independent of concrete social structures (Berger, 1991, p. 19). Without embedding the cultural effect in a spatially and temporally limited social group and specifying the mediating structure, a cultural explanation of entrepreneurship might sometimes seem inconsistent and *ad hoc* in the sense that the Western and Confucian cultural orientations have fundamentally different emphases, yet both are used to account for entrepreneurial activities. In other words, a mono-causal cultural approach without incorporating social structural and institutional factors is handicapped in predicting entrepreneurial motivations and behavior. After all of the above, we could see that the macro-level approach, economic or cultural, provides some necessary bases for understanding the importance of environment for business activity- why entrepreneurship is more developed in certain areas and among certain social groups. Although this approach has limited explanatory power in accounting for varying degrees of entrepreneurship within relatively homogeneous populations, why some people choose the business avenue while others within the same population or culture do not remains a question?

Our concentration in this paper and its limited space do not permit us to give integrated and comprehensive reviews of entrepreneurship studies at the individual level, which include the familiar and influential theories from Schumpeter (1936), Kirzner (1973) and McClelland's concept of *n* Achievement (need for Achievement) (McClelland, 1971) and other more contemporary orientations.

*An Eclectic Theory of Entrepreneurship: Policies, Institutions and Culture* (Verheul, Wennekers, Audretsch & Thurik, 2002) provided one of the recent outstanding entrepreneurship works which created a combined analytical framework for comparing the level of entrepreneurship across nations. Because there is no generally accepted definition of entrepreneurship (OECD, 1998; Van Praag, 1999; Lumpkin and Dess, 1996), measurement and comparison of the level of entrepreneurship for different time periods and countries is complicated by the absence of a universally agreed upon set of indicators (OECD, 1998). In this **Eclectic Theory** framework, the authors try to incorporate different disciplinary approaches (mainstream economics, institutional economics and cultural studies), levels of analysis (societal, structural and individual), a distinction between the demand (carrying capacity of the market) and supply (labor market perspective) side and a distinction between actual and 'equilibrium' level (a long-term equilibrium rate determined by the state of economic development, i.e., technology, market structure) of entrepreneurship. What is more encouraging, such a frame work has been successfully applied to cross-national research including U.S. and several European countries, which has proved to be substantially fruitful compared to the background of Western Capitalist countries (Audretsch, et al, 2002a).

On the other hand, the fall of the Berlin Wall made clear, the centrally planned eastern economies, built around economic concentration and the exploitation of scale economies, failed and ultimately disappeared. This fact has sent out an urgent call for the renaissance of entrepreneurial spirit and activity in the so-called 'transitional economies' which consequently demands continuous monitoring and study of entrepreneurship development in the former socialist nations.

China, unlike the Eastern European former socialist states which in many cases had adopted a "shock therapy" approach to the market and democratic principles, has been successfully implementing a gradual reform since 1978. The distinctive attribute of the Chinese reform exists in its abandonment of bureaucratic coordination of the economy through a process of gradually "growing out of the plan" and reaching the goal of a full-fledged market economy (Naughton 1995, pp.7-13), yet simultaneously preserving vestiges of the socialist political and ideological system. This unique character is very helpful when people try to understand the asymmetric development between the prosperous, exploding private sector and a lag in similar interest in the study of entrepreneurship in China. Largely due to the fact that it is a communist ideology, which creates tremendous uncertainty for entrepreneurial behavior, and the complexity of defining "private firms", most Chinese scholarship on entrepreneurship remains at the descriptive level. It is easy to conclude that in the absence of an efficient theoretical framework and representative data, descriptions based on limited cases and personal anecdotes are far from accurate.

Supported by some exceptional research on China's entrepreneurial environment (Li, 1997; GEM, 2003) and Chinese government's serial policies to protect private property and ownership, this paper advocates introducing sorely needed knowledge about entrepreneurial dynamics in China and a framework for examining the evolution of the entrepreneurial environment over the

last twenty years. In other words, instead of tangling with the debate on whether gradual reform in China is compatible with an entrepreneurial economy, we accept it as an irresistible trend and lay groundwork for future research.

## **2. Determinants of Entrepreneurship in China**

### **2.1 State and Development of Entrepreneurship in China**

Different indicators can be used to measure the degree of entrepreneurial activity (Wennekers and Thurik, 1999). The number of private businesses and their share in the national economy has been widely taken as equivalent of the entrepreneurial intensity in China because entrepreneurs together with their business, employees and the output are categorized as 'private economy' in Chinese official statistical material (Li, 1997).

More than ten years ago in 1994, industry and commerce (including wholesale, retail and restaurant sectors) respectively constituted 41% and 9% of the nation's GDP and they were the two sectors that had witnessed phenomenal expansion of private-owned businesses. As the fastest growing sector in China, private-owned industry grew at an average annual rate of almost 140% from 1979 to 1994, its share in the national industrial output increasing from zero to 12% (China State Statistical Bureau, CSSB, 1995). Meanwhile in the service sector, particularly in retail and restaurant establishments, Chinese entrepreneurs have already replaced their state owned counterparts that had dominated before 1994 (CSSB, 1992).

Today, comparatively longer time series data may enhance confidence about the current state of entrepreneurship in China (See Figure 1). While the private owned enterprises have proportioned more than 80% in total numbers of establishments since 1991, the contribution of private enterprises in output constantly increased to nearly 20% of total GDP by 1999, indicating the improvement of the private sector's competitiveness in China. Due to the variation of indicators

of the State Statistical Bureau, comparable data after 2000 are not available, but the issue of a series of legislative acts and government policies after 1999, seeking to foster the private economy, confirm about the continuity of this trend.

Figure1 about here

Using the performance of the private sector in the national economy as an indicator of the degree of entrepreneurial activity however does not permit a comparable research from a world wide perspective, especially when the comparison is among transitional countries and OECD countries. Such a deficiency can be partially addressed by another approach, the Total Entrepreneurial Activity (TEA) index. The TEA is a measure that identifies individuals that are active in either the start-up phase or the management of new businesses. It is developed as a prevalence rate, reflecting the number of individuals among all those 18-64 years old in the human population involved in start-ups or new initiatives (Global Entrepreneurship Monitor, GEM, 2003). The results of the 2003 assessment among 31 countries are presented in Figure 2, in which China appeared to be more entrepreneurial than the average (GEM, 2003). Year-to-year correlations are presented in Table 1 for four years of data on the aggregate TEA measure. The three year-by-year correlations: 0.81, 0.74, and 0.93 provide strong evidence for TEA as a relatively stable national characteristic.

Figure2 about here

Table1 about here

While the scholars can be particular about the rationality of TEA index, this paper tends to use it as an evidence, together with the performance of the private economy in China, in order to compare the deviation of China's entrepreneurship development track from that of other

countries. Observed by Carree, et al (2001), the development of entrepreneurship in most OECD countries can be characterized by a U-shape trend, with a decrease in entrepreneurship till the mid-eighties and an increase afterwards. However, entrepreneurship in China has been soaring since the beginning of its economic reform in the late 1970s (Li, 1997) and will likely carry this tendency into the near future. In the following parts, we discuss the logic of such a development and attempt to justify our prediction from a macro-level perspective.

## **2.2 Equilibrium Analysis of Entrepreneurship Determinants**

In this part of the paper, the determinants of entrepreneurship in China are examined, both from a static and a dynamic viewpoint and the current situation as well as development of the different variables influencing entrepreneurship in China are also considered. The explanation and analysis of entrepreneurial activity in China are based on the *Eclectic Theory* (Verheul et, al., 2002) due to its comprehensive theoretical approaches and its feasibility in cross-national comparison, which we have mentioned in part 1.

### **2.2.1 Demand Side Determinants**

Discrimination between demand and supply factors is customary when explaining the level of entrepreneurship (Blanchflower, 2000; Storey, 1994). The demand side stimulates entrepreneurial opportunities through market demand for goods and services. Meanwhile, the supply side provides potential entrepreneurs who can act upon the opportunities. A combination of factors including the stage of economic development, globalization and the stage of technological development may affect the demand for entrepreneurship via influencing the industrial structure and the diversity in market demand, and together ultimately lead to more profit (See Figure 3).

Figure 3 about here

### **2.2.1.1 Technology Development**

Based on the experience of the OECD countries, technological advancement often promoted the demand for entrepreneurship on two dimensions: First, contemporary technology developments, such as the application of information technology, seem to favor small-scale production through cheaper capital goods, a decreasing minimum efficiency scale and possibilities for flexible specialization (Piore and Sabel, 1984; Carlsson, 1989), which benefit small firms with more expectation and attention in the development and spread of innovations (OECD, 1996).

Moreover, the advances in information technology have created better access to information and communication devices that may facilitate small business ventures and thus enhance the competitiveness of established small businesses. As the costs of sending information across geographic space have been dramatically decreased (information can be transferred through email, fax machines, and cyberspace, and the availability of profitable information has also enlarged significantly (Audretsch and Thurik, 2000, 2001).

To obtain an impression of the level of technological development in China, the ‘innovation capacity index’, as developed by Porter and Stern (1999), can be used. In 2001, China was ranked No. 42 of all 75 countries on this index (Porter and Stern, 2000). In the recently released *Global Competitiveness Report 2004-2005* (World Economic Forum, WEF, 2004), China ranked 62<sup>nd</sup> among 104 countries with respect to the ‘Technology Index’.

Such continuing lagged performance in the innovation and technology areas given this horizontal comparison may induce Chinese people to compete more aggressively. Yet this is not an appropriate answer concerning the impact of technology on entrepreneurial activity from a historical perspective. The role of technology in the growth process differs by country, depending on the stage of development. It is widely understood that technological innovation is

relatively more important for growth in countries close to the technological frontier while the adoption of foreign technologies associated with foreign direct investment, or the technology transfer and dissemination in the domestic market will be relatively more important in a country such as China (WEF, 2004). The most striking feature that distinguishes direct investments through multinational companies from other forms of international capital flows – portfolio investment and foreign aid – is the long-lasting interest on the part of investing company in their subsidiaries abroad. This long-term interest provides not only for pure capital transfer but also for the transfer of product and process technology, know-how and marketing and managerial skills. According to the statistical data from the United Nations Conference on Trade and Development (UNCTAD), setting aside the special case of Luxembourg (owing to transshipping), China became the world's largest FDI recipient in 2003, overtaking the United States, traditionally the largest recipient, with inflows of \$53.5 billion and it has been in the leading position among all of the developing countries through the last decade (UNCTAD, 2004). The continuous huge inflow of Multinational companies (MNCs) not only created uncountable subcontracts for potential Chinese entrepreneurs in the supply chain, but also fostered a competitive market which forces domestic companies to learn from foreign companies about new product and process technology, marketing and organizational frameworks, as well as channels to new foreign markets. Such a healthy market environment is definitely crucial to entrepreneurship development in China.

What is more, the existence of an energetic external and internal technology market is also expected to expedite the diffusion of technology and produce more opportunities for ambitious entrepreneurs (see Figure 4 and Figure 5).

Figure 4 about here

Figure 5 about here

With a more and more active technology market and the uncertainty contained in the variation of profitable products, one could expect that more small business and new business will be set up by entrepreneurs in China so as to adapt to expanding market demand. Regarding this, entrepreneurship activities benefit from technological development both in China and in the OECD countries, although at different levels.

Additionally, due to the concern of constructing a powerful national innovation system and sustainable competitiveness in international markets, the Chinese government has fostered an ambitious high-technology business incubation program since 1987. By the year 2002, 436 technology business incubators (TBIs) had been established under this program. These incubators were created to provide physical support (room, office facilities, loans and innovation fund) and information networking for any technology specialist with a potentially profitable and manageable idea who was willing to start their business. Knowing the large numbers of TBIs in China that ranks second among all countries and the substantial 23,379 tenants being incubated there, it is reasonable to hold a comparatively optimistic view about China's technology driven entrepreneurial development in the future (Stough and Yu, 2004, forthcoming).

#### **2.2.1.2 Economic Development**

China's achievement in economic growth since the late 1970s used to be a common concern of economists and does not require more attention here. Our question is about the correlation between economic development and the improvement of entrepreneurial performance in China. The answer depends on the stage of economic development and on the intermediate factors through which economic growth exerts influence on entrepreneurship.

Several arguments have been offered supporting a conclusion that economic growth has a negative impact on the level of self-employment (Carree, et. al, 2001). Economic development is accompanied by an increase in wage levels and often by an improved social support system. Rising real wages raise the opportunity costs of self-employment and thus make wage employment more attractive (EIM/ENSR, 1996).

Figure 6 about here

Figure 7 about here

In contrast, as we have shown in Part 1 and Figure 6 and Figure 7, entrepreneurship development appears to be significantly positively related to economic growth in China (Li, 1997; Audretsch and Keilbach, 2003). There are several explanations for this. First, as the primary means of resource reallocation turns from the government's plan to market forces, the private sector and self-employed managers exhibit their entrepreneurial endowments and gain more profit from new market demand. Meanwhile, employees in the state owned enterprises experience a comparatively slow income increase, making self-employment a more preferable choice (Kornai 1992). Second, the surplus created by economic growth is considered to be very limited when it was distributed across China's huge population. The income per capita of China is only \$1,100, ranked No. 137 in the world and it is still a low income country (World Bank, 2004). Favorable living conditions and social security are not easy to acquire for those with average wage employment, especially for the large proportion of peasants in rural and also suburban areas with respect to the enlarging income disparity problems in China. Therefore self-employment activities may produce very limited opportunity cost but a relatively high expectation for profit. Moreover, a higher level of prosperity will tend to higher personal needs, as argued by Maslow. The higher need of self-realization is likely to be better fulfilled through self employment than

through routine organizations (Verheul et al., 2002). A market oriented economy evidently provides more options for people's career development than a bureaucratic centrally planned economy. Economic development accompanied by income increase per capita obviously decrease the barrier for potential entrepreneurs in China for obtaining their initial capital, thus making personal ambitions more reachable (Wang & Yao, 2002). The popularity of *Xia Hai*, a Chinese word indicating the phenomenon that more and more people choose to leave the bureaucratic system and start up one's own business strongly support this explanation (Li, 1997). Last but not the least, increasing prosperity gives people the means to buy more and greater differentiated goods. The increasing wealth and the demand of people for new goods then create incentives for business to fill these market niches. The demand for more varieties of products and services increases and small firms are well equipped to supply these new and specialized goods (Carlsson, 1989). Consequently, new firms in manufacturing and service sector in China are characterized by small firm size, thus creating opportunities for entrepreneurship (Li, 1997).

### **2.2.1.3 Globalization**

Globalization's impact on the level of entrepreneurship can not be addressed simply. Positively, globalization involves the integration of the world market and resources, which activates different countries' comparative advantage and promotes their productivity through the flows of capital, knowledge and human resources. For entrepreneurs, globalization offers more opportunities for exploiting scale as well as reducing trade barriers for the entrance of foreign producers. As a consequence, increasing competition in international markets may have a negative impact on the survival rates of business (Verheul et al., 2002).

The volume of international trade is a direct indicator of a country's degree of globalization. In 1978, one year before the implementation of China's 'Reform and Opening' Policy, total value

of imports and exports was 20.64 billion US dollars with the value of exports making up 9.75 billion US dollars of the total. Such figures have soared respectively to 620.8 and 325.6 in the year 2002. This sustained trend more clearly presented in Figure 8.

Figure 8 about here

Supported by Carree (1997) and Haltiwanger (1998), the risk of volatility caused by increased international market competition can be better absorbed by small firms. As we have mentioned, small businesses in China's private sector adapted more quickly to the emerging market demand created by international trade. Compared with large scale and state owned enterprises, less path-dependent problems exist in private small business making it easier for to absorb new technologies and management skills. Moreover, the potential comparative advantage of China in international trade—lower labor costs, is fully exerted by the small businesses served in manufacturing and service industries, which are believed to provide most of the new opportunities in a transitional economy (Li, 1997). All of the arguments and data above reveal why globalization has favored entrepreneurship development in China instead of suppressing it. Additionally, the increase in international competition and the increase in cross-cultural influences, through which globalization expresses itself, has made Chinese entrepreneurs and latent entrepreneurs aware of the existence of other cultures and their characteristics through the nature and type of products and services offered. This has resulted in a diversified and refreshed culture and cognition, which are more influential and important than the diversification of products or customer demand (Acs, Audretsch and Evans, 1994).

#### **2.2.1.4 Industrial Structure**

At present, countries in the Western world are experiencing an increase in the number of firms in the service sector. Most services are characterized by relatively small average firm size, creating

opportunities for self-employment (EIM/ENSR, 1997). This phenomenon is interpreted as a result of evolution through different economic development stages: In the first stage, economies specialize in the production of agricultural products, characterized by high levels of self-employment; then it evolves towards a manufacturing oriented economy, followed by increasing firm size; in the third stage, the economy shifts from manufacturing toward services, offering new opportunities for small-scale production (Acs, Audretsch and Evans, 1994; Rostow, 1971). As we have noted in Part 2.1, the reconstruction of China's entrepreneurship environment has been accompanied and continuously motivated by the revitalization of the service sector (tertiary industry) during the last two decades (See Figure 9).

Figure 9 about here

Described by Kornai (1992), in a central planned economy, the government's decision over resource allocation was guided by a set of rules giving priorities to industry over agriculture, heavy industry over light industry, production goods over consumer goods, and large installations over small ones. Consequently, the service sector was officially suppressed as well as consumers' requirements. Towards the goal of building a market oriented economy, the Chinese government gradually eliminated the regulations mentioned above. Therefore, the reallocation of resources quickly filled the vacancy in emerging market demand and led to the prosperity of the service sector. So, the significant growth of China's service sector should be mostly regarded as the result of an optimal adjustment in the market economy instead of as advancing to a more advanced development stage.

How the development of the services will influence entrepreneurial activity in China within the coming 10 years is not clear. In other words, the coefficient of this determinant has to rely on the policy of the Chinese government and the availability of stable economic growth. When more

and more economists insist on speeding China's evolution to a service economy so as to favor the development of entrepreneurship, it is important to take time to consider potential but possibly looming, such as the flood of unemployment, the huge income gaps among different groups (low, middle and upper classes; rural vs. urban; and coastal vs. interior locations) and the disfunction and vulnerability of financial institutions, which may cause severe crises or a great depression.

### **2.2.2 Supply Side Determinants**

Viewed by macroeconomic theory, the level of entrepreneurship in a particular country can be explained by the equilibrium between the supply side (labor market perspective) and the demand side (economic development, technology development and industrial structure). The supply side of entrepreneurship is dominated by population characteristics, i.e., demographic composition. Furthermore, because people's individual attitude towards entrepreneurship, i.e. preferences and culture and institutional factors also influence the supply side of entrepreneurship, this paper will address them briefly after the analysis to supply side determinants in the sense of population.

#### **2.2.2.1 Population Density and Urbanization Rate**

Evidence is mixed when we consider the impact of population density or the urbanization rate, on the level of entrepreneurship (Verheul et al., 2002). On the one hand, population density and urbanization can lead to the pursuit of economies of scale which reduce 'space' or opportunities for small firms and self-employment. Moreover, some research in western countries has found that thinly populated areas with many dispersed small villages often have many small retail stores, indicating that population density can have a negative effect on the level of business ownership (Bais, Van der Hoeven and Verhoeven, 1995). On the other hand, more researchers support a conclusion that proximity to market and business infrastructure benefits entrepreneurial

activity. In addition, because most research centers and universities are often situated within urban areas, there is a more qualified work force and better knowledge access for entrepreneurs. Furthermore, the establishment of enterprises in certain areas is likely to attract other ventures because of the opportunities for cooperation, spillover effects and the ‘signaling effect’ (Audretsch and Fritsch, 2000; OECD, 1998)

The general situation of population density in 1998 in China is presented in Figure 10.

Figure 10 about here

Historically, most of the population of China has been concentrated in the middle and eastern parts of China, especially along the coastal areas. Since the economic reform, urbanization in such high population concentrated areas has accelerated dramatically (See Table 3).

Table 3 about here

According to the principles of the Chinese government when implementing economic reform, deregulation policies or the so-called ‘privileges’ were initially activated in cities then are expected to be universally legalized, first in open coastal areas as has occurred then pushed forward to internal regions which is now occurring (China Council for the Promotion of International Trade, CCPIT, 2004). Under this political-economic logic, increasing population density in eastern China, which are regarded as the effect of entrepreneurs’ rational responses to unbalanced economic development and administrative deregulation, could lead to a higher business success rate there (See Figure 11).

Figure 11 about here

Meanwhile, judging from the positive relationship between the urbanization rate and entrepreneurship intensity shown in Figure 12, clearly more benefits have been spilled over to entrepreneurs after the rate of urbanization increased.

Figure 12 about here

### **2.2.2.2 Unemployment and Income Disparity**

There are conflicting hypotheses that explain the influence of the unemployment rate on the rate of self-employment. At the macro level a high rate of unemployment can negatively impact the level of entrepreneurship through suppression effects on new ventures, i.e., a decrease in the availability of business opportunities induced by a depressed economy (EIM/ENSR, 1996). Such an assumption, based on the observation of OECD countries, will fail to explain the pattern in China where the nation experienced an increase in both the national GDP and the unemployment rate (See Figure 13).

Figure 13 about here

The transition from a centrally planned economy to a more market oriented economy announced vast and significant restrictions on the use of administrative protection of state owned enterprises (there were a few exceptions in sectors considered to be crucial, e.g., energy and transport) and equalitarianism as an inefficient income distribution principle. State owned enterprises (SOEs) have been forced to improve their productivity and competitiveness; otherwise they are to be removed from the market and replaced by competitive private owned enterprises. Even the very few remaining giant SOEs that are still to some degree supported by the government also attempted to import modern management systems. They were obliged to construct reward-punishment mechanisms as an incentive to create higher productivity and “profit”. Millions of employees from the SOEs have been laid off due to enterprise bankruptcy or because of labors’ poor performance (Howe, Kueh and Ash, 2003).

Moreover, the return of ownership of land to Chinese peasants who compose nearly 80% of the total population of China not only rebuilt the incentive for more output and higher productivity

but also introduced the problem of how to manage the labor force surplus that has been liberated from the agriculture sector. While the existing household registration system limits legal permanent migration from rural to urban sectors and across regions, a large proportion of this labor force surplus chose to establish businesses or join in such enterprises as employees.

Therefore, China has witnessed a boom of so-called Township and Village Enterprises (TVEs) since the 1980s (Nolan and Dong, 1990; Byrd and Lin 1990; Naughton, 1992).

Based on the experience of China, (the risk of) unemployment is likely to have a positive effect on the level of entrepreneurship through reduction of the opportunity cost of self-employment.

When there is little chance of finding paid employment, unemployed people have no other productive or legal option than to become self-employed. This is especially true in China where there is a serious lack of social security benefits to unemployed people and an expanding gap between the rich and poor (UNDP, 2004). This in turn is driving people at the lower end of the income distribution to take the risk associated with self-employment and thus to establish businesses.

### **2.2.2.3 Other Supply Side Determinants**

Some other demographic factors have also been mentioned as supply side determinants for entrepreneurial activities, such as population growth (Bais, Van der Hoeven and Verhoeven, 1995), age structure of the population (Cressy, 1996; Acs, Audretsch and Evans, 1994), immigration (Borooah and Hart, 1999; Bates, 1997) and women participation in the labor market (Buttner and Moore, 1997; Brush, 1992). All these determinants have proved to be influential to entrepreneurship development in OECD countries based on empirical studies. But since China has a huge population which is more than the sum of OECD countries and its special background in demographic and economic transition, the determinants listed above do not appear to be

significant, at least, in the short term. Thus, a detailed analysis of these determinants is not made in this paper.

As a complement to our equilibrium analysis of entrepreneurship development in section 2.2, two more exogenous variables: government intervention and culture together with their influence on entrepreneurial activities in China are discussed below.

### **2.3 Government Intervention**

The government can fulfill different roles in the economic environment. First, it creates a legal framework in which the property rights of all market parties are defined, guaranteed and protected (Verheul et al., 2002). In neoclassical economics (Samuelson, 1970) and institutional economics (North 1981), the general role of the government is supplemented with an ‘adjusting’ role in case of market failure. Combining the Austrian Economists’ theory of entrepreneurship and all the related elaborations just mentioned, recent studies have evolved a new concept of entrepreneurship, that sheds more light on the role of government. As a system necessary for economic growth, entrepreneurship consists of three components: entrepreneurs that desire to achieve their goal of economic survival and advancement; the social constitution that grants the right for forming and operating “free enterprises” is; and government that has the ability to motivate entrepreneurial behavior toward social development and growth and to adjust the constitutional system that works at its best to protect each individual entrepreneur (Audretsch, et al, 2002; Lowrey, 2003).

Compared with the OECD countries where small government and a mature market economy used to exist, the Chinese government’s intervention in fostering an entrepreneurial environment is far more crucial and decisive than any other determinant. Without the premise of reforming the socialism system in China, the emergence of entrepreneurship would not be possible nor would

the existence of a private economy. Socialism is rooted in the claim that state ownership is the only viable form of property right and that bureaucratic coordination of the economy is superior to market coordination (Kornai, 1992). Traditional socialist systems pushed the bureaucracy further than any other systems to the extent that it became a system with “strong thumbs, no fingers” (Lindblom 1977, p. 239), leading to problems of information overload, mis-prioritization, inefficient factor allocation, inadequate technology, conflict of incentives, and failure of national planning (Ellman, 1989), and with devastating consequences such as chronic shortages, suppressed consumption, lack of worker incentives, gross inefficiency, and, ultimately, to economic stagnation and political crises (Kornai, 1992).

The reaction to such crises by the Chinese Communist Party and the Chinese government has been a tentative and inconsistent process of deregulation and decentralization. These series of deregulating and decentralizing measures, which include the return of fiscal power to local governments, the expiration of government price and government price guides, the protection of fair competition, the establishment of an efficiency based income distribution principle and so on were engaged to rebuild and strengthen the market mechanism yet spontaneously required. In turn they have induced a private sector and entrepreneurship renaissance following the sequence of launching deregulation policy, from central cities to peripheries, from coastal regions to interior regions.

Why did the “big bang” marketization and privatization strategies in Eastern European socialist economies generate dramatically more social, economic, and political costs than gradual reform of China? Why was the social transition less painful in Romania, Czech or Poland than that in Russia? There are many historic, economic and institutional explanations to these questions while the Austrian economists remind us about the importance of the relationship between

entrepreneurship and market dynamics (Schumpeter, 1936; Kirzer, 1973). When we trace the state of entrepreneurship in these transitional economies, Russia suffered more from the lack of entrepreneurship than its peers due to the longer domination of a central planned economy while China benefited more from the revitalization of an entrepreneurial society that significantly absorbed and digested the turbulence and fluctuation in a transitional economy.

But the realization of sustainable economic growth in China requires more than a spontaneously formed entrepreneurship environment, in other words, the unconscious intervention of the Chinese government in fostering entrepreneurship will not be sufficient for continued economic growth in the future. Lowrey (2004) argues that although Romer's explanation of long term economic development due to human capital-accumulation of knowledge and skill, scientific knowledge and technical skills is central to economic growth in the 21<sup>st</sup>. century, these factors merely determine potentialities. The realization of ideas, such as business formation or economic advancement crucially depends on the cost and the risk factors related to the quality of the labor force. Entrepreneurship is the crucial mediator that transforms 'knowledge' to the labor force with the profit motivation and therefore it turns out to be the key determinant of sustainable economic growth.

While it has already been shown above that non-economic conditions such as value systems and institutions that are not hostile to entrepreneurial activity and a government that is able to maintain law, power and policy consistency are necessary for the development of entrepreneurship (Papanek, 1962; Baumol, 1990), the Chinese government seems to still be struggling with the paradox created by its communism ideology and the demand for encouraging entrepreneurship. Such a hesitation in the construction of an entrepreneurial society has greatly delayed the study of entrepreneurship in China and weakened its voice. Moreover, the

ambiguous attitude of the Chinese government to entrepreneurship development increased the uncertainty about entrepreneurial activity and may thus ultimately suppress the growth of its entrepreneurial niche (Li, 1997). Knowing these, the future effect of Chinese government's intervention in entrepreneurship development becomes more unpredictable and is tightly linked to the direction its political reform takes.

## **2.4 Culture**

There are intensive literatures on the importance of culture for economic structure and performance. The role of culture has been analyzed at the macro level (Fukuyama, 1996; Landes, 1998; Lynn, 1991; North, 1990 and 1994; Olson, 1982 and 1996) and the firm level (Casson, 1991; Hofstede, 1991; Whitley, 1992). The most famous approach to measure the cultural influence across nations was made by Hofstede (1980) who analyzed the empirical data of an exceptionally large survey of IBM subsidiaries in 40 countries in 1968 and 1972. Hofstede produced four dimensions of national culture: individualism, power distance, masculinity and uncertainty avoidance.

It would be interesting to spend more effort on the analysis of culture's effects on entrepreneurship development. However, the diversified and controversial assessment of the relationship between entrepreneurship and culture, at least in the case of Chinese entrepreneurship, oblige us to give it up in this paper. When we try to display the complex role of culture in the rise and fall of business-ownership, more extensive and international comparable data regarding cultural dimensions at the country level are needed to create or test the beliefs about the influence of culture on entrepreneurship and the relevant social and economic processes involved. Although we acknowledge the importance of culture in cross-national

entrepreneurship study, the effect of culture is not evident without the premise of concrete social structural transition, which makes culture less significant in a macro level determinants analysis.

## **Conclusion:**

Industrial restructuring and the requirement for promoting international competitiveness in Western societies, economic revitalization in developing countries, and market transition processes in former socialist states all interpret the growing interest in the role of entrepreneurship in economic and social change. While the level of entrepreneurship differs considerably across countries and periods, this paper tries to provide a profile of the entrepreneurship development in China during the last two decades and in the process devise a framework to analyze its determinants.

First of all, both the private sector's climbing share in the national economy and China's high rank by the TEA index are introduced to demonstrate the existence of an entrepreneurial niche and its growth in China. Unlike the U-shaped entrepreneurship development curve shown by the OECD countries, China's self employment activities exhibited a persistently ascending trend not only in quantities but also in competitiveness. Such a fact may appeal to scholars to extend the existing entrepreneurship theories to better fit the development experience of entrepreneurship in developing and transitional economies.

Second, **the Eclectic Theory** of entrepreneurship development (Verheul et al., 2002) combined with orthodox entrepreneurship economics, has been adapted to analyze the macro-level determinants of entrepreneurial activities in China. Equilibrium analysis based on demand side factors (i.e. technology development, economic growth, industrial structure and globalization) and supply side factors (i.e. demographic variance, unemployment rate and income disparity) shows that continuous social and economic transitions have activated the latent entrepreneurial

spirit in China which once motivated will increasingly tend to become a seemingly irresistible tide. Moreover, it is easy to tell from many empirical studies that the development of entrepreneurship is supposed to strengthen these determinants thus ultimately leading to a self-reinforcement process. Hence, we may expect the emergence of an even more entrepreneurial Chinese society in the future.

Third, the Chinese government, that not only implemented a successful top to bottom economic reform but also preserved much of its socialist political system, is taken as the most influential determinants of entrepreneurship development. On the one hand, the renaissance of entrepreneurship in China was laid on the pedestal of Chinese government's decentralization and deregulation measures. On the other hand, while more and more Chinese economists (Zhang, 1995; Hua, 2004) begin to advocate entrepreneurship's importance to technology innovation and sustainable economic growth, when and how will or can the Chinese government restore the reputation of entrepreneurship that might conflict with its ideological principles, becomes an interesting and crucial problem.

## Appendix

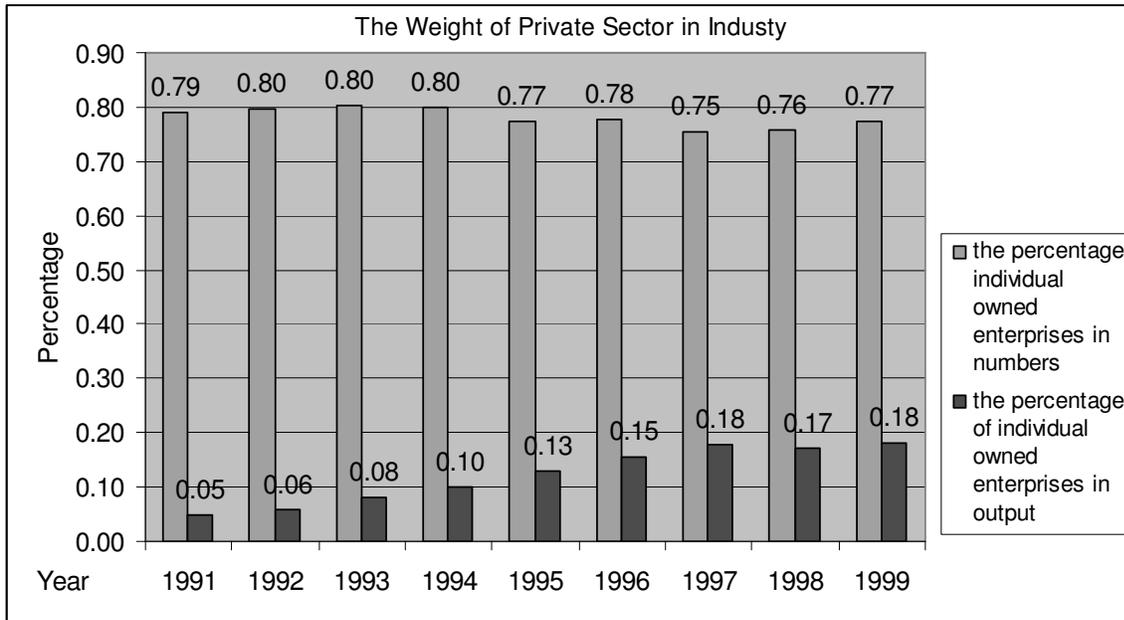


Figure 1 the Growth of Private Sector in China

Source: National Statistic Bureau. [Online]< <http://www.stats.gov.cn/tjsj/ndsjsj>>

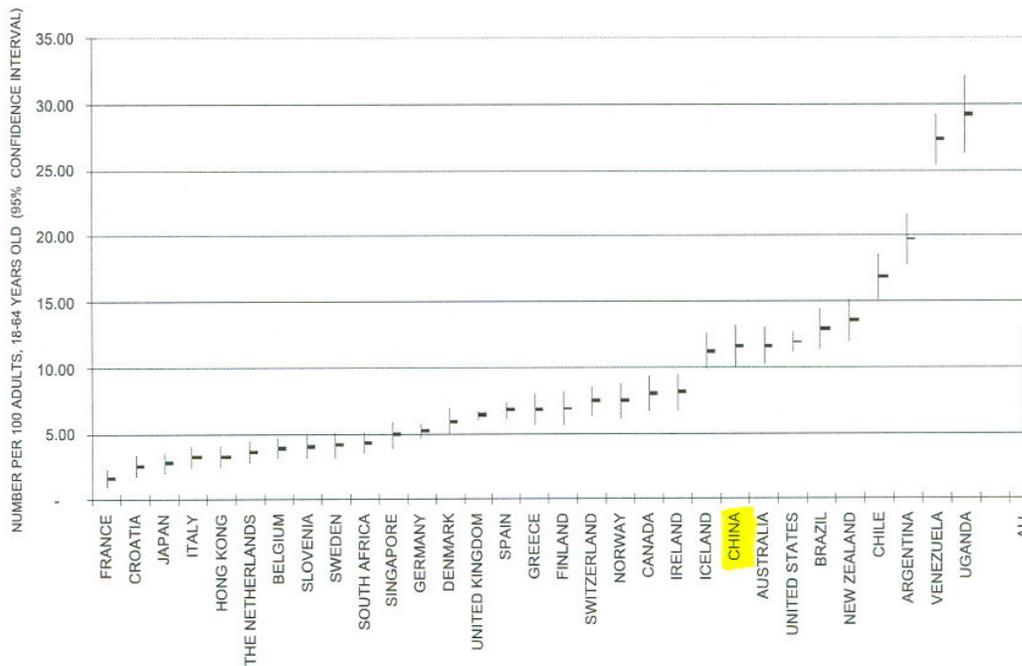


Figure 2 Total Entrepreneurial Activity by Country: 2003

Source: Global Entrepreneurship Monitor, 2003 Executive Report.

[Online]: <http://www.gemconsortium.org>

Table 1 Stability in the TEA Index Form from 2000 to 2003

| Overall        | TEA 2000     | TEA 2001     | TEA 2002     | TEA 2003     |
|----------------|--------------|--------------|--------------|--------------|
| TEA 2000       | 1.00         |              |              |              |
| TEA 2001       | 0.81(20)**** | 1.00         |              |              |
| TEA 2002       | 0.65(20)***  | 0.74(28)**** | 1.00         |              |
| TEA 2003       | 0.64(17)**   | 0.72(21)**** | 0.93(28)**** | 1.00         |
| TEA Average(2) | 0.86(20)**** | 0.91(29)**** | 0.94(37)**** | 0.97(31)**** |

(1) No. of countries in parentheses; Stat Sign (1-tailed): \*\* < 0.01; \*\*\* <.001; \*\*\*\* <0.000  
(2) TEA Average computed for 1-4 years, depending on number of years country was in the project. As it was later determined to be in error, the year 2000 Ireland TEA measure was excluded.

Source: Global Entrepreneurship Monitor, 2003 Executive Report.

[Online]: <http://www.gemconsortium.org>

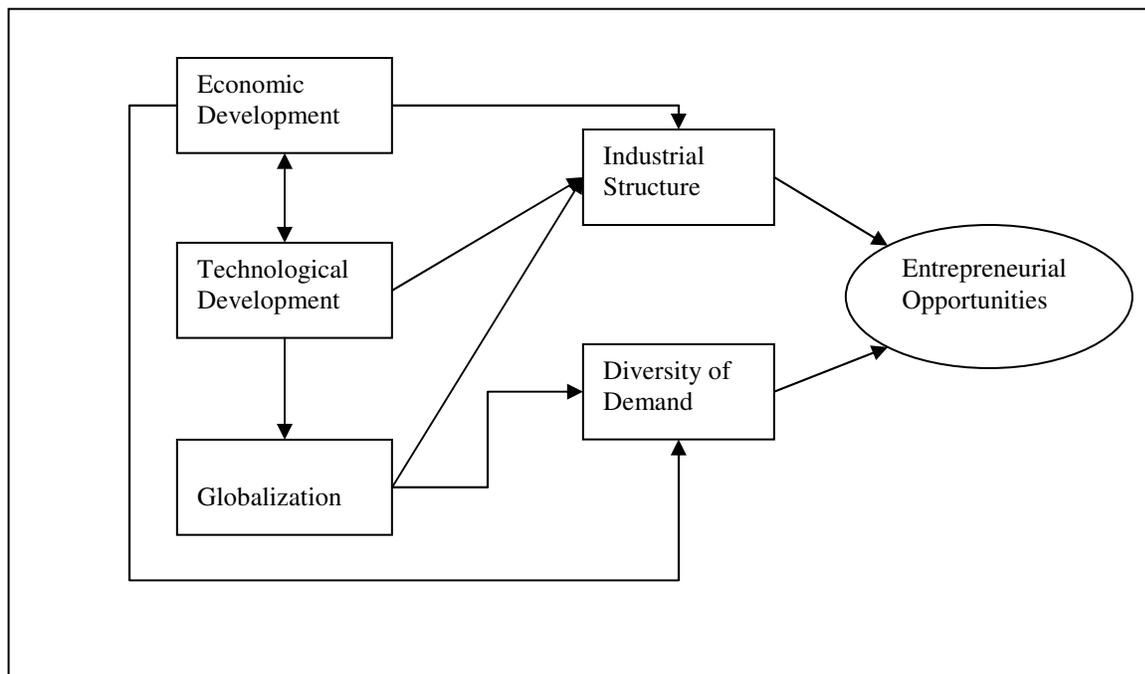


Figure 3 Demand side determinants of entrepreneurship

Source: Audretsch, et al, (2002a), p. 23.

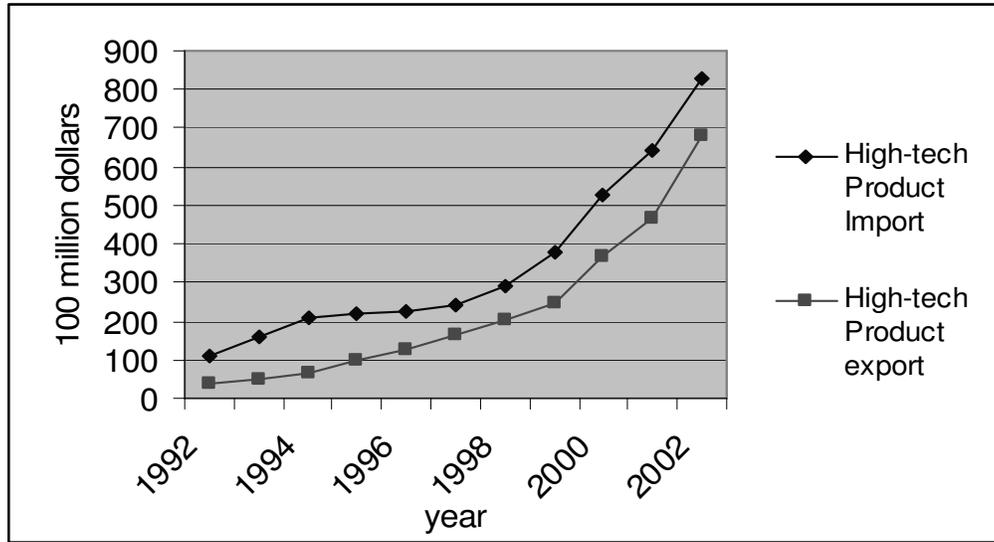


Figure 4 High-tech Products Trade of China (1992~2002)

Source: China National Statistic Bureau. [Online]< <http://www.stats.gov.cn/tjsj/ndsj>>

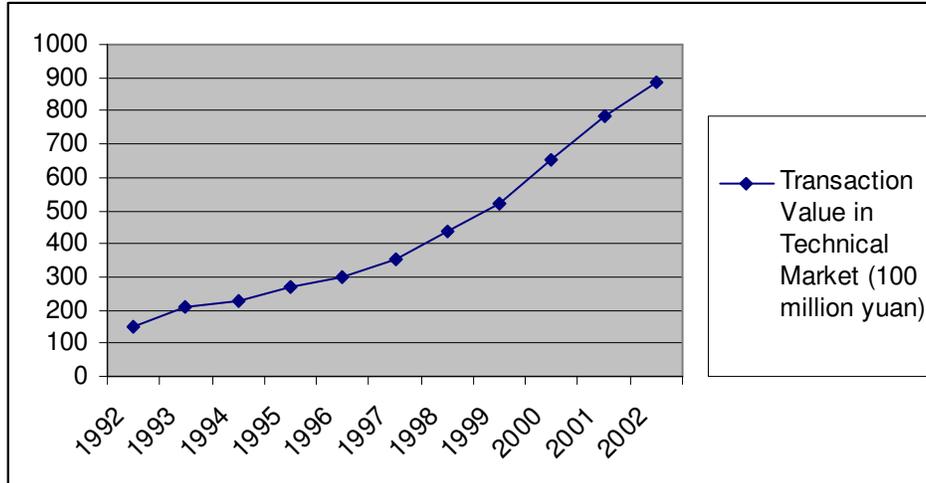


Figure 5 Transaction Value in China's Technical Market (1992~2002)

Source: National Statistics Bureau. [Online]< <http://www.stats.gov.cn/tjsj/ndsj>>

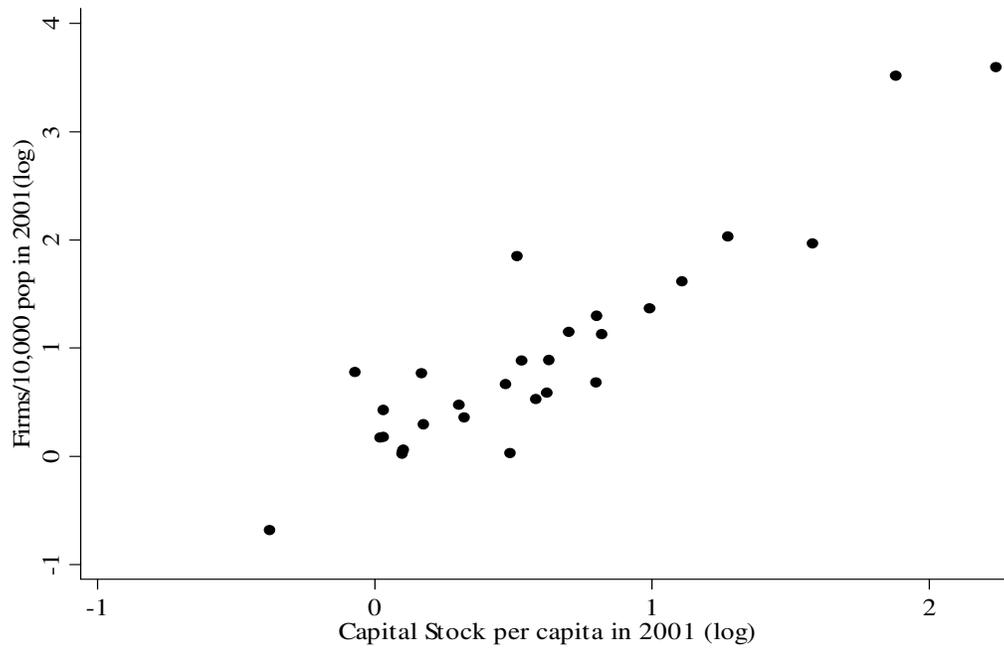


Figure 6 Entrepreneurship Intensity and Provincial Capital Stock per capita

Source: Calculated by the author from National Bureau of Statistics, 2001, 249

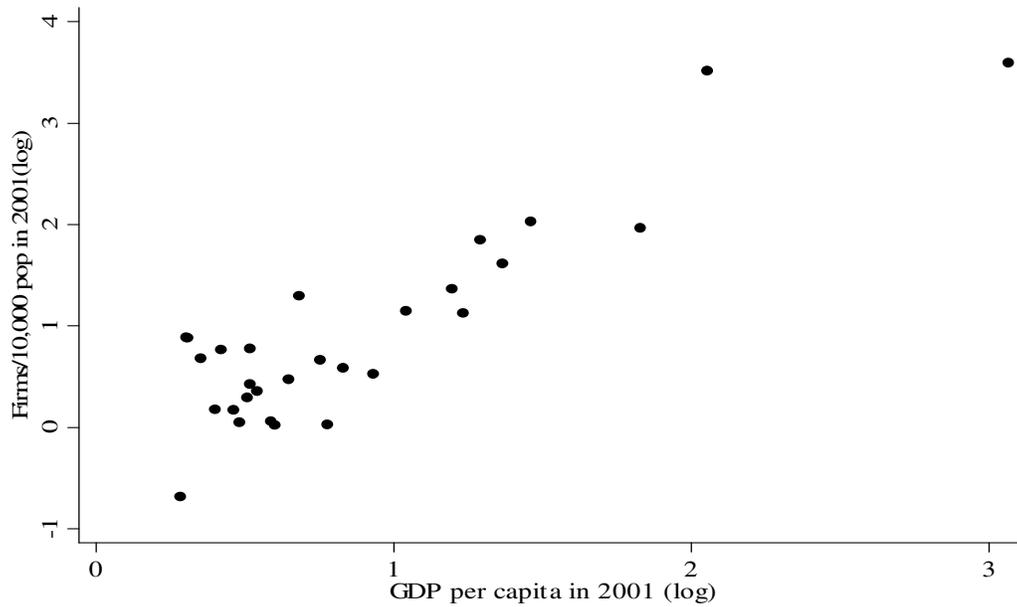


Figure 7 Entrepreneurship Intensity and Provincial GDP per capita

Source: Calculated by the author from National Bureau of Statistics, 2001, 249

Table 2 Scale distribution of China's industry: 1995

| Categories   | Number of firms      |              | Output value                |              | Employment                     |              |
|--------------|----------------------|--------------|-----------------------------|--------------|--------------------------------|--------------|
|              | Amount<br>(thousand) | Share<br>(%) | Amount<br>(billion<br>yuan) | Share<br>(%) | Amount<br>(million<br>persons) | Share<br>(%) |
| Total        | 7,341.5              | 100          | 8,229.7                     | 100          | 147.4                          | 100          |
| Large firms  | 6.4                  | 0.09         | 2,182.8                     | 26.52        | 24.1                           | 16.35        |
| Medium firms | 16.6                 | 0.23         | 907.8                       | 11.03        | 14.8                           | 10.06        |
| Small Firms  | 7,318.5              | 99.69        | 5,139.1                     | 62.45        | 108.5                          | 73.59        |

Sources: National Statistics Bureau, 1996

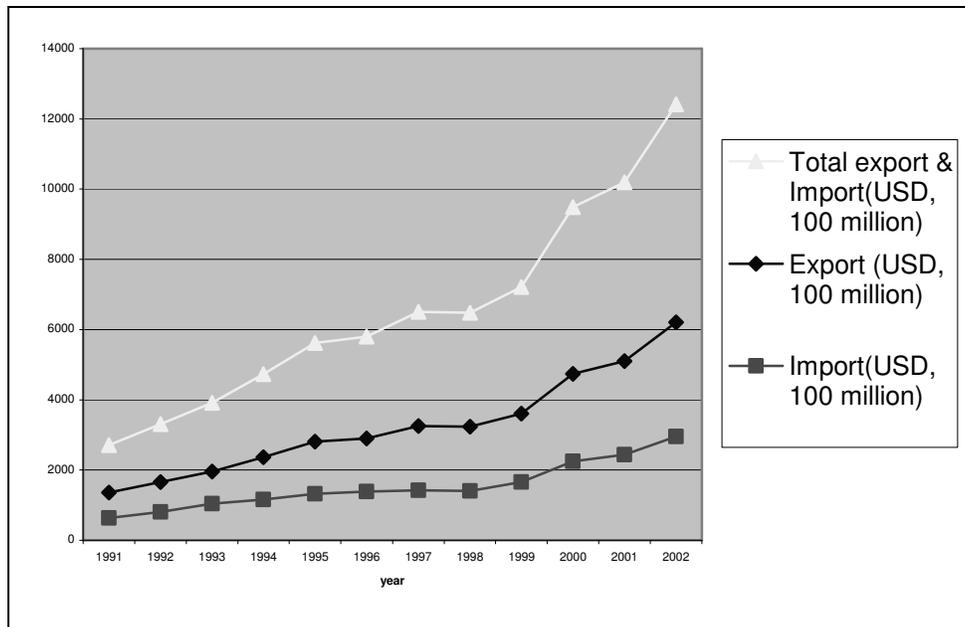


Figure 8 China's Import and Export from 1991-2002

Source: National Statistics Bureau. [Online]< <http://www.stats.gov.cn/tjsj/ndsjsj>>

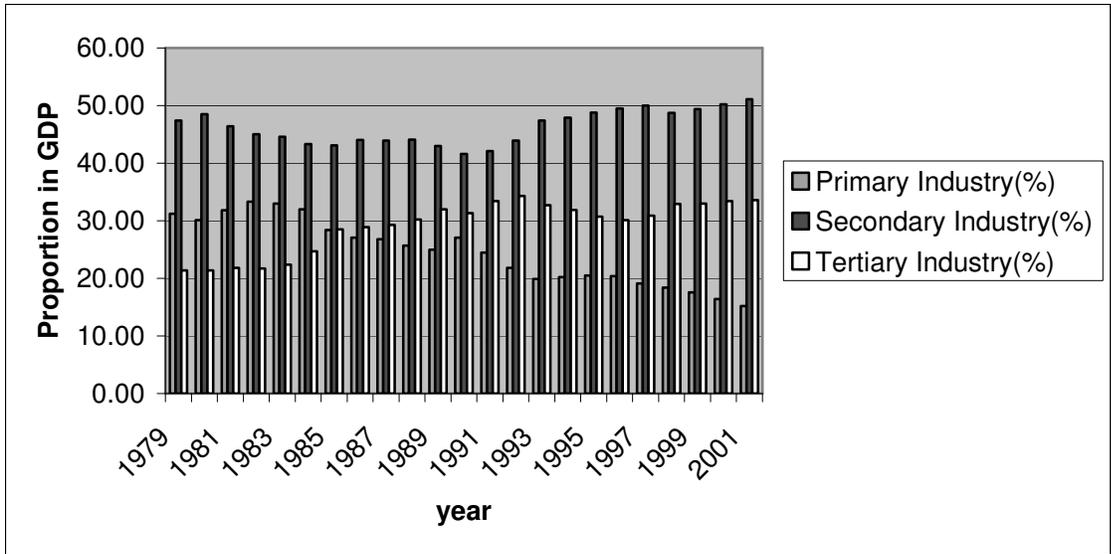


Figure 9 the Structure of Industries in National GDP, 1979-2001

Source: National Statistic Bureau. [Online]< <http://www.stats.gov.cn/tjsj/ndsjsj>>

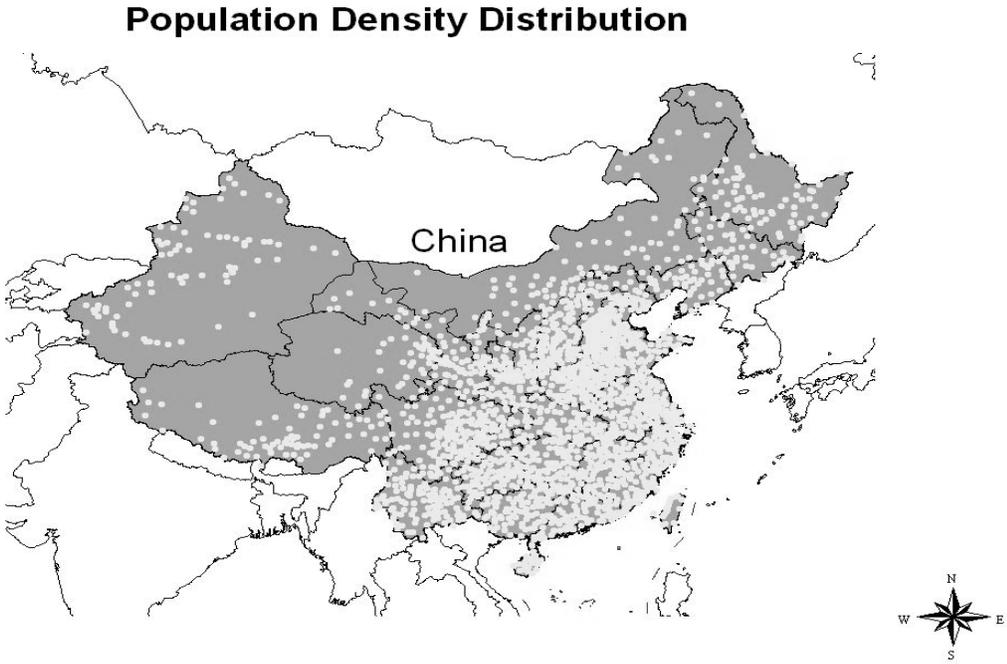


Figure 10 Population Density at the County Level in China

Source: National Fundamental Geographic Information System, [Online] : < <http://nfgis.nsd.gov.cn>>

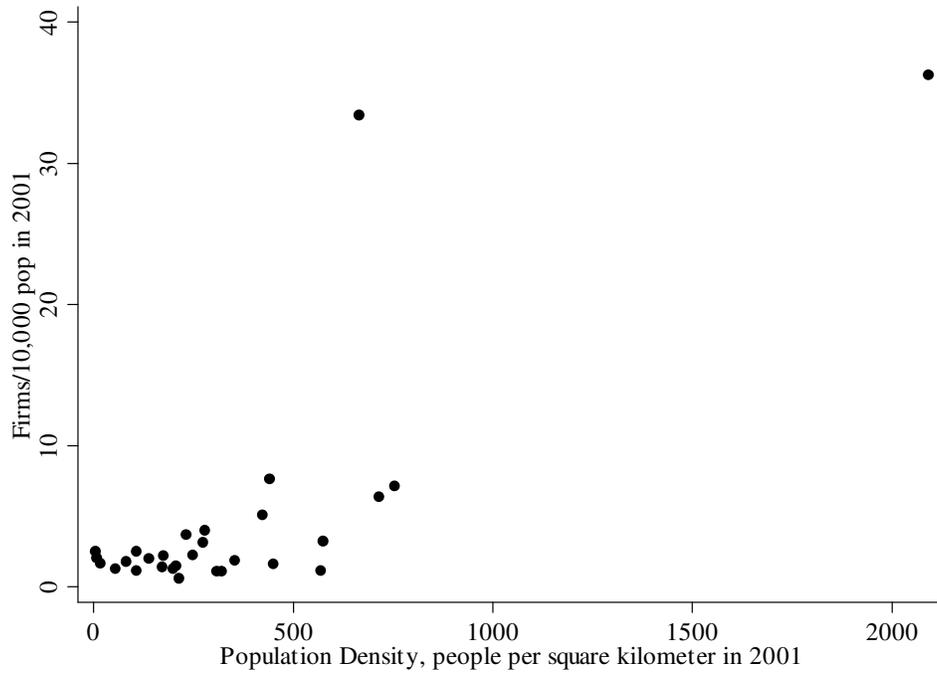


Figure 11 Entrepreneurship Intensity and Provincial Population Density

Source: National Statistics Bureau. [Online]:

<http://www.bjinfobank.com/IrisBin/Text.dll?db=TJ&no=195526&cs=7538658&str=人口密度>

Table3. City Distribution in China

|      | East | Mid | West | <b>Total</b> |
|------|------|-----|------|--------------|
| 1978 | 78   | 95  | 43   | <b>193</b>   |
| 1998 | 300  | 247 | 121  | <b>668</b>   |

Source: China National Statistics Bureau. [Online]<<http://www.stats.gov.cn/tjsj/nds>>

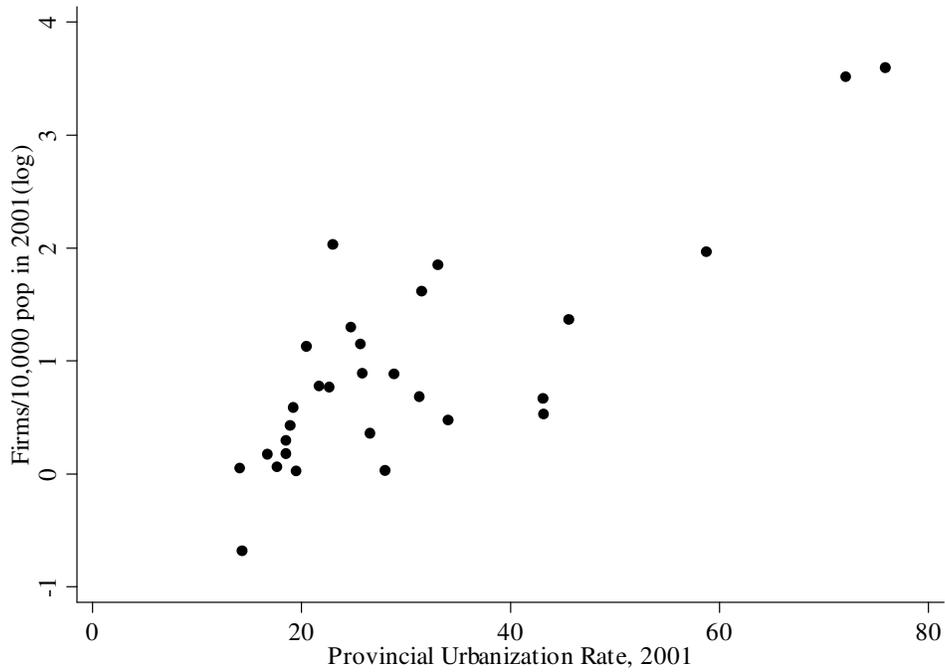


Figure12 Entrepreneurship Intensity and Provincial Population Density

Source: National Statistics Bureau.

[Online]:<http://www.bjinfobank.com/IrisBin/Text.dll?db=TJ&no=222177&cs=6131964&str=城市化水平>

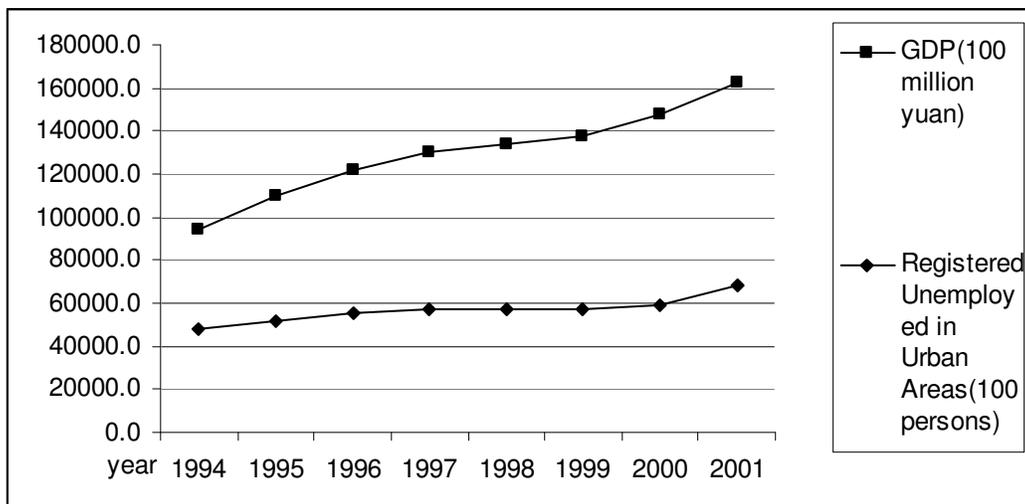


Figure 13 the Increase of GDP and the Unemployment Rate in China

Source: China National Statistics Bureau. [Online]< <http://www.stats.gov.cn/tjsj/ndsjsj>>

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# THE ROLE OF GOVERNMENT IN INCUBATOR-INCUBATION DEVELOPMENT

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## Abstract

Existing studies of government's role in supporting business incubator development are scattered everywhere in the so-called 'incubator-incubation research' (Hackett and Dilts, 2004). The absence of a systematic summary and analysis on this topic not only deduced unnecessary repetitions in discussion, but also committed confusing and paradoxical evaluations of the government's influence in different countries. Therefore, the purpose of this paper is to review and refine the existing literatures' explanation about the government's role in incubator-incubation development by integrating institutional theory with entrepreneurship economics to move toward a more explicit illustration.

## **Introduction**

Temali and Campbell (1984) initiate the academic attempt to study business incubators by describing their operation in United States. Twenty years later, the subsequent literatures in this field have boomed simultaneously with the world's increasing concern on entrepreneurship and small business. Most of the current works are categorized into five primary research orientations: incubator development studies, incubator configuration studies, incubatee development studies, incubator-incubation impact studies, and studies that theorize about incubators-incubation.

(Hackett and Dilts, 2004)

While the statements of government and their functions such as the preacher of incubation concept, the sponsor of early incubators, the organizer of supportive network and the arbitrator of incubators performance have almost been mention in each orientation, a systematic review and explicit explanation with powerful theories remains conspicuously absent.

North (1981), the vigorous theorist of institutional economics, founded a clear and persuasive framework to analyze the government's motivation in creating economic institutions and organizations. Combining his contributions in the property right and the transaction cost theories, this paper will build a new path leading to an institutional interpretation of the government's role in incubator-incubation development.

Moreover, this paper also concerns about the absence of precise entrepreneurship economic explanation to incubator-incubation construction in term of the governments' unique function. Although business incubators were used to be regarded as a component of the government's policy in fostering entrepreneurship, the necessity and importance of the governments' involvement haven't been manifested and clarified by entrepreneurship theories up to now. With regard to the various approaches to entrepreneurship study, the oncoming parts choose a socio-

economic perspective which is not only supposed to support the active participation of governments in incubator-incubation development but also provide instructive policy implications for the comment of our case studies.

At last but not the least, a comparative case study among U.S., several nations of E.U., Middle East countries and China will be formed when we combine the theory framework with incubator-incubation history of different nations. Distinctive government's roles with the respect to undertaking business incubating activities in above regions are depicted and the logics behind such diversifications are analyzed adopting the methodologies that have been mentioned. Policy implication with a short but essential conclusion which summarizes the different modes of government's interference in incubator-incubation development will be found at the end of this paper.

### **1. Questions and Relative Methodology**

There is a ubiquitous recognition of the government's propulsive effect to business incubator construction (Pace, 2001). But extant literatures have mostly been obsessed to repeat the identical content of policies across different countries instead of notifying some significant distinctions in property right distribution which have already existed and define the scope of government behavior. For example, U.S. government and E.U. nations' government are used to share the cost of building and financing incubators with the local community and private sectors, while the government independently invested for business incubators in the early 1990s. On the other hand, we could see that the governments in Central Asia and Middle East tended to completely rely on international organizations' investment when they build incubators. We are going to prove that an overlook of such important facts directly resulted in academic incapability of appropriately modeling the government role in different nations.

Only three years before Temali and Campbell's ground-breaking work in incubator-incubation research was published, North (1981) established his well-known theory which delicately interpreted the changes and evolutions in economic history via a model locating the state's role to devise and set up organizations and institutions.

The basic service of state has two objectives: One, to specify the fundamental rules of competition and cooperation which will provide a structure of property rights for maximizing the rents accruing to the ruler.

Two, within the framework of the first objective, to reduce the transaction cost in order to foster maximum output of the society and, therefore, increase tax revenues accruing to the states. (North, 1981, p.24)

North testified his theory with the example of 'state', a synthesized political and economic organization which had existed in human being's civilized history all along. Moreover, the emergence and evolution of some subordinate organizations such as markets, companies, churches and parties were also involved so as to reveal the government's influence within this framework.

Can we apply North's theory to examining the role of government in incubator-incubation development? Our reply is: we can and we have to. This is not only because institutional economics has been widely regarded as a triumph in explaining varied and diversified government behaviors in different economic organizations, but also attributed to the logical consistency between the fascinating phenomenon and the extant theoretical tool: As have been mentioned, the already existed divergence among the property right mechanisms in different countries' incubator-incubation career calls for concerns and persuasive interpretation. North appropriately educated people how a government would devise the property right mechanism of a certain organization according to its profit motivation and highlighted the crucial influence of this mechanism with respect to the organization's long term economic performance. Meanwhile, since the extant studies give much light to socio-economics and transaction cost theory (Cormie,

2003) when they attempt to describe the incubator's synergistic effects to regional economy, North's second criteria, which defines that whether a government will adopt the policy to reduce transaction cost of the whole society or not depend on its cost-benefit analysis of the monitoring expenditure and potential tax revenue, enlightens us to give more comprehensive understand of different governments' attitude to incubation network.

More details of North's theory are going to be introduced in the coming sections when we try to exhibit and analyze the characteristics of incubator-incubation activity in different countries, which will be simultaneously combined with the popular entrepreneurship economic theory.

### **Entrepreneurship Economics**

In the advent of globalization and a knowledge economy era, a constant restructuring and readjustment of regional economies which responses to the changing consumer preferences and production technologies has become mandatory (Rietveld & Shefer, 1999). Therefore, entrepreneurship economics' market dynamics theory rather than the neoclassic economics' static 'general equilibrium theory' appears to be increasingly instructive and flexible for regional development strategy.

From a classical entrepreneurship economic approach, Schumpeter (1936) and Kirzner (1973) both relate entrepreneurial activity to the process through which the market economy adjusts in response to factors which create disequilibrium. This is why business incubators have been overmuch elaborated as 'the nest for entrepreneurs' (Hackett and Dilts, 2004). This approach mainly focuses on entrepreneurs' personal traits such as an innovator, a risk taker and a self disciplined manager. As a result, many literatures interpret business incubators' function to be an inexhaustible miner for the storage of entrepreneurs as special human resources. In these literatures, however, the role of government is universally overlooked or even excluded due to

the repulsion to government interference in traditional entrepreneurship economic theories, e.g. Hayek (1972).

A gradually fledged entrepreneurship economics tends to relocate the position of government in its conceptual frame work (Lowrey, 2003). The most prominent character of these theoretical progresses is that they represent more comprehensive attempts at identifying the economic importance of entrepreneurship than the theories we considered above.

Etzioni's (1987, 1988) approach which incorporates socio-economic study in entrepreneurship economics has been regarded as an outstanding contribution among relative literatures. Etzioni pointed out the tendency which blurs the distinction between the entrepreneurs as an economic agent and entrepreneurship as a system that consists of entrepreneurs, a legal and institutional arrangement and an environmental structure. His socio-economic analytical framework is not a theory of individual entrepreneurs or a theory which places much emphasis on the possibility of entrepreneurship at individual level. While Etzioni suggests that some individual entrepreneurial activity may occur on an *ad hoc* basis, the most endemic form of entrepreneurship occurs in a collective institutional form in which decisionmaking is made routine and thus entrepreneurship is made routine (Etzioni, 1987). In this respect, Etzioni argues that collectivism is the basic form of human organization, social and economic, and that collective beliefs and values determine the preferences for, and constraints upon, decisionmaking and therefore upon activities such as entrepreneurship. In this sense, government with its power in hands, turns out to be particularly influential during the legitimization of entrepreneurship no matter in a national or local level. When people try to identify, explain as well as evaluate the governments' impact in business incubators development, such as the government's motivations and their differentiated policies,

entrepreneurship economics, especially its modern socio-economic approach will soon be proved to be compatible and foresighted in our case studies.

## **2. Case Studies.**

### **2.1. United States**

The United States is among the earliest countries to implement business incubation promote small business development. The first incubator in the United States appeared in the late 1950s, but the massive attention and resources devoted to incubation programs did not show up until the late 1980s. It was estimated that more half of currently existing incubation projects were established during that period (Adkins, 1996).

Business incubators have been serving as a crucial vehicle for new business creation and thus an integral part of economic development in the United States. Successful incubation programs intend to cultivate entrepreneurship, create and accelerate new, and often small, business, and produce financially viable “graduated” firms. In so doing, these programs directly create considerable new jobs, enlarge local wealth base, and generate economic momentum and dynamics to local economy. In addition, business incubators are often employed to empower economically disadvantaged population and to revitalize economically depressed regions in the United States.

It is highly desirable for the federal, state and local governments to participate, if not directly manage, incubator programs in the United States in light of their significant positive effects. However, due to the strong “free market” ideology in the United States, the governments only play a limited role, that is, complement that of private market in the creation and operation of business incubators. Specifically, the federal government, upon request, is mainly responsible for providing necessary start-up grants and loans to new incubator programs. A number of

federal agencies may have various funds for incubation programs, including the U.S. Department of Commerce, the U.S. Department of Housing and Urban Development, the U.S. Department of Health and Human Services, the U.S. Department of Agriculture, and others. These federal funds, however, typically cover only the programs' construction costs (Rice & Mathews, 1995).

Similar to the role of the federal government in existing incubation programs in the United States, state governments try to focus on areas where market mechanism does not fully function. A manifest example for this complementary role of state governments is that they generally mobilized various local resources and provide, if not exclusively, favorable financial support to "risky" small business owners, who are often hard to find private financial sources (OECD, 1999). State governments also enhance small business development through legislative processes. For example, the State of Michigan passed its "*Michigan Business Incubator Act*" in 1984. The Act explicitly stated that the Michigan state government shall encourage and assist the establishment and expansion of business incubator centers within the state in hopes of improving state and local economy.

Since there are piles of literatures to introduce and analyze the United States' practice in incubator-incubation development and many of them have occasionally mentioned the government role from different perspective, the U. S. case in this paper will be simply displayed and clearly concluded based on our methodology: knowing the existence of a strong 'free market' ideology, the U.S. government chose to encourage a joint or inclusive property right mechanism which on the one hand allows the government to cultivate entrepreneurship and innovation spirits into the local milieu, and on the other hand reduces the friction among different interest groups via the negotiation within a certain incubator's committee. In this regard, the government may obtain its benefits by reactivating backward regions or increasing the

national technology competitiveness, but also minimize the transaction cost which might derive from the resistance from local communities. Therefore, the inclusive property right mechanism of U. S. business incubators could be regarded as an efficient institution system following the North's rationale.

While the networking situation among business incubators and other local organizations in U. S. is very much similar to that in European countries, which we will exhibit more specifically later, the legitimization of entrepreneurship promotion activities in a local context, e.g. the "*Michigan Business Incubator Act*", turns out to be a uniqueness of the U.S. government role in strengthening spatial interactions and mutual support. This character could be regarded as a viable option with respect to embedding incubators into local networks.

## 2.2. European Countries

The concept of business incubator was firstly imported to western European countries while they were facing serious unemployment problem due to the failure of adaptation to knowledge economy in the early 1980's (Acs, 1998). As a reaction to the successful experience of U.S.A in regional economic transition, European countries such as Britain, Germany, France and Italy formed the consensus that entrepreneurship and its favorable environment are necessary for the revitalization of traditional industry clusters. Therefore, the construction of business incubator and its network with local economy has been implemented at a marvelous scale and speed during the past two decades. Following the collapse of Communism in central and east Europe and the later reconstruction of market system in such area, the significance of entrepreneurship as well as business incubator activity were soon adopted by these countries (Lalkaka and Abetti, 1999; Bateman, 2000).

Comment [yjb1]: Citation

Table1 here

Just like the case in U.S, our institution economic methodology could identify that maximization of the European government's profit in business incubator construction is based on the incubators' embeddability in local economy and their catalytic action to small business prosperity. On one hand, European countries' governments have to invest certain amount of capital in setting up incubators due to the lack of entrepreneurship in these nations and the possible market failure considering incubators' significant externality effect (OECD, 1999), no matter that the money are from territorial governments or commonwealth and federal governments. On the other hand, the governments will tend to share the property right with local communities; otherwise an exclusive control of the government must lead to isolation between the incubation supply and the regional economic demand. Such isolation equals the failure of an incubator's intention to promote local entrepreneurship, which is totally against our socio-economic approach.

Comment [yjb2]: Citation

### **2.2.1 The Property Right Mechanism**

The most supportive case for an inclusive model in European Countries is the German case. Germany began setting-up incubators noticeably later than the other G7 nations. This was because regional development was first organized on a truly regional basis in Germany in the 1980s (OECD, 1999). In 1983, the first incubator was set up as an initiative from the parties responsible for technology transfer at the Technical University in Berlin together with support from the Berlin Parliament. Even in the start-up stage, federal and state level authorities had only very limited influence there.

Between 1984 and 1986 the number of German incubators doubled each year due to the widespread concerns on technology innovation. The next push which came after German unification in 1990 was catalyzed by numerous areas in East Germany seeking to achieve

economic restructuring and transition with incubator-incubation activities. The double demand from a national level with respect to Germany's technology competitiveness and a regional level related to the renaissance of economic backward areas provided sufficient encouragement for the government participation in business incubator development. Additionally, the unique background of the formation of German government's profit motivation naturally forced it to fit the local communities' strong preferences.

Today, the majority of incubator projects are implemented as initiatives from regional economic development offices together with chambers of commerce. The relationships between these two bodies were not always without disagreement and attempts to co-operate often remained as intentions only in the past. It is the creation of incubators that builds a concrete basis for this cooperation. In more than 30% of German incubators the two bodies are both partners. In addition, there are numerous cases in which a town gets part shares in an incubator and the chamber of commerce is active in management. Many incubators have also managed to involve the financial sector in their projects development. In 45% of incubators, financial institutions are listed among the partners. Although these institutions are mainly public savings banks and still very few private banks tend to invest, with regard to the accusation that banks in Germany were used to disregard new innovation- oriented firms, such a progress is very positive. Another optimistic phenomenon is the recent progress in eastern Germany, where various universities and private companies (mainly the so-called research and development Gmbhs- or limited companies –previously belonging to the R&D departments of large industrial firms) have become actively involved in the creation of incubators.

While an agreement to transform from traditional industrial economy to knowledge economy exists between the German government and its local communities, the maximization of

government's profit could be easily achieved via the cooperation among different interest groups and the reduction of social transaction cost. Therefore, the German government selects to play an intermediary role and modestly attempt to facilitate the plan of making local communities more entrepreneurship, e.g., business incubator construction. As a result, the government's favorable operations with respect to the supply of institutional products have become an element of entrepreneurship, and successfully embedded business incubators in Germany into their local context.

### **2.2.2 The Government's Role in Networking and Benchmarking**

When more and more communities start to develop their business incubator programs, the enthusiasm on the part of federal, state, and local funding agencies and legislative bodies has been uneven (Sherman and Chappell, 1998). The case coming up in Italy will give us an illustration about the government's role in balancing the uneven enthusiasm and reducing the transaction cost which generated in the process of sharing information.

Local alliances for business incubator's development in Italy are composed of political, commercial and trade union leaders because the government hopes to integrate its policies with the local interest groups' concerns all along. The Calabria regional government put this forward by becoming a shareholder in the new Business Incubator Center under construction there, which is also a good example for securing the local authorities' oral commitment of support into practices. A key factor in building such alliances is that the governing system could be made neutral by designing a board or committee. The majority of these boards are comprised of business, community and government representatives in Italy while all the representatives are required to be aware of two principles: firstly, they have to submerge their differences and commit themselves to work together to achieve common goals; and second, each leader has to

have a broader vision of and for their community than their own role in it (OECD, 1999). SPI— *Promozione e Sviluppo Imprenditoriale S.P.A.*— which is dedicated to entrepreneurship and development is one of the principal agencies responsible for inspecting the formation of an incubator's board.

Meanwhile, in an age of decreasing financial public support of government programs, there is increasing pressure on economic development programs to clearly justify their benefits (Sherman and Chappell, 1998). Both the policy makers and stockholders demand to identify and establish good practice as well as develop 'benchmarks' to measure performance and impact. As a reaction, benchmarking projects in Europe have been ubiquitously supported by governments not only at the national level but also at an international level. For example, in 2002 UK business incubation (UKBI) initiated a project sponsored by Welsh Development Agency to develop an incubation benchmarking framework, with a view to establishing a set of 'benchmarks' for the incubation industry in UK. Organizations which are doing the same research funded by national governments can be found as ADT - Association of German Technology and Business Incubation Centers in Germany, SPI in Italy. What is more, the European Commission's Enterprise Directorate-General has created Business Incubators Database which objects to provide an overview of the business incubators in the 15 EU Member States, the EEA countries (Norway, Iceland, Liechtenstein), Switzerland and the 13 candidate countries. It also engages in establishing network and implementing benchmarking among all the incubators in European countries.

Without the inclusive property right mechanism, incubator construction in European countries will not be able to contain so many interest groups' (e.g. the government, local entrepreneurs, financial institutions, and research institutes) incentives and continuously attract their

participation and investment. Followed by the case of China, this part particularly exhibited the importance of institutionally converging the government's interest and the local communities' interest with the respect to cultivating entrepreneurship and fostering incubation programs. Hereby, the government role as a supplier of appropriate institution and a coordinator in incubators' networking as well as continent wide benchmarking should be acknowledged and emphasized based on the European case.

### **2.3. China**

The research of incubator-incubation development in China is not novel to people (Harwit, 2002; Lalkaka, 2003). Since the first technology business incubator was established in 1987, the total number of business incubator has soared to 435 which ranked the second across all nations (China Torch Program, CTP, 2004). While most of the current literatures are paying much attention to the impressive output of Chinese incubators in production, patent and job creation, few of them is successfully to explain the government's role and make it comparable to the other countries. Even there are some experts who questioned Chinese government's mighty, bureaucratic control of business incubator (Harwit, 2002), the absence of a solid and coordinated theoretical frame work obviously limited their influences.

The following noticeable facts which are related to the property right mechanism of Chinese business incubators have inspired our hypothesis that: the government's role in incubator-incubation development followed a completely different model in China. According to the statistic of the Society of China Incubator Central Commission (SCICC, 2004), state owned business incubators which stands for a purely ownership of the government, dominate in this field with a proportion over 75%. Moreover, before the late 1990s, all the incubators in China were state owned and belonged to Torch Program, which is a national high-tech industrialization

initiative (Yu and Stough, forthcoming). Regarding to these facts, property right mechanism of incubator-incubation development could be categorized as a government monopolized exclusive model in China.

What is the rationale behind such a unique model? How the rationale had affected Chinese government's attitude and behavior to reduce transaction cost generated from incubators' networking process? How to evaluate this model's current and future influences to business incubator development in China? Adopting the methodology of institutional economics and entrepreneurship economics, we will try to find corresponding answers in turn.

Unlike U.S. and European countries who built up incubators directly to underpin their formulated strategies for promoting revitalizing regional economics and promote entrepreneurial activities (NBIA, 2003), the startup of Chinese incubators served for the central government's Science and Technology (S&T) mechanism reform (Yu and Stough, forthcoming). In the late 1980s, rural economic reform and the following market oriented industry reform in urban area led to a remarkable prosperity in China. At the same time, while China is gaining more and more profit from the Opening policy and her participation in the international trade, the nation's comparative disadvantage, such as the scarceness of capital and backwardness in the development and deployment of modern technology, forced Chinese central government to launch another trial in order to revise the traditional (S&T) mechanism--Since too much time, fund and too many talents had been consumed in military related high-tech zones, China is too far behind developed countries in commercial and civil products related techniques; Meanwhile an obvious vacancy impeded the transition from S&T research achievement to applicable products favored by domestic consumers. Such embarrassment should be charged to the

indifference and dullness to market demand of the government directed R&D institutes, such as the National Science Academy and most of the universities (CCPCC<sup>①</sup>, 1985).

In 1985, the concept of business incubator was introduced by United Nations to China (Mi, 2001). Professor Song Jian, then head of the China State Science and Technology Commission, sang high praise for incubator's inspiration to adjust Chinese S&T mechanism to a market-driven one. Soon after that, the first business incubator was established in Wu Han city named Dong Hu Business Startup Center in 1987. But the real scaled production of business incubators of China did not begin until the year 1988 when the declaration of the Torch Program came (CNSC, 1994).

Comment [spp3]: More document

While most of the extant literatures describe Chinese government's objective of incubator-incubation development as organizing the network system in Figure1, they were failed to recognize this network as a substitute to traditional S&T mechanism

Figure1here

in China. Regarding this, this paper attempts to conclude the Chinese government's profit motivation in supporting incubator construction as the establishment of a networking system which can effectively join the research institutes and the technology market so as to form a competitive, market oriented S&T mechanism. Therefore, incubator programs were initially devised to restructure the academic and technological resources of Chinese central government, rather than promote regional economic performance and foster entrepreneurship.

After all above, it is clear why Chinese government choose to carry out incubator programs independently. Firstly, evolved from a central planned economy, Chinese government occupied substantial power and resources which allowed it to set up, operate and sustain huge incubator programs without negotiating with local communities. Moreover, after a more than 30 years' experience of highly central-planned economy, local communities or even local governments had

just started to recovery from the deprivation of economic decision-making power in 1980s. They were strong and matured enough to participate in financing or operating incubators. What's more, since the private or even joint-stock enterprise did not gain complete and trustworthy legitimacy in the middle of 1980s, Chinese government could not count on other strengths as a partner to implement S&T mechanism reform. In conclusion, the exclusive model could be institutionally explained as the best option for Chinese government considering expeditiousness and viability. While the superficial organization reform of S&T mechanism had been swiftly finished, the negative impacts of the exclusive model were soon exposed. Conducted by the Torch Program, the transaction costs derived from negotiation or coordination among different interest groups as what happened in western countries have been transformed into the monitoring costs in a principle-agent bureaucratic system (Harwitt, 2001; Stough and Yu, forthcoming). Such a routine system is doomed to be incompatible with the sensitivity and flexibility required by innovative entrepreneurs. This could be told from the low proportion of incubatees which finally graduated from Torch Program's incubators and became competitive companies (Mi, 2001). Since the incubators had not been organically embedded into the network shown in Figure 2, there were hardly any spontaneous cooperation between the incubator and local community unless the cooperation was forced by administrative command. The ignorance of Torch Program incubators to entrepreneurship cultivation through local socio-economic network gradually broke down their connection to territorial markets, human resources, financial supports and the research institutes.

From the late 1990s, the uniformed concern of sustainable regional economic development stimulated Chinese local governments' enthusiasm and input to incubator-incubation development, and the total numbers of technology business incubator soared from year 2000's

131 to year 2002's 436 (CTP, 2004). We could expect that the explosion of local interests in incubator-incubation development may break through the unsustainable exclusive model and realize the combination of entrepreneurship promotion with S&T mechanism reform, which announces the adjustment of the government role. But we should also be aware of the isolation of most Chinese incubators to their local network.

#### **2.4. Middle East and Central Asia**

In recognition of the contribution to the economy that smaller firms make, a number of federal, state, and local government-sponsored intervention programs have been introduced to facilitate the creation and growth of small start-up business (Sherman and Chappell, 1998). Since we have introduced and characterized the role of government in operating business incubators in some counties, we do not include identical practices in Japan, Australia/ New Zealand and Latin and South America, although many interesting developments are occurring in those countries as well. In the following part, more light will be given to the unique incubator-incubation activities in Middle East and Central Asia countries.

Compared with the inclusive model in U.S.A and the exclusive model in China, the government's role in business incubation and development activities in Central Asian and the Middle East countries locates in attracting foreign investment. While there may be some foreign corporate investment activities involved with strengthening technology-based start-ups, most business incubation activities appear to be linked with US and international development programs (Johnsrud, Theis & Bezerra, 2003).

Central Asia countries such like Armenia, Tajikistan, Turkmenistan, etc. are mostly former Soviet states. Historically, these countries were poorly industrialized or simply relied on unitary industry. For their transitional economies, the import of business incubator had been placed on

the task to shift away from deeply entrenched ideas, values, legal and financial structures, and other elements of previously state-controlled economies toward an economy based to varying degrees on free market capitalism. Consequently, it is necessary to encourage growth and development of an entrepreneurial spirit, provide training and awareness about basic business organization forms, operations and competition, and restructure the legal, regulatory, banking and other elements. Hereby, the government's profit motivation in incubator-incubation development exists in a successful, overall restructure of the national economic institution. With regard to Middle East countries like Jordan and United Arab Emirate, their so-called developing and emerging economies, have slightly different demand based on free market capitalism. In these situations, the task more often than not is to strengthen an existing informal capitalist economy and to nurture its growth and expansion. While most of outputs in Middle East countries are produced by large scale oil industries, the benefits brought by small business in market and technology innovation, a comprehensive improvement in national economic competitiveness derived from widespread entrepreneurship, become more and more remote to them. Too much reliance on unitary industry and limited numbers of state own giant factories, which is going to increase the risk of depression in face of various crises, urges the governments to refocus on small business. So, profit motivation for the governments in business development and business incubation systems which have been recently established serve to provide access to technology, improve production processes, expand markets, and provide a range of other assistance to entrepreneurs and small and medium-sized enterprises (SMEs). Rather than re-orient the populace toward entrepreneurship, the emphasis is more often on strengthening the existing base of entrepreneurs and helping them to achieve business growth.

Both Central Asia and Middle East countries were challenged by the weakness of their governments and local community when they intended to set up an appropriate property mechanism for the incubator- incubation development, which made it impossible for them to copy the conceptual model of European countries or China. In Central Asia, most of the governments have just been organized after 1991 and it will be a long journey for them to establish a powerful and effective institutional system so that they could afford the costs of supporting incubator construction like Chinese government. We will get the same conclusion in Middle East area, although the specific situation is more likely to be that the strong religious society there has in some degree diminished the governments' influences to local communities, especially when the governments attempt to build network for incubators. Moreover, the inclusive model in U.S. and European countries will not be viable here since the formation of local community's economic function has just started in transitional economies or even been interfered by religious power in Middle East countries.

The import of business incubators as foreign investments pulled out the governments of above countries from the dilemma we have mentioned. With the assistance from outside international and foreign sources (See Figure 2), including the World Bank, the US Agency for International Development (USAID), United Nations Industrial Development Organization (UNIDO), United Nations Educational, Scientific and Cultural Organization (UNESCO), United Nations Development Program (UNDP), United Nations Development Fund for Women (UNIFEM), and the Eurasia Foundation, those governments with transitional and developing market economies successfully obtained incubator-incubation services from abroad at the price of property right. While the majority of tenants in these international or foreign invested incubators are local

enterprises, they will be expected to gradually promote entrepreneurship at regional level and meet the maximization of the governments' profit in this business.

Table2 here

Despite the triumph in settling property right mechanism, government's role in organizing socio-economic network for incubator-incubation development which aims at expediting information communication and creating local innovative milieu have not been highlighted so far in Central Asia and Middle East. Besides improving the cooperation with international investors, how to provoke the governments' interests as well as their unconsolidated local communities' motivation in such activities will remain as a challenge for these countries, particularly where neither the government nor the local community possess a share of the business incubator.

### **3. Policy Implication**

With respect to the inclusive model which is popular in the United States and European countries, it serves well to the government's intention of promoting technology competitiveness and entrepreneurial activity in national level. Meanwhile, it also functions comparatively better regarding to its efficiency and sustainability which should be ascribed to the inclusive model's property right mechanism and the incubator's embeddedness in socio-economic network. The weakness of this diversified property system could be the conflicts among different interest group, which consumes time or even opportunities to coordinate them. Moreover, the diverse legal status, and consequently the different aims, can have a profound influence on the incubator managerial policy, particularly in the selection of the projects and in the assistance in raising capital and preparing for the market. Such complex situation would certainly requires the

government to support and undertake national wide or even international wide benchmarking work so as to scientifically evaluate and improve the incubators' performance.

As we have shown, the amount of government fund available for incubator-incubation development and the level of government participation varied significantly across countries. But learned from the socio-economic explanation of entrepreneurship and the case of United States, European countries, it is more sensible for the government to play a 'catalytic' role rather than direct management role in incubator development. The case of China displays how a powerful central government could quickly accomplish huge incubator construction plan with a pure exclusive model. But it simultaneously reminds us that the dynamics of entrepreneurship and innovation depends on a tight interdependence among different actors within the regional system, it must be territorially based on the network rather than on the hierarchy, on the spatial interconnection rather than on the isolation, on the mutual learning and reciprocal exchange of technologies rather than on the interdependent managerial enterprise model.

The experience of incubator-incubation development in Middle East and Central Asia shows the role of government in technology and entrepreneurship promotion where neither a powerful government nor a conformed, resourceful local community exists. The problem that might derive from those governments' dependence to international incubator programs is whether these exogenous resources could synergize with the local context. According to our socio-economic rationale, the government in Middle East and Central Asia countries must learn how to play a role of 'guide' or 'coordinator' so as to facilitate the communication between those international incubators and local communities.

#### **4. Conclusion**

Although there is now a convergence of different governments' attitudes to incubator-incubation programs, an overlook to these governments' diversified understanding of business incubator as well as their specific strategies to carry it out has existed in extant literatures. Therefore, this paper attempts to extract and categorize the government role via case studies to representative countries incorporating the methodology of North's (1981) institutional economic theory and the socio-economic approach of entrepreneurship economics (Etzioni, 1987, 1988).

Through the case study to United State, European countries, China, Middle East and Central Asia countries, three models can be generalized based on the paper's methodology. First, 'the inclusive model' with the premise that the maximization of the government's utility exists in technology innovation and sustainable regional economic development. United State and most of the European countries' government adopt this model since they own comparatively full developed local communities and entrepreneurship enlightened governments. A completely opposite exclusive model has been driving the incubator program in China while the central government administratively nailed incubators into local community to reform its S&T research mechanism. With the explosion of local communities' strength, this model seems to be on the edge of restructuring now. The last model which is widely accepted in Middle East and Central Asia countries depends on the investment and aids from international organizations. These governments tend to utilize international support to accelerate their economic transition or steps toward entrepreneurship before their local communities accumulated sufficient socio-economic capital.

Policy implications based on corresponding theoretical and empirical analysis have been provided at the end of case studies. However, since many countries face the wide socio-economic gaps existing between core and peripheral regions, between advanced and backward

regions, and these gaps often exacerbate spatial, social and political unrest, this part sheds more light on the importance of the government's acknowledgement to socio-economic network.

### **Endnotes**

①CCPCC, Chinese Communist Party Central Committee.

②CNSC, China National Science Committee.

**Appendix 1**

Table1. Business Incubators in European Economic Transition Countries

| Country  | Incubators Total | Survey Sample | Average Investment (US\$ 1000) | Building Net m2 | Tenants Firms | Employees |
|----------|------------------|---------------|--------------------------------|-----------------|---------------|-----------|
| Czech R. | 27               | 17            | N/A                            | 5,757           | 26            | 105       |
| Poland   | 19               | 19            | N/A                            | 1,813           | 15            | 88        |
| Turkey   | 5                | 2             | 568                            | 951             | 16            | 72        |

Source: Lalkaka, 2002.

**Appendix 2**

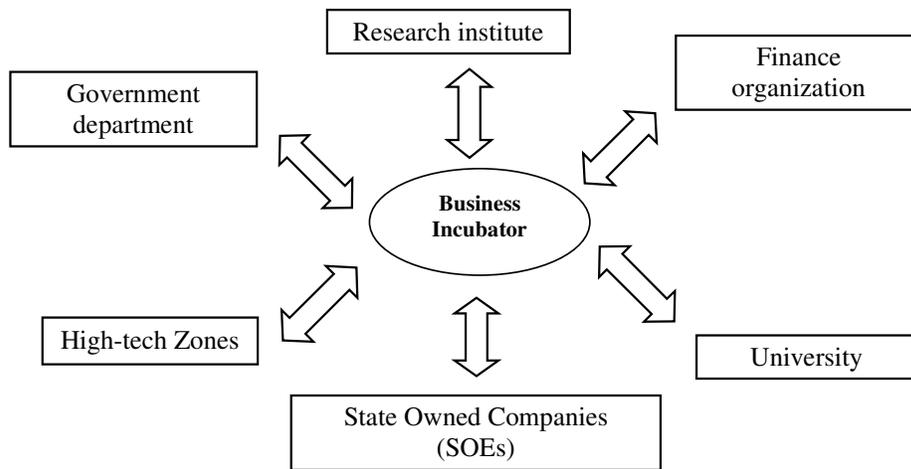


Figure1 Conceptual Network for Business Incubators in China

Source: Yu and Stough, 2005 (forthcoming).

### Appendix 3

Table2 International Development Agencies in Central Asia and the Middle East

| Name of the Agency | Recipients  |
|--------------------|---|
| World Bank         | N/A   |
| USAID              | Kazakhstan, Kyrgyzstan,<br>Tajikistan, Turkmenistan, and Uzbekistan   |
| UNIDO              | Uzbekistan  |
| UNESCO             | N/A   |
| UNDP               | Albania, Armenia, Azerbaijan, Kazakhstan,<br>Kyrgyzstan, Tajikistan, Turkmenistan, Ukraine,<br>Uzbekistan. 17 countries in Middle East and North Africa |
| UNIFEM             | Kazakhstan  |
| Eurasia Foundation | Armenia, Azerbaijan Kazakhstan, the Kyrgyz Republic,<br>Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.  |

Source: Johnsrud, Theis and Bezerra, 2003

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## **Navigating the Choppy Waters of Economic Development: How Does Entrepreneurship Promotion Fit Into the Mix?**

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### **ABSTRACT**

This study provides insight into how entrepreneurship promotion fits within state and local economic development strategies. This is achieved by tracing the evolution of entrepreneurship policies and programs and how they supplement or complement other developmental tools within the state and local government's economic development arsenal. The study discusses the importance of entrepreneurship for economic development and provides the background for why it must be a central component of any economic development strategy. An overview of entrepreneurship policy is presented with emphasis on micro-level entrepreneurship policies and policies targeted at developing the entrepreneurial climate, which are the primary tools of entrepreneurship promotion used by state and local economic development practitioners and policymakers. The four waves of economic development strategies are introduced and entrepreneurship promotion as an approach to economic development in the context of these waves is discussed in-depth.

### **INTRODUCTION**

This study reviews the use of entrepreneurship support and promotion as an economic development approach against the backdrop of the shifts in state and local economic development strategies. The goal is to provide insight into how entrepreneurship promotion fits within the context of state and local economic development strategies. This is achieved by tracing the evolution of entrepreneurship policies and programs. Four waves of economic development are introduced and entrepreneurship promotion as an approach to economic development in the context of these waves is then discussed in-depth.

For this study, the focus is on economic development at lower levels of government such as at the state and local levels. The analysis is limited only to developmental efforts within the U.S. and does not cover economic development activities of the national or federal government. Economic development is defined as the efforts on behalf of state, municipal, and local governments to "encourage private investment in a particular jurisdiction for the purposes of generating or retaining jobs, expanding the tax base, and increasing the general level of economic well-being" (Eisinger, 2002, p. 20). Such definition of economic development, therefore, includes all efforts by the states, regions, and cities to develop an entrepreneurial base and encourage entrepreneurship.

## **ENTREPRENEURSHIP AND THE ECONOMY**

Why is entrepreneurship important for economic development? Why should developing an entrepreneurial base and promoting entrepreneurial activity be a central component of any economic development strategy?

Entrepreneurship and entrepreneurial firms have been important drivers of economic growth in the U.S. Nearly 70% of the U.S. economic growth can be attributed to entrepreneurial activity (Reynolds, Hay & Camp, 2000). Since the 1980s, the majority of new jobs generated in the American economy can be attributed to entrepreneurial firms (Slaughter, 1996). Entrepreneurial firms have contributed close to two-thirds of the net new jobs in the 1990s (NCOE, 2002).

Entrepreneurial firms have also been found to be responsible for more than half of the innovations changing our economic and social landscape. 67% of all inventions (Zacharakis, Reynolds & Bygrave, 2001) and 95% of all radical innovations created since World War II (Timmons, 1999) can be attributed to entrepreneurial firms. Some examples of innovation produced by entrepreneurial firms include microcomputers, cardiac pacemakers, overnight package delivery, auto airbags, air conditioning, artificial skin, frozen foods, heat sensor, hydraulic brake, safety razor and soft contact lenses (Slaughter, 1996; Timmons, 1999).

### **POLICIES TO ENCOURAGE AND PROMOTE ENTREPRENEURSHIP**

Policies to promote entrepreneurship can be broadly classified as macro policies aimed at the macroeconomic environment, micro policies supporting entrepreneurs and entrepreneurial firms, and policies aimed at improving or supporting the entrepreneurial climate (Glancey & McQuaid, 2000). The goal of macro policies is to provide a conducive economic environment within which entrepreneurship can occur. Since these economic conditions are not specific to entrepreneurship, but are instead necessary for all transactions within the economy, these macro policies affect all economic activity, not only entrepreneurial activity. Micro level policies, often adopted by state and local governments, on the other hand, are aimed at assisting individual firms and entrepreneurs (Malecki, 1994). These policies seek to encourage collaboration among firms and entrepreneurs, support and/or enhance the flow of resources such as information and financing, and to provide a flexible response to entrepreneurship factors specific to a region or locale. Policies aimed at the entrepreneurial climate and culture are based on the assumption that a supportive entrepreneurial culture will lead to greater entrepreneurship. The Commission of the European Communities (1998), for example, has found that the development of an entrepreneurial culture is critical if a region hopes to increase its entrepreneurship levels.

States, regions and cities have increasingly begun to understand the unique role entrepreneurs play in the U.S. economy. They have increasingly become involved in developing policies and programs targeted at facilitating and encouraging entrepreneurship and have introduced them into their cache of economic development tools. At the state and local levels, most policies and programs targeted at entrepreneurship can be categorized as micro-level policies. Policies targeted at improving and supporting an entrepreneurial climate have also been used by states and local governments to encourage entrepreneurship. These micro-level policies and

entrepreneurial climate- or culture-related policies will be the primary focus of this exploration of entrepreneurship promotion in the context of state and local economic development.

## **ENTREPRENEURSHIP PROMOTION AND ECONOMIC DEVELOPMENT**

The previous sections have provided both an understanding of why entrepreneurship promotion is an important element of any economic development strategy and an introduction to the types of policies and programs underpinning entrepreneurship support and promotion. This section will provide an in-depth review of the four waves of economic development and will discuss how the promotion of entrepreneurship and entrepreneurial activity fit into each wave.

### **First Wave: Focusing on Big Business through Industrial Recruitment**

The first wave of economic development strategies, which began in the 1930s and continued in popularity until the 1970s, has traditionally been referred to as industrial attraction and recruitment or smokestack chasing. During this first wave, economic development “meant organizing an industrial sales force in the state’s economic development agency, arming it with a menu of subsidies to lure footloose plants and back office operations across state lines” (Ross & Friedman, 1990, p. 3). Success was measured by the number of firms captured and the number of jobs created, with little regard to the types of jobs and industries being developed (Waits, 2000). First wave programs were primarily designed as locational incentives to lure manufacturing facilities and back office operations from outside the state or region by lowering the costs of production. The typical economic development policy tools for the first wave were subsidized or low-interest loans, land write-downs, investment credits, direct payments to firms for relocation expenses, tax abatements and reductions, and labor-training grants (Bradshaw & Blakely, 1999; Eisinger, 1995).

This first wave was based on luring businesses from outside a region by lowering the costs of production. The emphasis was on large, established manufacturing corporations with branch plants or facilities. Policy tools used during this period were specifically tailored to the needs of these big businesses. The heyday of the first wave, the 1950s and 1960s, was the era of big business. Small firms were seen as less efficient and less productive compared to big business (Audretsch, 2003). Entrepreneurial firms were not at all the focus of economic development efforts, primarily because economic development practitioners and policymakers saw much more potential for job creations coming from the large manufacturing plants. In its search for new branch plants and other major facilities, first wave economic development strategies often ignored the role of small- and medium-sized businesses and entrepreneurial companies. The practice of economic development often ignored the needs of these firms, instead, tailoring economic development programs and tools to meet the lower production cost needs of big businesses.

### **Second Wave: Growing Locally, Emphasizing Small- and Medium-Sized Businesses**

The second wave of economic development came about in the late 1970s and in the wake of the recession of the early 1980s. In addition to the goal of job creation, the second wave was also oriented towards economic diversification. The second wave saw a shift in focus from attracting

out-of-state firms to building, retaining and expanding indigenous businesses. While the second wave came about primarily as a result of the widely accepted belief in the undependability of smokestack chasing, several other factors also contributed to the rise of the second wave, including increased global competition, rapid changes in technology, new studies linking small firms and their contributions toward economic growth, and the retreat by federal government from economic development (Eisinger, 1988; Ross & Friedman, 1990; Kossy, 1996, Blair, 1999; Waits, 2000).

Birch's (1987) groundbreaking book *Job Creation in America* had a significant impact on the second wave approach taken to grow and develop local economies. Thanks to new knowledge about the role of small businesses in job creation, economic development practitioners and policymakers realized that they could no longer ignore small- and medium-sized businesses. The large manufacturing branch plants – the holy grail of first wave economic development strategies – had become more elusive targets as they began to look abroad for even lower production costs. With advancements in production technologies, manufacturing processes became more capital intensive, and the large manufacturing corporations became less attractive as sources of job and wealth creation for states and local economies.

To maintain a strong and vibrant economy, economic development practitioners and policymakers could no longer rely on big business. Instead, they had to adopt new strategies that were aimed at increasing the number and size of homegrown businesses. As the backbone of the economy and the primary creator of jobs, these homegrown businesses needed to be incorporated into the economic development agenda.

Economic development efforts of the second wave were focused on offering services that made it easier for homegrown small- and medium-sized firms to do business. This was primarily achieved by lowering the costs of doing business. When these businesses had trouble obtaining financing, capital access programs such as revolving loan funds, below-market loans or tax increment financing were created. When businesses required affordable real estate space, the first generation of business incubators were developed and put into practice. When the small and mid-size businesses had specific training needs for continued growth, inexpensive training programs and training subsidies were provided. Specific technical or informational needs were addressed using counseling from small business development center, technology assistance and commercialization programs, and centers for entrepreneurship. Combined, these initiatives created a business support infrastructure in the community or state.

Entrepreneurship promotion of the second wave took the form of micro-level policies aimed at providing specific assistance to individual firms and business owners. This assistance ranged from financial assistance, information and training, technology and technical assistance, and business and management assistance. The basic philosophy behind the second wave was to meet every business need or fill every service gap faced by homegrown businesses. New organizations, programs, and/or services were created to meet every new need, resulting in programmatic sprawl with a plethora of new programs providing a multitude of economic development activities (Pages et al., 2003). In addition, state and local governments also had to be entrepreneurial in providing economic development support, as “the public sector is called on

to play entrepreneurial roles such as market developer, broker, financial partner, and risk bearer” (Robinson-Barnes & Waugh 2000, p. 1588).

As this discussion illustrates, the second wave of economic development strategies was more entrepreneurially-oriented than the first wave. The goal was to support not only the growth and expansion of small and medium businesses, but also the start-up and creation of these businesses. The model behind this second wave is what Mokry (1988) calls an “entrepreneurial model,” which is based on the assumption that entrepreneurs and their new firms have a large and untapped potential to improve the health and condition of local economies. However, Pages et al. (2003) argue that economic development practitioners have, for many years, paid lip service to the importance of entrepreneurship to local economies, yet doing little to encourage and support entrepreneurship. I believe that despite the good intentions of second wave economic development practitioners, encouraging and supporting entrepreneurship was not the primary emphasis of their programs and services. These programs and services provided mostly business support, and not entrepreneurial support. Business support addresses the basic needs of all types of firms, whereas entrepreneurial support addresses the unique needs of entrepreneurs and their firms.

### **Third Wave: Economic and Institutional Capacity Building**

Third wave economic development strategies hit the economic development arena in the late 1980s and early 1990s. Eisinger (1995) suggests that the third wave of economic development strategies was essentially in response to the lack of scale and accountability of the entrepreneurial development programs of the second wave. The third wave was also based on the new realization that while government is responsible for assuring the accessibility of necessary economic development resources, it does not have to be the sole supplier of such resources (Ross & Friedman, 1990). Third wave strategies, therefore, expanded the economic development paradigm by shifting the focus of economic development efforts to “creating the context for economic growth through public-private partnerships, networks that leverage capital and human resources to increase the global competitiveness of a group of strategically linked firms” (Bradshaw & Blakely, 1999, p. 230) or what Eisinger (1995) called capacity building. Many of the best examples of collaborative partnerships for third-wave programs were aimed at building institutional capacity such as through the promotion of technology and technology transfer, business development, and job retention.

The third wave involved a shift in both the content and delivery of economic development policy (Pages et al., 2003). The former involved a shift away from a provider-driven model of business assistance to a customer-driven model. While the focus remained on small- and medium-sized businesses, the approach taken to support these businesses had changed. This change in content involved moving beyond simply emphasizing reducing business costs to having a wider application that include specific business assistance related to process and manufacturing modernization, technology investment, and strategic planning.

Compared to the first and second waves, the third wave of economic development strategies was also more holistic. Policymakers and practitioners had come to the realization that policies related to education and other infrastructure also “determine the configuration and the quality of

the “playing field” on which all economic activity occurs” (Kayne, 1999, p. 1). This realization pushed many economic development practitioners and policymakers towards incorporating educational, infrastructure, and other aspects of development into the economic development mix.

From a delivery mechanism perspective, the third wave’s new approach shifted the delivery of economic development programs away from the public sector as nonprofit and private sector organizations became more involved. These organizations were assumed to have a better grasp of business needs and better able to more effectively deliver the services. Economic development organizations were no longer lone rangers in the crusade. Instead, a range of government agencies, and their nonprofit and private sector partners, acted together to build local, regional, and state competitiveness.

While third wave programs, for the most part, continued in the path of micro-level entrepreneurship policies achieved through supporting new small- and medium- sized businesses, there were also broader programs targeted at the entrepreneurial culture. Entrepreneurship policies of the third wave sought to influence or shape the region’s entrepreneurial climate. A fundamental philosophy behind the third wave was that a clear set of well-articulated economic development policies targeted at entrepreneurship, combined with an effective business-community organizational structure, will create a climate and infrastructure that facilitate new firm establishment as well as the retention and expansion of existing firms.

Third wave economic development strategies did not offer much guidance or assistance to the growing service sector or to the growing numbers of self-employed individuals and start-up firms that might offer hope to the more distressed communities that lack major home-grown industries. While the emphasis had been on small- and medium-sized businesses, the majority of economic development programs tended to enhance the competitiveness of existing firms, while neglecting to build entrepreneurial capacity for future growth (Pages et al., 2003).

#### **Fourth Wave: Entrepreneurial Development**

The late 1990s and early 2000s marked the beginning of the entrepreneurial age in the U.S. This entrepreneurial age also coincided with the onset of the “new economy” and its associated emphasis on entrepreneurship and technological advancement. Entrepreneurs and their companies, especially those in technology-related industries, played a pivotal role in transforming the economic landscape. The pivotal role of “gazelles” or high-growth small entrepreneurial firms in all industries also helped set the stage for entrepreneurial development of the fourth wave.

Thanks to these technology firms and gazelles, many economic development practitioners and policymakers have come to realize that entrepreneurs are essential change agents in the new economy and are major contributors to economic growth. The transition to the new economy, in the late 1990s, prompted the states to reexamine their economic development policies. For example, several states have adopted development strategies to improve their economic competitiveness in industries such as advanced manufacturing, biotechnology, information

technology, and telecommunications. Entrepreneurs and entrepreneurial firms are critical elements of these new strategies.

There has been some confusion over the fourth wave, which began gaining a foothold in the late 1990s. Pages et al. (2003) introduce the fourth wave as entrepreneurial development. Waits (2000) discusses the emergence of a fourth wave that is based on cluster-based economic analysis and strategy development. I believe that entrepreneurial development is at the heart of the fourth wave of economic development strategies, achieved through a combination of technology-based development and cluster-based development. The goal of this entrepreneurially-driven fourth wave is business creation and growth, rather than number of firms attracted or jobs created and retained.

While second and third wave programs targeted small- and medium-sized businesses, most fourth wave programs and services favor entrepreneurial and technology companies. The transition to the new economy, in the mid to late 1990s, prompted economic development practitioners and policymakers to adopt strategies to improve their economic competitiveness in select industries such as advanced manufacturing, biotechnology and life sciences, information technology and telecommunications. Entrepreneurial development plays a prominent role in building these industries. States have invested heavily in research and development efforts and have created programs to stimulate commercial and entrepreneurial activity around technology innovations. These programs are often targeted towards specific high tech industry clusters.

As a developmental approach, clustering allows firms to develop a high degree of specialization, creates specific industry niches, eases entry and new business start-ups because of low vertical integration, facilitates greater access to capital, and creates spillover effects. Enhanced entrepreneurial activity is a direct outcome of clustering and its creation of critical mass.

“While most state policies for small business benefit entrepreneurs, there are important aspects of entrepreneurship that can be nurtured by effective state policies targeted to their specific needs” (Rubel & Palladino, 2000, p. 7). This is where the fourth wave of economic development strategies came into play. Second and third wave strategies were oriented more towards the needs of small and medium businesses, with the needs of entrepreneurs and their organizations being subsumed under these broader business needs.

In addition, entrepreneurial development programs had previously been scattered throughout state and local government and did not fall completely within the purview of economic development. During the fourth wave, the trend has moved away from single-standing programs or organizations toward housing entrepreneurial development activities within larger and more traditional economic development organizations. Traditional economic development, especially the second wave, has often been plagued by what Pages et al. (2003) call “program-itis.” When a new business need was identified, economic development practitioners and policymakers responded by creating a new program to address this need, and then creating an organization to provide the program. Encouraging and promoting entrepreneurship, through the fourth wave’s entrepreneurial development, however, requires a more holistic approach. Numerous government agencies, private sector leaders, and non-profit organizations must come together to build an

infrastructure that provides education, linkages, learning opportunities, and other services for entrepreneurs.

These shifts indicate two important aspects of entrepreneurship promotion during the fourth wave. First, is the mainstreaming of entrepreneurial development as the entrepreneurship mission becomes more central to economic development. Second, is the increasingly central role of entrepreneurship promotion as a core economic development program. During the fourth wave, entrepreneurial and business assistance programs of the third wave were increasingly becoming integral parts of the economic development landscape.

Technology-based development is also a major component of fourth wave economic development strategies. Initially, this development was tightly clustered in specific cities or regions, such as Seattle, San Francisco/Silicon Valley, and other “techpoles” or “innovative milieus.” In these communities, economic development is founded on supporting technology-based entrepreneurial firms. The goal of economic development is to create agglomeration forces through promoting the availability of venture capital, increasing the strength of research universities, maintaining high quality of life, and ensuring the presence of a strong labor pool with the requisite technology skills. Technology-based development overlaps with entrepreneurial development to create regions – such as Boston’s Route 128, San Francisco’s Silicon Valley and Austin, Texas – and states – such as Massachusetts, Washington and California – that lead the country in terms of economic growth and prosperity.

In other areas of the country – particularly the small- and mid-sized cities – a different kind of technology-based development is taking place. This approach to economic development is oriented around meeting the technology needs of local companies, regardless of their technology orientation. While these technology needs may be related to information technology and telecommunications, they could also be manufacturing- or process-related, retail- or inventory-oriented, or simply be related to general business services (Sommers & Heg, 2003).

Most fourth wave entrepreneurial development programs and services favor technology companies. States have invested heavily in research and development efforts and have created programs to stimulate commercial activity around technology innovations. States are highly focused on ways to create investment capital though access to such capital may or may not be useful to all entrepreneurs (Rubel & Palladino, 2000). Where states have specifically created programs for entrepreneurs and their organizations, they are targeted towards specific industry sectors. The most common industry sectors have been biotechnology, telecommunications, software, computing, advanced manufacturing, etc.

Economic development of the second and third waves have primarily utilized micro-level entrepreneurship policies. The fourth wave approach to economic development, on the other hand, is much more reliant on entrepreneurship policies that seek to develop or enhance the entrepreneurial culture or climate. The entrepreneurial development model is based on several philosophies (Pages et al., 2003), which include (1) focusing on an entrepreneurial eco-system; (2) promoting cultural change; (3) serving individuals, not firms; and (4) focusing on high growth.

## CONCLUSION

As shown by the later economic development waves, supporting entrepreneurial firms and encouraging entrepreneurship have become important to practitioners and policymakers as they contemplate enhancing and diversifying their region's economic base. "As states and local governments move beyond industrial recruitment approaches and seek to develop locally based business and foster clusters of related small firms, questions of how entrepreneurial activity can be amplified become important to state policy" (Goetz & Freshwater, 2001, p. 59).

The state's role in facilitating access to financial capital has a long and varied history, and over time states have implemented a variety of measures to increase capital availability for entrepreneurs such as through state venture capital funds, guaranteed loans, and angel networks. As education became more integrated into the economic development arena, the number of university-based entrepreneurship centers and entrepreneurship curriculums exploded. States have invested in creating entrepreneurial centers of excellence, in addition to funding and supporting the development and implementation of entrepreneurship curriculum within the primary, secondary and post-secondary educational systems, and a variety of other educational programs. Provision of direct entrepreneurial support, such as through small business development centers and incubators, has also undergone transformations, both in content and service delivery. All these changes are evident if we analyze the evolution of modern economic development to begin to understand how entrepreneurship promotion rose from obscurity to become the core of today's economic development practices.

This study identified the different waves of economic development within the American landscape of the past seventy years, and traced along the progression of approaches taken by state and local governments to encourage and support entrepreneurship and entrepreneurial activity. It provides an understanding of when and why various entrepreneurial programs came into existence and how they evolved from the early focus on small- and medium-sized businesses to the current focus on technology entrepreneurship and gazelles.

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# DEVELOPING A TOOL FOR COMPETENCE ANALYSIS WITHIN A REGIONAL SME CLUSTER

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## ABSTRACT

The globalization of the German economy requires new marketing strategies for SMEs since their traditional marketing management is not sufficient in achieving success. This paper is focused on 'Musicon Valley', a regional SME cluster based on musical instrument industry ties, geographical closeness, and networking. This cluster in the Saxonia Vogtland is continuously facing growing competition, particularly from Asian competitors. It is becoming a difficult task for an individual company to be successful, therefore the cluster becomes the way to protect and strengthen competitiveness of individual firms.

Following a description of the cluster, in this paper a basic framework for competence analysis is explained. Since this instrument has been developed for application to a different situational context, the necessities of and starting points to adapting it to the analysis of competencies within the cluster Musicon Valley are discussed.

## INTRODUCTION

In this paper the conceptual basis of an instrument for the analysis of the competencies within a regional SME cluster is outlined. Such a competence analysis is a part of a recently started research project funded by the German Federal Ministry of Education and Research (BMBF). The overall goal of this project is to strengthen the competitiveness of individual firms as well as the whole cluster by inducing a learning process within the network aiming at the optimization of the marketing activities. The diagnosis and building of competencies are therefore considered as fundamental prerequisites for this process.

The paper is structured as follows. In the next section the SME cluster 'Musicon Valley' and its market and competitive situation are described. Then the basic ideas of an analytical framework

for competence analysis are presented. The following section of the paper discusses the adaptations necessary in order to apply this framework to the analysis of the cluster Musicon Valley. Finally, starting points for this task are suggested.

### **THE SME CLUSTER MUSICON VALLEY**

The cluster Musicon Valley consists of musical instrument manufacturing companies in the Saxonia Vogtland, a region in East Germany where this industry has an internationally unique tradition and concentration.

A few facts may suffice to underline this appraisal:

- In the year 1677 the first German craft guild of violin makers was founded;
- Already at the beginning of the 19th century a wide range of musical instruments and accessories were manufactured;
- From 1870 overseas trade and export began (especially to the USA; even setting up of sales branches);
- To date approximately 140 firms exist;
- Around the geographic center of the cluster, the city of Markneukirchen, the musical instrument industry represents between 60 and 65 percent of the economic infrastructure.

Despite this impressive tradition and economic significance for the region, the development of the Vogtland musical manufacturing industry in the 20th century was neither linear nor unbroken. The First World War, the world economic crisis, the Third Reich and the Second World War, the subsequent integration into the Eastern Bloc economy with its nationalizations of businesses and finally the breakdown of the Eastern Bloc and the German reunification each led to specific structural discontinuities and crises.

After the recent economic setback following the German reunification in 1990 a consolidation of the regional industry was reached. Nevertheless, a substantial drop in employment had to be accepted resulting beyond numerous insolvencies from the change from the predominating concentration on mass production during the GDR back to a production based mainly on craftsmanship. The available employment figures (1964: 6416 employees, 1995: 1033, 2000: 1213, 2005: 1120) indicate that after a dramatic loss of jobs a slight relaxation took place until the year 2000. Meanwhile, the growing competitive pressure resulted again in a loss of jobs. The following table 1 shows the percentages of the firms and of the employees which are engaged in manufacturing the different kinds of products.

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Table 1 about here

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Approximately three quarters of the cluster members are firms concentrating on tailor-made production of single high-quality musical instruments, especially in the fields of string instruments, bow making and plucked instruments. One half of the firms (ca. 70) are very small, employing altogether 225 people (ca. 20 percent of all employees). In contrast, roughly 30 firms are small and medium-sized businesses with up to 250 people employed. The latter specialize in

standardized large scale production of brass instruments, hand and mouth harmonicas, music electronics and electric basses and guitars.

With a share of approximately 50 percent of the total sales the export plays an important role for Musicon Valley. The most important export markets are the USA, Japan, Korea, and the European countries, whereby the tradition and quality of the instruments are regarded as being salient choice criteria for the customers. For the international sales it is crucial to visit trade fairs and get into direct contact with potential customers, some firms also attempt to sell via the internet but this medium does not yet contribute significantly to the figures of total sales. In the field of high-quality instruments the relationship between manufacturer and customer plays a prominent role for the sales success because the buyers wish to be treated like a partner who is involved in the production process.

Due to the ongoing economic globalization (Sheth & Parvatiyar, 2001, Yip, 2003) the Vogtland firms are facing a constantly growing competitive pressure. Especially the increasing threat by Asian (China, India, Korea, Vietnam) and East European (Hungary, Czech Republic, Romania) competitors makes it necessary to restructure their business activities, a task which proves to be very difficult for individual businesses by themselves. The low-price segment already seems to be hopelessly lost to the competitors, while at the same time there are growing problems even in the higher priced segments due to tremendous quality improvements of the foreign manufacturers.

In the year 2000 more than 120 firms have joined the network Musicon Valley that is taking part in the BMBF initiative InnoRegio, a program intending to enhance the innovativeness of East German regions. Other members apart from the musical instrument manufacturers are research and educational institutions, business associations, public administrations, etc. Conceptually, Musicon Valley can be regarded as a regional cluster in Porter's (1998a, 1998b) sense, whose respective criteria are, e.g., the geographical closeness or the close ties within an industrial branch, but also as a network (Sydow & Winand, 1998, Hinterhuber & Stahl, 1996). Here the broader cluster concept is preferred.

A central cluster player is the registered society Musicon Valley e.V. which within the context of the InnoRegio initiative has the function of organizing and moderating the network and also performs free services for the members (international image building activities, collection of information, acquisition of public funds, project management, controlling of the network activities). After the end of the InnoRegio initiative in 2006 Musicon Valley e.V. will only be able to sustain if it succeeds in finding new sources of income, e.g., revenues from paid services and membership fees. Another important network player is MIGMA e.G., a registered cooperative society, which has been performing sales functions for the craft businesses since the 1940s. Additionally, chambers and craft guilds play a role for the network and even single 'grassroots activities' can be named. The latter are efforts of cooperative marketing and sales activities.

Nevertheless, it has to be stated that the cluster players did not yet succeed in making full use of the potentials the network and its umbrella brand 'Musicon Valley' are offering for the international marketing activities. This appraisal marks the starting point for the competence analysis.

## **AN ANALYTICAL FRAMEWORK FOR COMPETENCE MEASUREMENT**

The basis of the competence analysis forms a framework developed by Zanger and Deckow (2003, Deckow & Zanger, 2002, Deckow, forthcoming) which at first distinguishes between the two dimensions of competencies related to single persons and those specific for the firm as a whole. Because the analytical unit of interest is the firm, only the latter will be dealt with in this paper.

The firm-specific competence dimension consists of collective capabilities, skills and knowledge which - in the sense of a (sub) system specific potential - allow fulfillment of a distinct category of tasks or requirements in a reliable and sustainable way (Dosi et al., 1992, Cohendet et al., 1999). In sum, they are the basis of core competencies (Prahalad & Hamel, 1990) the existence of which is crucial for building and securing a company's success. Resources are regarded as firm-specific assets which, due to the existing implicit knowledge and transaction costs, are far from being imitated easily by competitors (Teece, Pisano & Shuen, 1997). The core competence approach is adopted here because of its ability to connect the conflicting perspectives of the market-oriented and the resource-based view of strategic management.

In order to gain a rough structure of the firm-specific competence concept, the subdivision suggested by Turner and Crawford (1994) that differentiates between company, management and technology competencies is applied.

First, company competencies are those potentials mirroring a firm's current market position and public image, e.g., the financial and innovative strength, the scope and price-performance ratio of its products and services, and its marketing and order processing capabilities.

Second, the term management competencies addresses those potentials which allow to control a company's processes necessary for planning, organization, leadership, supervision, and coordination.

Third, technology competencies comprise those potentials enabling a firm to continuously create product and process innovations as well as to master the processes of production, logistics, services, and technology oriented cooperation.

Indicators for the factors of the described rough differentiation were derived by means of an interdisciplinary literature review and a following dimensional analysis (Faix & Krupp, 2002). In the next step the appropriateness of these indicators was examined during expert interviews (Deckow, forthcoming). The resulting list of basic indicators for measuring firm-specific competence is shown in the appendix.

## **ADAPTATION NECESSITIES TO THE ANALYSIS OF MUSICON VALLEY**

Due to the fact that developing competencies has to be understood within the specific situational context (Van de Ven, 2004), each competence analysis requires the evaluation of the appropriateness and a following adaptation of the general framework to the objects of interest and research questions, respectively. For the cluster Musicon Valley four aspects are regarded as being of crucial importance.

1) The analytical framework described above has been developed for the requirements of the marketing of the so called 'contract goods' (Kaas, 1992). Therefore, it is not only based on approaches from management research but also on ideas from the economics of institutions and economics of information. The latter stress the vital role that credence qualities play for the marketing of complex plants and systems (Schade & Schott, 1993) and, therefore, the necessity of a 'signaling' (Spence, 1973, 1976) through competence marketing (Deckow, forthcoming). In contrast, for the marketing of the products of the Vogtland manufacturers of musical instruments,

search and experience qualities are more prominent compared to credence qualities (Nelson, 1970, Darby & Karni, 1973).

Accordingly, it is argued here that the specific international market situation of the cluster Musicon Valley and its members requires specific signaling activities. Since the numerous political changes during the 20th century altered the situational context several times in an unfavorable way, after the German reunification in 1990 the Vogtland musical instrument manufacturers could not start from such a prominent market position they were holding until the end of the 1920s.

This implies that the international reputation of the cluster is not as good as it could be without the discontinuities it had to suffer - considering the unique combination of regional concentration, historic tradition and craftsmanship. Here, it is argued that signaling capabilities in the sense of management and marketing competencies have to be built up which allow the single firm as well as the whole cluster to transmit this combination to potential customers. After all, many companies offer high end products which are not adequately valued by the market. Hence, particularly the smaller firms could benefit from a strong network brand in order to stand out from the mass of international competitors. Further, it is assumed that the signaling impact of the cluster (through regional tradition) could by far exceed what is possible for a single firm.

2) In general, most of the small enterprises are only capable to fulfilling the prerequisites and tasks of a successful international marketing in cooperative efforts. This implies that besides the single firm perspective it is necessary to analyze the competencies of network structures.

3) An additional difference between the competence analysis of the cluster Musicon Valley and the previous analyses by Zanger and Deckow (2003, Deckow, forthcoming) results from their focus on the single business transaction in the marketing of contract goods - even if it has to be acknowledged that usually there are intense interactions following the sales transaction. In contrast, developing a relationship management and marketing (Parvatiyar & Sheth, 2001; Sheth & Parvatiyar, 1995) is a crucial step for advancing towards the goal of continuously rising or stabilizing the sales of musical instruments.

4) The Musicon Valley cluster consists of SMEs. This kind of businesses differs from large companies not only with regard to the resources available, also its management is much more oriented towards the entrepreneur himself. Hence, approaches of an 'entrepreneurial management' (McCarty, 2003, McGrath & MacMillan, 2000) seem to hold valuable potentials - especially for understanding the cooperative efforts of the single firms within the network.

## **STARTING POINTS TO THE ADAPTATION OF THE ANALYTICAL FRAMEWORK**

As central aspects of the core competence approach are already integrated in the basic framework by Zanger and Deckow (2003; Deckow, forthcoming), with regard to a managerial foundation of the competence analysis in the special case of Musicon Valley especially the cooperative, network and relationship aspects are to be considered.

Highly stimulating for this task proves Vanhaverbeke's (2001, 97) study who develops a framework for the analysis of the 'construction and home furnishings' business cluster in South West Flanders (Belgium) by "combining the ... 'value constellation' concept [Normann & Ramirez, 1993] and the literature about industrial districts". Vanhaverbeke (2001, 97) points out that the "advantages related to geographical concentration of economic activities are insufficient in the competition with companies that are linked to each other within a value constellation". He further argues that it is not very likely that such a customer-oriented network evolves by chance

because SMEs are locked in their traditional ways of doing business. Moreover, a customer-oriented network has to be built intentionally. With regard to participation in a network O'Driscoll et al. (2000, 193, 194) even address the danger of a "network myopia" where "continued participation in a particular network [e.g., a cooperative sales system in the cluster], with its shared information resources, mindset and expectations, can blinker the firm to opportunity and advantage elsewhere".

Central network actors like business associations or local institutions which are capable to act as disseminators can play a crucial role in overcoming those mental blocks even if they are also underlying a tendency "to being locked into traditional and unproductive patterns of interaction" (Vanhaverbeke, 2001, 113).

The analyses performed so far within the cluster Musicon Valley confirm all assumptions. Neither are most of the firms unwilling to give up their autonomy in production and marketing in favor of a network nor are the active network actors enjoying enough trust to convey major marketing tasks to them. But interestingly, there are 'grassroots' activities like the cooperation of four string instruments manufacturing companies which have been entering a cooperative marketing by joint activities like internet sales and exhibition stands at trade fairs. This example indicates that potential for cooperation exists which could be extended further.

Due to the assumption that an intensified cooperation in the field of production is currently facing insuperable resistance, it was decided for the competence analysis to concentrate on marketing and sales because the chances for cooperation are estimated to be better in these fields. Beyond the 'hard' factors of cooperation (e.g., synergies from joint sales systems) weak factors are important as well (e.g., the better conditions for signaling image aspects like tradition.

## APPENDIX

The basic indicators for measuring firm-specific competence (Zanger & Deckow, 2003)

|  |
|--|
| <b>Company competence</b>                        |
| Size (number of employees)                       |
| Public awareness                                 |
| Market share                                     |
| Financial strength                               |
| Geographical closeness to customers              |
| Know-how of workforce                            |
| Scope of product program                         |
| Price-performance ratio of products and services |
| Marketing capabilities                           |
| Market image                                     |
| <b>Management competence</b>                     |
| Order-related planning                           |

|  |
|--|
| Order-related organization                             |
| Resource-efficient order processing                    |
| Schedule effectiveness                                 |
| Flexibility of delivery                                |
| Capabilities to manage customer relations              |
| Communication capabilities related to order processing |
| Scope of services                                      |
| Quality of services                                    |
| Customer-oriented organization                         |

|  |
|--|
| <b>Technology competence</b>                           |
| Product and process know-how                           |
| Innovative capability                                  |
| Knowledge concerning market trends                     |
| Customer-oriented product developing and manufacturing |
| Adaptability (technological flexibility)               |
| Quality management                                     |
| Time management concerning product developing and      |
| Capability to adopt innovative technologies            |
| Capability of technology-oriented cooperation          |
| Technological services                                 |

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Table 1: The products and services (percentage of firms and employees)  
Source: Musicon Valley e.V.

|                             | <b>Percentage of firms</b> | <b>Percentage of employees</b> |
|-----------------------------|----------------------------|--------------------------------|
| Woodwind instruments        | 20.0                       | 30.0                           |
| Brass instruments           | 19.0                       | 23.0                           |
| Bow making                  | 16.0                       | 2.0                            |
| Hand and mouth harmonicas   | 11.0                       | 14.0                           |
| String/ plucked instruments | 11.0                       | 10.0                           |

|  |     |     |
|--|-----|-----|
| Components and accessories                             | 6.0 | 2.8 |
| Boxes for musical instruments                          | 5.0 | 4.0 |
| Musical toys/ percussion instruments,<br>musical boxes | 4.0 | 4.0 |
| Music Electronics,<br>electric basses/ guitars         | 3.0 | 9.0 |
| Strings for musical instruments                        | 3.0 | 1.0 |
| Piano making/ repair                                   | 2.0 | 0.2 |

# INTER-ORGANIZATIONAL COMMUNICATION AND DECISION SUPPORT IN SMALL BUSINESSES

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## **Abstract**

There has been very limited research in the area of small business decision making. Many issues remain unexamined and one important issue is the communication processes underlying the inter-organizational decision making in small businesses. In the trend of globalization, small businesses build network or alliance with other businesses to tap into external resources. Considering this web of relationships, decisions of small business are often made as an inter-organizational communication and negotiation process. To examine how technology can support such communication process, a case study is conducted and problems in the communication process are identified, including information ambiguity and conflicting understanding, trust issue, domination of bigger companies, and communication workload problem. For each problem, preliminary technological solutions are proposed.

## **Introduction**

Small businesses are an important and integral part of every nation's economy (Hambrick and Crozier, 1985). In the United States, small businesses account for almost one-half of the gross national product, create two-thirds of new jobs and invent more than one-half of the technological innovations (U. S. Small Business Administration, 2001). From many perspectives, small businesses are unique. They are likely to be limited in financial, management, human, and information resources (Aspelun & Moen 2003), with different managerial processes and structures that are less rigid, sophisticated, and complex than those in larger firms.

In the last past decade, with the increase of evidence in the awareness and investment from small businesses to information technologies, there has been significant convergence of IS research and small business research. The major stream of small business IS research has been focusing on the technology adoption decision and implementation practices in small business. However, small business research has been criticized as adapting theories exclusively developed for large corporations (Southen & Tilley 1999) and a number of important areas are under-researched (Premkumar 2003).

One area of small business IS research warrants more exploration from the academicians are decision support. Sporadic studies have been conducted which examined how analytic models

can be used to complement the intuitive decision styles and bring more scientific operational management into small businesses (e.g. Hayen 1982; Houben, lenie and Vanhoof 1999). These researches were conducted in a context where a single or a small number of small business managers made decisions independently. Nonetheless, in the new business environment of increasingly globalization and more-than-ever intensive competition, decisions in small businesses are often made in a new fashion. Small businesses, typically with limited resources, build a network and alliance with other businesses to expand its operation into a larger market with the help of external resources. Decision in one small business is influenced by other businesses in this network. To carry out its plan, one small business often relies on the commitment of other businesses and the impact of one small businesses' decision will ripple through the network. The new decision-making environment demands collaboration and communication between different businesses. Therefore, though traditional model-based DSS still hold its place in small businesses, it is also important to develop an understanding how the communication-intensive decision-making in small business can be facilitated by decision support systems. To that end, this paper first reviews existing literature from several fields; based on the literature review results, the research question is refined; a case study in a small business with a network of business partners is presented; typical communication-intensive decision making scenarios are accounted; problems and issues are identified and preliminary analyses are done in terms of how information technologies work or fail to solve these problems. The paper concludes with a discussion of the contribution and limitation of this paper and suggestion for future research.

## **Literature Review**

### **Small Business and Decision Support**

The definition of small business is controversial. A variety of different standards including industry type, sales volume, the number of employees and etc. have been used. This paper adopts one of the most popular definitions from U.S. Small Business Administration: Small Businesses are independently owned and operated and not dominant in its field of operation (Small Business Administration 2003). Past organizational science research has found the importance of the role of owner manager in small businesses. There are often only one or two managers in small businesses and the businesses are very dependent on the decisions of the owner manager ( Feltham, Feltham & Barnett 2005). In view of three levels of management activities: strategic, managerial and operational, small business lacks of long-term planning as long-term planning is considered time-wasting or resource-costly (Miller & Toulouse 1986; Temtime, Chinoka & Shunta 2003). Other researchers explained from another perspective that small businesses' strategic planning is constraint by the competition level it is faced with and small businesses tend to adopt the strategy of market leaders instead of inventing strategies of their own (Dodge, Fullerton & Robbins 1994). Small business managers, however, are very involved in operational management but they resist the use of quantitative methods, more comfortable with intuitive decision making (Chaudhry, Salchenberger & Beheshtian 1996; Dianich & Gupta 1983).

Small business decision support research has focused on introducing operational management principles and theories into small businesses. Model-based decision support systems were found improved the efficiency and quality of decision making in financial planning (Hayen 1982),

inventory management (Chaudhry, Salchenberger & Beheshtian 1996), and other management activities. Some researchers attempted to find ways to use rational decision making method to complement the intuitive way of decision making (Dianich & Gupta 1983). In addition, several studies have been done on the adoption and implementation of DSS in small business (Lai 1992; Raymond & Bergeron 1992). At the same time, industry practitioners have called for the use of more powerful software and applications in small businesses (Heathfield 1997). However, from a technology determinism perspective, they along with the adoption research stream have assumed the benefits inherent in the use of technology, failing to examine the complexity of small businesses.

### **Small Business and Communication**

Small businesses are considered characterized by a flat organizational hierarchy and close proximity to coworkers, which is believed to contribute to effective communication practices, often comprised of informal channels (Vinten 1999), and typically carried out face-to-face as the need arises rather than through formal communication channels such as scheduled meetings. Nonetheless, it is found that as small business grows, especially into a global market, traditional face-to-face is not sufficient any more.

Small enterprises are increasingly active in international markets (Erramilli and D'Souza 1993; Haahti, Hall, and Donckels 1998). In addition, a growing body of research has found the trend of building business-oriented relationships outside organizational boundaries in small businesses (Street & Cameron 2004). The web of external alliances provides a wide variety of tangible and intangible benefits. Small businesses use external relationships to tap into these resources to extend their reach. Such practices help small businesses to overcome resource constraints of time, capital, and expertise by looking outside the company for colleagues and collaborators (Gomes-Casseres 1997; Lipparini and Sobrero 1994). More and more, companies have to see their business processes in a wider context where many companies contribute complementarily to achievement of business goals. In this light, the companies have to integrate business partners into effective information and communication. Moreover, as decisions will impact a small business' partners in the network and many decisions need to be carried out collectively by the businesses in the network, external communication becomes an integral part of decision making. In the communication process, information is exchanged, understanding is established and commitment is promised. Such process crosses organizational boundaries and geographical distances and has to be facilitated by information and communication technologies.

Considering the potential significance of networking strategy toward the wellbeing of a small enterprise (Feindt, Jeffcoate, and Chappell 2002; Alvarez and Barney 2001; Hite and Hesterly 2001), it is imperative to examine the external communication process small business managers engage in when making decisions with partner businesses and how information technologies can be developed or used to support the process. The literature review in the last section shows that, from this perspective, the small business decision support research has not been adequate. They are more objective model oriented and little has been actually known about the communication processes underneath decision making.

### **Social Communication**

The inter-organizational communication involved in small business decision makings is rife with risks: Business partners in the network may not have common goals in every decision making scenario and understand the problem from the perspective developed from their own individual experience. Information may be withheld from others and even wrong information may be intentionally conveyed. Inter-organizational trust may not be at a level to make one business to commit to the decision from another one. Due to the small scale of operation and resource constraint, facing with conflicts and differences, a small business cannot use dominant buying or selling power to force compromise from other parties, like big corporations would be able to do. Instead, a typical inter-organizational decision-making communication process in small business is expected to be a process of establishing mutual understanding, negotiating differences and fostering trust. Smoliar and Sprague (2002) view such a process as social communication in interactive decision making, which has three dimensions: meaning, authority and trust. "Meaning" simply means what things mean. Smoliar and Sprague (2002) explains the volatility of business world makes difference in understanding what things mean a norm. They emphasize that the right format and material through which information is presented is essential to solving difference in "meaning" understanding. By "authority", they mean the authority from the organizational position or functional expertise. They think conflicts are inevitable, but conflicts should be solved through negotiation not authoritarian mandate. Authority determines more on the responsibility of what a person brings to the communication. Technology can be used to facilitate communication to move away from authority. However, awareness of who has the expertise should be fostered. Trust is needed for members to accept interpretations of meaning. To build trust in communication, technology should be used to improve awareness of prevailing opinions through collecting, visualizing and filtering opinions.

The proposals of Smoliar and Sprague provide insights into the social interaction process in interactive decision making and give an organized way to look at the situation. They emphasize conveying the "meaning" and create shared understanding of "meaning". While they inspire this paper on the shared understanding issue in the small business issue, they do not consider many other important issues such as information sharing, motive conflicts and etc.

In summary of the literature review section, there has been very limited research done in the small business decision support field. The existing literature yields little knowledge on the inter-organizational decision making process in small businesses. The communication processes underlying such decision making is subject to various risks. Nonetheless, theoretical research by Smoliar and Sprague, though not addressing the unique situation of small business, gives some initial thoughts.

After thorough review and drawing on different perspectives, the research question raised at the beginning of the paper is refined as: what problems actually exist in the inter-organizational communication processes underlying interactive decision-making in small businesses and how such problems can be overcome from a technological perspective.

## **Research Method**

As the first attempt in this research field, this paper is not to get deep theories. It aims to do a descriptive study of this new issue and give preliminary analysis. As Benbasat et al. (1987) suggest, when an area is new and few prior studies have been done, the researchers can begin with recording the trial-and-error process of the practitioners and formalize knowledge from accumulated understanding. They suggest case method is appropriate for a research question where no established theories exist and the research question is of an exploratory nature. Small business IS researchers have criticized using quantitative method and modeling based on theories which are exclusively developed for large corporations (e. g. Southen & Tilley 1999; Swartz & Boaden 1997). These researchers also recommended qualitative research method.

In this study, case study is conducted to identify the actual problems in the decision process this paper targets.

### **Case Study Site Selection**

The study site should be a small business with typical resources constraints and dependence on owner manager. Also the study site company should have a network of external partners and collaboration in the network is extensive. The decision processes should often involve interaction with other businesses, so the manager can give a good account of decision making experience the study is looking for. To select such a company, the author talked to several small business managers and choose Company A (the name is changed for privacy purpose). This company meets all the standards. Also the author has strong connection with the managers of this company so the managers trust the author and gave rich information.

### **Overview of the Study Site**

Company A is an E-commerce retailer. It sells brand-name gifts and its customer base consists of customers from all over the world. It has five employees and one owner manager. The owner manager along with another manager conducts all managerial activities in the company and is also into the daily operations of the company. The annual sales of the company are under \$1 million and the company is actively seeking new business partners to expand its business. The order fulfilling process of the company is carried out in close collaboration with its suppliers. The company does not carry any inventory. When an order arrives, the company processes the order then send shipping request to the suppliers. The suppliers ship the product from their warehouse. Very high level of collaboration is required to fulfill each order. Decisions about the company's product and service offering, and pricing and marketing strategy are largely influenced by the information provided by and the ability to cooperate of the suppliers and also need the supplier to work together to make the decisions a reality.

### **Data Collection Method and Analysis**

Case study should use multiple data collection methods and results collected through different channels can be used to triangulate in order to improve the objectivity and validity of analysis and conclusions (Benbasat et al. 1987). In this case study, three data collection methods were used. First, the managers were interviewed in-depth about detailed processes of inter-organizational decision-making, communication practices involved, communication technologies

used, and issues and problems associated with the communication. Second, the managers were also observed making such decisions. Third, communication record including IM transcripts and emails were collected. The information collected from the latter two methods corroborates the description of the manager and complement it with a higher level of details. No conflicting results were identified. It is believed that the data collected from the three methods give a cohesive and objective picture of the inter-organizational decision making processes in Company A.

Patterns about problems which occurred during the communications are induced and reasons are explored. In the following section, the results about the problems and the reasons behind the problems are presented and illustrated by typical scenarios. It was found Company A uses phone calls, and text message exchange in email and instant messaging to communicate with its suppliers. These basic communication tools cannot provide effective solutions to the problems. Therefore, for each problem, how other technologies can help is analyzed.

### **Problems, Reasons and Solutions**

First, information ambiguity and understanding conflicts

The message conveyed is ambiguous and the decision makers from different parties may interpret the message in more than one way. There is no shared understanding of what the message means. The owner manager gave an example about this problem: Company A needed to decide on the price on some new laptop models. The supplier of the laptops emailed the spread sheet containing the prices upon the request of Company A. There were three types of prices in the spread sheet: market price, retail price and wholesale price. The manager of Company A determined that the “market price” is the price other retailers in the market use and the “retail price” is the cost Company A needs to pay the supplier. It turned out that “retail price” was actually the dominant price on the market and “wholesale price” is the cost Company A needs to pay. The problem occurred mainly because of information asymmetry and the poor way information is presented. The supplier is in a country where the retailers usually list an “official” market price but actually sell the product at a discounted price. Since this becomes the standard practice of the retailers, the actual market price is the “discounted” retail price. However, Company A is not aware of such a phenomenon. Also the prices are presented as mere numbers and there lacks the additional cues through which the managers of Company A would’ve gained better understanding.

This problem is a common issue, as the businesses are in different market positions and knowledge of different companies is developed in different business environments and social cultures. The consequence of this problem can be highly costly if critical business decisions are made with wrong interpretation. It also slows down the decision making process. It takes time for the managers to find out about the problem and revise the decision. To solve the problem, technology should facilitate the awareness of the context where information is created. No GDSS or CSCW studies have been found addressing this problem. Some communication theories have touched on the issue, though.

McGrath and Hollingshead (1993) proposed a relationship between medium and task types based on information richness. Task types include idea-generation, negotiation, and intellectual tasks. Negotiation tasks are further categorized into cognitive conflict and mixed-motive tasks. Cognitive conflict tasks are those in which group members have conflicts of viewpoint and mixed-motive tasks are those in which group members have conflicts of interest. Both task types exhibit equivocality and uncertainty phenomena. They argue that to reduce equivocality, richer communication means should be used. Then it can be inferred that to solve information ambiguity problem, increase the bandwidth of communication technologies in terms of the capability to convey multiple cues will help. For instance, automatic hyperlinks can be added into the spreadsheet so documents, videos, or audio files which provide additional background information on an item in the spreadsheet will be retrieved. However, this preliminary solution only provides a starting point. How such rich communication media should be actually integrated in the whole decision processes is still a question.

Visualization tools can be used to present the information in a visualized way managers can intuitively understand the information with little cognitive efforts. Many DSS tools come with a set of visualization functions. Also it will be useful if the visualized results from one company's DSS can be read by commonly available application which the manager of another company may use and can be used directly as input to the DSS of the other company.

Recent development in semantic integration also sheds light on the solution of the information ambiguity problem. When ambiguity arises because of difference in the contexts of information receiver and sender, shared ontology can be developed to representing, processing, and reconciling heterogeneous data semantics. However, to date ontology sharing technology only address differences in object context variables such as currency, weight measurements and etc. In the small business inter-organizational decision making process, communication barriers exist, in many cases in the sharing of subjective data such as managers' judgments and evaluation.

## Second, trust problem

Trust problem occurs when there are conflicts of interests. Conflicts arise often because each business acts in an individually rational way for its own good or seeking to maximize its own utility. The manager of Company A depicts such an example: Company A needed to decide on which new models of a brand-name watch will be added to their E-commerce website. They asked their supplier what options the supplier could provide. The supplier wanted to make as much profit as possible. Even though they could not guarantee the stable supply of some models, they withheld this information from Company A. Instead they told Company A to market all the new models. Later on, Company A had to remove some models from their website after several experiences where the supplier did not have the product in stock. Reputation and credibility of Company A was damaged in these incidents.

To solve this problem, Smoliar & Sprague (2002) propose that technology can be used to collect and visualize the prevalent opinions which are hold by most parties in the negotiation. DeSanctis & Gallupe (1987) suggest a similar solution where the opinions of team members are aggregated and presented in a way everyone in the team can see. Besides that, the author believes increasing external transparency will help. Street & Meister (2003) explains that external transparency is the outcome of communication behaviors directed outside the organization. From the supply chain

management perspective, information exchange between supply chain partners (e.g., Lamming et al. 2001) is described as a type of transparency. One type of information that can be made transparent is cost. With such transparency, one company will believe the truthfulness of the information provided by other companies and will be able to collect information the other companies unintentionally omits to transmit. The positive role of IS in increasing transparency has been highlighted (Min et al. 2002). However, detailed solutions on increasing transparency have not been studied. The author proposes some additional features of DSS may increase external transparency. For instance, a list of businesses which will be impacted by the decisions is recorded in the DSS; when a decision is being made, the DSS also models the impact on the other businesses. A report is automatically generated including, for example, cost consideration, action plan and etc, and sent to the other businesses.

### Third, domination of larger partners

Larger partners possess dominant power over smaller ones in the supply chain and are often unwilling to reconcile in case of interest conflicts or to cooperate with other businesses when collective efforts are needed. The managers of Company A complained about some of their bigger partners and here is an example: High-quality service is one of the primary strategies Company A deploys. They provide services such as sending a free greeting card along with the gift and these services have distinguished Company A from its competitors. The actual fulfillment of these services often falls onto the shoulder of the company's suppliers. However, when deciding on what service the company can provide with the pearl jewelry products, the manager found it hard to negotiate with the pearl jewelry supplier, the largest pearl jeweler in the country, even when Company A is willing to pay for premium costs for the services.

This issue is similar to the "authority" issue Smoliar & Sprague posit, in that bigger companies generally have more authority in negotiation. Traditional GDSS addresses this issue by implementing anonymity feature in hope that participants will not be judged by their organizational position or expertise and social barriers to participation will be removed. However, this approach will not work in the context of small business problem as the domination of bigger players cannot be overlooked or circumvented. To address this problem, technological support must be designed in the context of the relationship of bigger companies and smaller companies. Some artificial intelligence research has been trying to find ways to reduce the influence of domination. For example work practices may be mediated by conversational agents as a move away from authority figures (Smoliar & Sprague 2002). The capabilities of such artificial agents have been investigated by Elizabeth Churchill et al. (2000).

### Fourth, communication workload

Most of the decision making, due to the negotiation nature, is communication intensive. Also because of the volatile business environment, decisions have to be reevaluated frequently and new rounds of negotiation begin. This creates large volume of communication workload and results in communication fatigue. As the manager of Company A explains: For each new product or service, he has to negotiate with his suppliers and negotiation lasts intermittently over a few days before a final consensus can be reached. Sometimes, he simply gets tired of communication and makes a hasty decision.

To deal with this problem, technologies should be used in a way that facilitates efficient communication. First of all, communication media need to be carefully chosen. For example, communication media with features such as presence awareness, real-time exchange of messages, like instant messaging, results in higher response rate than telephone calls (Herbsleb et al. 2002) and can be used to initiate a communication process. Also managers should control the variety of communication tools they use to reduce information complexity (Rennecher & Godwin 2003). In addition, as small business managers need to frequently reevaluate the basis of decisions they made, the DSS models should be designed to be easily understood by the managers. The models should also be easily tried and modified so the managers have less workload in revising decisions.

## **Discussion**

The four types of problems identified in the case studies are interrelated. For example, information ambiguity may be attributed to information withholding or distortion due to lack of trust. They should not be viewed as existing independently.

Traditional DSS technologies fail to address these problems effectively. The communication-based GDSS are more oriented towards groups who work for one organization and do not address the social aspects of communication processes such as trust or shared understanding. Actually social processes in decision-making groups are considered detrimental to the quality of decisions. It is often assumed that removing social influence of the group on its members improves group decisions. GDSSs are increasingly used to remedy the social faults of the decision-making process in groups. In these systems, anonymity is seen as tool to reduce the impact of the group over its members, and therefore as the key to improved group performance. In their meta-analytic review, Postmes and Lea (2000) examines the assumption that anonymity in GDSSs is beneficial for group decision-making on a range of performance indicators. They find that the effects of anonymity on group performance are mixed and argue that performance in decision-making groups partly depends on the social context and relevant social norms. Therefore, to support communication-based inter-organizational decision making in small businesses, GDSS design must facilitate the inter-organizational social communication process and address the special problems in the process.

Some agent-based decision making research have also attempted to facilitate communication processes in the group interactive decision making. One popular agent-based process is multi-attribute negotiation process. According to Jonker and Treur (2001), the multi-attribute negotiation process includes the following five steps: (1) Evaluation of the attributes of the initial solutions made by the participants; (2) These evaluations are aggregated into overall utilities of these initial solutions; (3) Provision of the target utility; (4) Based on the target utility and the distribution of attributes, the values of the target attributes are determined, which lead to a new round of decision making; (5) For each of the target attributes, an attribute value is chosen that has an evaluation value as close as possible to the target evaluation value for the attribute. However, this method assumes 1) the participants will objectively and truthfully evaluate the attributes and set the objective; 2) the participants will trust the input from each other; 3) there is no authority issue. These three assumptions do not hold in the case of small business inter-organizational decision making.

The contribution of paper is that it identifies an important area where researchers can provide wisdom and guidance to the practitioners. Moreover, some preliminary technological solutions are proposed and may inspire the small business practitioners to use technologies to better support their inter-organizational decision making process. As the first study in this field, this paper serves as a starting point for future research.

However, this paper is not without its limitations. This paper only studies the support of the inter-organizational decision making from a technological viewpoint. The author recognizes that technology alone cannot effectively solve the problems. The organizational and managerial factors must be studied in light of how they can significantly improve the process and be combined with the use of technologies.

Also this study uses the method of single case study. A major concern about case study has been about generalizability. Generalizability may be impacted by the subjective lens through which the researchers collect and interpret case study results as well as the small number of research sites. The findings of this study should be tested in more varied types of organizations. Also, in future study, quantitative method, such as questionnaire survey, should be used to get data from a large number of small businesses and rigorous statistical analysis should be conducted to triangulate with the results from the case study. Such “in-between” research methodology will yield more confident inference and more convincing results (Swartz & Boaden 1997).

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TECHNOLOGICAL ENTREPRENEURSHIP: THE ROLE SMALL BUSINESS  
INNOVATION RESEARCH (SBIR) PROGRAMS PLAY IN DEVELOPING AND  
COMMERCIALIZING TECHNOLOGIES

EXTENDED ABSTRACT

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Technology entrepreneurs or technology development firms are companies that seek to differentiate themselves and develop a strategic competitive advantage through innovation. Their focus is on technology development and commercialization. Though idea rich, technology entrepreneurs are typically resource poor. Government programs like the Small Business Innovation Research (SBIR) program can play a vital role in helping technology entrepreneurs develop and commercialize technology. This conceptual paper examines entrepreneurial orientation, the organizational processes, methods, styles, practices, and decision-making activities employed by entrepreneurs that lead to bringing new products to market. It describes the SBIR program and develops a series of research propositions to describe the interaction between entrepreneurial orientation and the SBIR program.

**INTRODUCTION**

In a seminal book, Michael Porter (1980) identifies three generic strategies for competitive advantage: differentiation, cost leadership, and focus. Differentiation strategies allow companies to build brand loyalty and charge higher prices, as buyers perceive the company's product or service offerings as unique and superior to other products or services offered in the market place. One of the key types of differentiation strategies involves innovation to create new products and services which embody new technologies and offer up-to-date features (Miller, 1986).

Many small business ventures or entrepreneurs develop and commercialize new technologies in order to obtain a sustainable competitive advantage (Kelley & Rice, 2002). Although innovation can be beneficial to many industries or services, innovation is especially important to high-tech industries. Industries such as telecommunications,

biotechnology, artificial intelligence, and the software industry, are built upon innovation (Zahra, 1996a). A coherent technological strategy which harnesses innovation can help lead to superior financial performance (Zahra, 1996b).

Even recognizing the importance of innovation, high-tech start-ups or technology development firms often lack sufficient operating capital to implement a coherent technology strategy. These firms may lack the resources to pursue interesting research ideas, to develop prototypes, and to commercialize products and, investors typically give preference to commercially developed innovations. Given the lack of resources, technology entrepreneurs may need to act entrepreneurially to find the resources to fund R&D and commercialization. One key source of funding for technology entrepreneurs are government programs such as the Small Business Innovation Research (SBIR) program.

This research is motivated by a perceived need for a better understanding of the conditions and drivers that transform technology into value creation and bring it to market. We examine the entrepreneurial orientation of a firm and the relationship between the entrepreneurial orientation and the conceptual role that government technology programs can play in facilitating the entrepreneurial process in high-tech start-ups. Lumpkin and Dess (2001) define entrepreneurial orientation as the “strategy-making processes that firms engage in entrepreneurial activities” (p. 429), and it is conceptualized to have five general domains: autonomy, innovativeness, risk-taking, proactiveness, and competitive aggressiveness (Lumpkin & Dess, 1996). We use the structure posited by Lumpkin and Dess (1996; please see Figure 1) and focus on the interaction between the program and a firm’s entrepreneurial orientation. (The role that government technology programs can play in the environmental and organizational factors is discussed in another paper.)

[Insert Figure 1 here]

Although it is possible to examine the impact of a number of government programs on technological entrepreneurship, it is helpful to focus on a specific program in developing the conceptual framework. As the Small Business Innovation Research (SBIR) program was specifically established to help entrepreneurs and to promote innovation and assist in the commercialization of technology, we have selected the SBIR program as our initial focus. The impact of other government programs, such as those focusing on technology transfer, can be studied in future research projects.

### **SMALL BUSINESS INNOVATION RESEARCH PROGRAM (SBIR)**

Founded in 1982, SBIR was formed to assist in the development and commercialization of technology. The SBIR’s goal is to facilitate the technological development and subsequent commercialization and, at the same time, promote small businesses, create new jobs, and develop alternative sources of supply. Additionally the program is designed to help promote minority and disadvantaged businesses.

The Departments of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, and Transportation, as well as, the Environmental Protection Agency, the National Aeronautics and Space Administration, and the National Science Foundation each have at least one SBIR office. Some departments, such as the Department of Defense, have multiple SBIR. For example, the Army, Navy, and Air Force each have SBIR offices. Finally, there may be multiple SBIR offices within an organization. As an example the Navy has an SBIR office devoted to sea defenses and another devoted to air defenses.

US for-profit technology companies with 500 or less employees can apply for grants under the SBIR program. A Phase I grant, capped at \$100,000, is typically used for a feasibility study to explore a technology. A Phase II grant, capped at \$1 million, is usually considered the stage where a prototype is developed though, under special circumstances, the funding may be used to further develop a technology. Although no SBIR funds are awarded for Phase III projects, Phase III of the program is considered the commercialization stage when the technology is successful in attracting funding from customers or other government programs, such as the Transition Assistance Program.

SBIR has multiple stakeholders, including small businesses, the government agency or department interested in exploring the technology, and the SBIR program office, itself. The small businesses can be technology development firms that specialize in developing and commercializing new technologies or newly formed entrepreneurial business ventures organized to develop and commercialize a specific technology. On the micro-level, the program manager of the program office that originates the topic call for the new technology is a direct stakeholder. On the macro-level, the public is a major stakeholder and is represented by the Congress which funds and oversees the program.

The level of success of an SBIR project is related to the goals and objectives of each stakeholder. The project manager of the sponsoring agency and SBIR are interested in a project outcome, was the technology developed within a reasonable time-frame at a reasonable cost. The firm can have multiple goals, such as, implementing a component of its technological strategy, technological or production superiority through innovation and profitability, and developing a new technology in order to license, sell or spin-off the technology. Sometimes, the firm's objective can be as basic as survival. SBIR and, depending upon their objectives, the firm also want to commercialize the technology.

The conceptual relationships between the SBIR and technological entrepreneurs and a series of research propositions are developed in this paper.

### **Entrepreneurial Orientation**

Entrepreneurship can be distinguished from entrepreneurial orientation. Entrepreneurship can be thought of as a dynamic process of creating something new and assuming the risks and reward (Schumpeter, 1976). Entrepreneurial orientation involves the organizational processes, methods, styles, practices, and decision-making activities employed by entrepreneurs that lead to new entry (Stevenson & Jarillo, 1990; Lumpkin & Dess, 1996;

Lumpkin & Dess, 2001). We discuss and develop a series of research propositions for each of the five components of entrepreneurial orientation --- autonomy, innovativeness, risk-taking, proactiveness, and competitive aggressiveness --- along with possible relationships with the SBIR program. The proposed conceptual interactions between participation in SBIR and entrepreneurial orientations are shown in Figure 2.

[Insert Figure 2 here]

### **Autonomy**

Autonomy can be thought of as the initiative or independent spirit used to develop ideas and visions and to carry them through to completion. Lumpkin and Dess (2001, p. 431) conceptualize autonomy as “independent action by an individual or team aimed at bringing forth a business concept or vision and carrying it through to completion.” Autonomy can involve a relative freedom from organizational constraints and an empowerment to act. Autonomous organizations often empower a key manager to be the primary decision maker or product champion (Shrinivastava & Grant, 1985; Burgelman, 1983).

Participation in a program such as the SBIR can potentially place limitations on a firm’s independence through program oversight, reporting requirements, and other program specifics. Therefore, entrepreneurial firms that are more autonomous would be less likely to become involved with a government program.

P1: There is an inverse relationship between autonomy and willingness to participate in government programs that support technology development.

### **Innovativeness**

Innovativeness “reflects a firm’s tendency to engage in and support new ideas, novelty, experimentation, and creative processes that may result in new products, services, or technological processes” (Lumpkin & Dess, 1996, p. 142). Activities associated with innovativeness include developing new processes, introducing new products/services, supporting R&D, and focusing on technological leadership (Lumpkin & Dess, 2001, Lumpkin, 2002). Market pioneering is often considered an expression of an entrepreneurial orientation (Covin et al., 1999). Technology strategy involves a firm’s commitment to acquire, develop, and deploy technology which is inherently linked to innovation (Lumpkin & Dess, 1996). As the SBIR program was developed specifically to promote innovation, innovative entrepreneurial organizations may be more likely to take advantage of available resources. Therefore

P2: There is a positive relationship between the innovation component of entrepreneurial orientation and willingness to participate in a government program that supports technology development.

### **Proactiveness**

Proactiveness is a forward-thinking perspective which includes activities such as opportunities identification and assessment and forming teams to develop and exploit the opportunities (Kropp et al., 2004). It involves introducing new products/services and acting in anticipation of future demand, and acting opportunistically. Proactiveness is especially important to firms in the early stages of industry development (Lumpkin & Dess, 2001). Proactive firms may be more willing to seek assistance in turning their visions into reality. Therefore,

P3: There is a positive relationship between the proactiveness component of entrepreneurial orientation and willingness to participate in a government program that supports technology development.

### **Risk-taking**

In the context of entrepreneurial orientation, risk can be conceptualized as the “uncertainty and potential losses associated with the outcomes which may follow from a given set of behaviors” (Forlani & Mullins, 2000, p. 309). Strategic risk may include significant borrowing, committing a relatively large share of assets to a project, and venturing into new and unknown territory (Baird & Thomas, 1985, p. 231-232, cited in Lumpkin & Dess, 1996). Although entrepreneurs generally are willing to take risks in return for potential rewards, arguably, when possible, they would prefer to lower the risk aspect of the risk-return equation. Since the SBIR program provides funds to explore technologies and develop prototypes, it helps lower exposure to financial risks. Therefore,

P4: There is an inverse relationship between the risk component of entrepreneurial orientation and willingness to participate in a government program that supports technology development.

### **Competitive Aggressiveness**

Competitive aggressiveness involves a willingness to gain market share by challenging rivals directly (Lumpkin & Dess, 1996). Competitive aggressiveness is more helpful to firms in later stages of industry development (Lumpkin & Dess, 2001). Earlier-stage ventures technology entrepreneurs may often lack the ability or motivation to be competitively aggressive. However, more mature technology development firms may be willing to participate in programs that support technology development as these programs may provide a competitive advantage. Therefore,

P5A: There is a positive relationship between the competitive aggressiveness component of entrepreneurial orientation for a mature technology entrepreneur and willingness to participate in a government program that supports technology development.

P5B: The relationship between competitive aggressiveness and willingness to participate in a government program will be mediated by the firm's stage of development such that earlier forms will be less motivated than later firms.

## **DIRECTIONS FOR FUTURE RESEARCH**

This paper is conceptual and only examines the interactions between entrepreneurial orientation and SBIR. Linkages between environmental and organizational factors need to be examined. The entire model then needs to be tested empirically. Subsequent research should focus on participants in other SBIR programs, and participants in other technology development programs.

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**Figure 1: Conceptual Framework of Entrepreneurial Orientation (Lumpkin & Dess, 1996)**

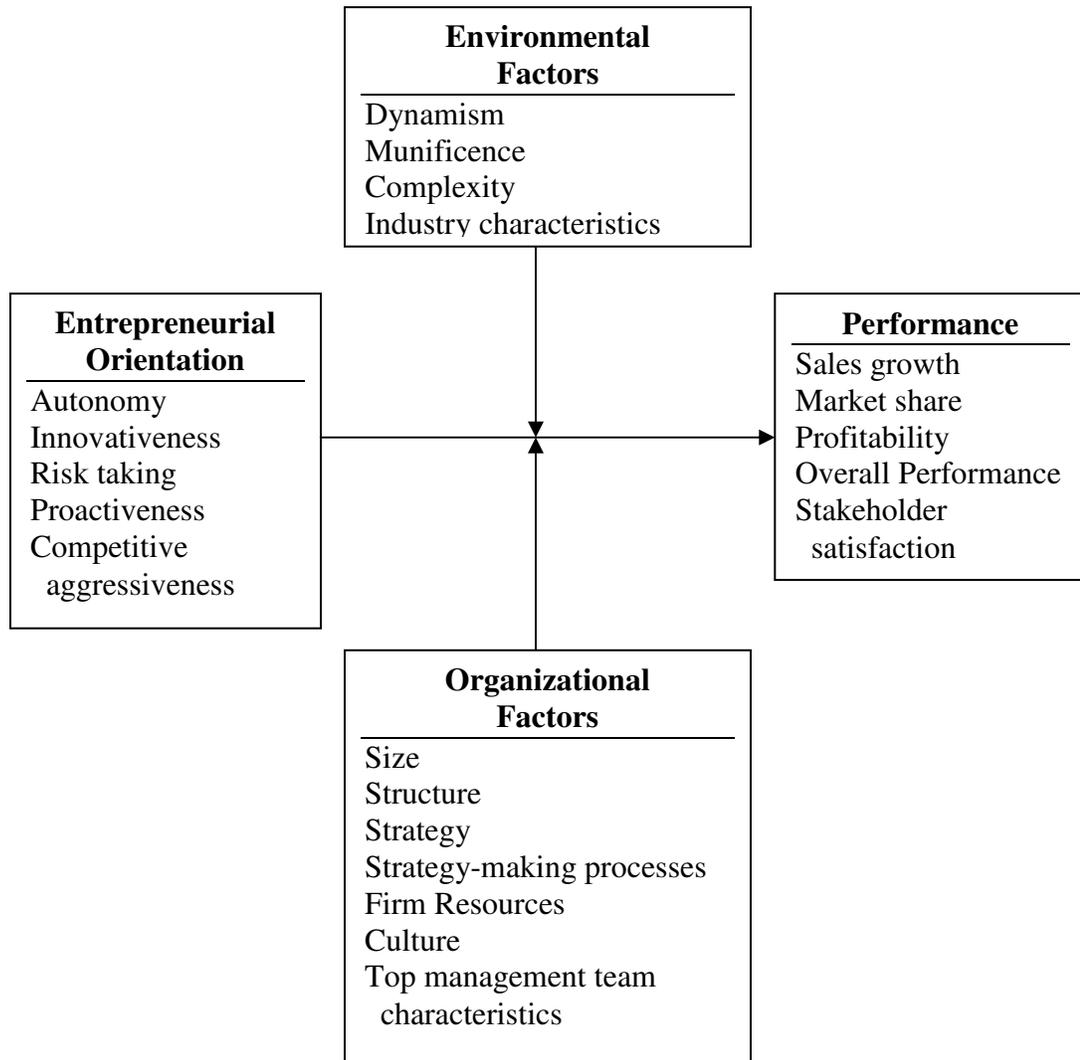
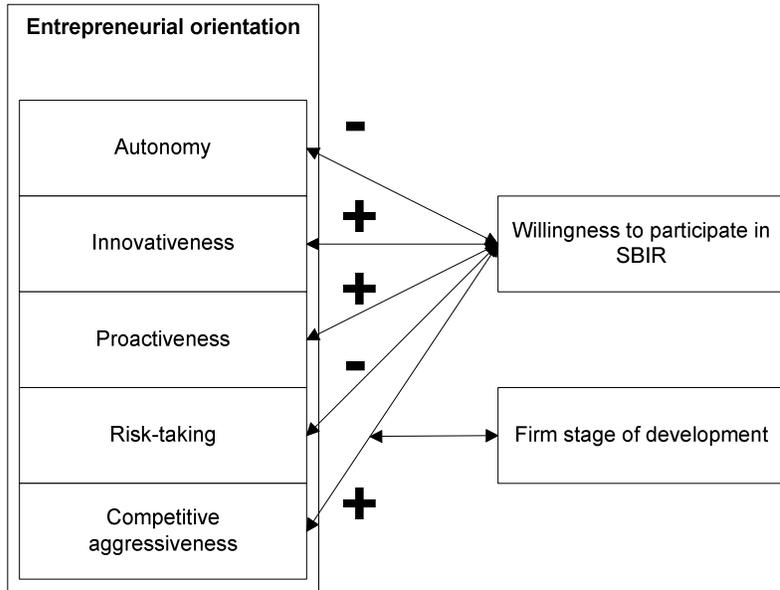


Figure 2 Theoretical model predicting the effects of entrepreneurial orientation on willingness to participate in technology development programs.



**INFLUENCE OF ECONOMIC FREEDOM ON DOMESTIC FRANCHISING:  
A HURDLE RATE PERSPECTIVE**

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## **Abstract**

While generally accepted that entrepreneurship and small firms play a vital role in economic development and job creation, certain areas, such as franchising, have received much less attention than others. A recent study conducted by PriceWaterhouseCoopers for the International Franchise Association examined the economic impact of franchising in the United States and found that franchised businesses provided 9,797,117 jobs and produced output of \$634.6 billion (Price, 2004). However, the percent of jobs, by state, attributable to franchising ranged from highs of 20.0% and 19.4 % for Nevada and Arizona respectively, to lows of 6.3% and 8.1% for the District of Columbia and New York. What accounts for this wide variation?

In this study, the relationship between state economic freedom and the economic impact of franchising will be investigated. The hurdle rate model, borrowed from the field of finance, generally reflects the minimum rate of return that an investment must provide in order to be acceptable to managers of a firm (Liesch and Knight, 1999). Government barriers such as time and money expended in complying with regulations, as well as taxation, reduces the rate of return of an investment in a new business. Stated differently, reduced economic freedom increases the costs and hence, the hurdle rate for new business formation. In this study, we use a hurdle rate model to hypothesize that individual states' economic freedom will have a mediating effect on the impact of franchised business by state.

## **Introduction**

While it is generally accepted that entrepreneurship and small firms play a vital role in economic development and job creation (Shane, 1996), certain areas pertaining to small businesses have received much more attention than others. One of the major areas of entrepreneurship which has been relatively ignored, given its importance, is franchising. Shane and Hoy (1996, p. 325), describe the shortcoming in franchising research by stating that "the lack of research attention paid to this form of business is problematic, given the relative economic importance of franchising." For example, in 1995, franchising accounted for 33% of U.S. retail sales and 10% of U.S. gross domestic product (Shane and Hoy, 1996). While not to suggest that research on franchising is non-existent, the research has left large areas under-explored.

One such under researched area is franchising's economic impact. A recent study conducted by PriceWaterhouseCoopers for the International Franchise Association looked at the economic impact of franchised businesses in the United States and found that franchised businesses provided 9,797,117 jobs and produced output of \$634.6 billion (Price, 2004). This study once again highlighted franchising's importance to the U.S. economy. What this study does not address, however, are the factors which influence the economic impact of franchised businesses on the state level. For example, the percent of jobs, by state, attributable to franchising ranged from highs of 20.0 % and 19.4 % for Nevada and Arizona respectively, to lows of 6.3 % and 8.1 % for the District of Columbia and New York respectively (Price, 2004). What accounts for this wide variation?

Economic freedom as a measure of the cost of starting or expanding a business is one possible perspective from which to examine franchise expansion subsequent impact. In this study, the relationship between economic freedom by state and franchising's economic impact will be investigated.

## **A CONCEPTUAL EXPLANATION OF FRANCHISE EXPANSION & ECONOMIC FREEDOM**

### **Franchising Expansion & Growth**

As previously noted, small, entrepreneurial firms are widely recognized as the primary drivers of economic growth and job creation (Shane, 1996). As a result, various entities, both public and private are intensely interested in assisting small firm growth. As Fischer and Reuber (2003, p.347) have noted, various entities “focus on high growth firms due to their value as job creators.” A wide range of factors influencing firm growth have been looked at, including patterns of growth, measures of growth, external factors, life experiences of the owner-manager, management style, personal factors (i.e. beliefs and expectations) and public sector assistance (Fischer and Reuber, 2003). Widely differing and often competing findings have resulted. Thus, there is no clear overall understanding of how and why entrepreneurial firms, including franchises, grow.

Scholars have applied various theories to the phenomena of firm growth. Despite these efforts, Wiklund et al., (2003, p.254) correctly assert that “knowledge of small firm growth is still quite incomplete and incoherent.” Not surprisingly, due to the large number of factors affecting business growth, an overriding framework has not been identified. Such a framework would be extremely useful to the wide range of parties interested in firm growth. As Morrison et al., (2003, p.424) point out, “Quite simply, if a means to identify what economic and social factors drive small businesses to become growth oriented can be achieved, then support agencies have the potential to target and nurture these factors.”

According to Shane and Hoy (1996), a major unexplored area of cooperative entrepreneurship is franchising. As previously mentioned, various public and private entities expend a great deal of time, effort and, most importantly, money, in attempting to assist entrepreneurship and small firm growth. Clearly, encouraging and assisting a phenomena such as growth, is not possible without a clear understanding of how and why the phenomena occurs. Much of what impacts entrepreneurial firm growth has either not been studied or is still not clearly understood. Franchising, as previously noted, has a significant impact on the United States economy as a whole and this study will examine one of the factors which may help explain this impact.

Elango and Fried (1997, p.69) define franchising as “an organizational form in which a company grants an individual or another company the right to do business in a prescribed manner over a certain period of time in a specified place in return for royalties or the payment of other fees.” These authors also define a franchising system as the franchisor along with all units whether franchised or company owned. Historically, franchising research has utilized three primary perspectives: 1) limited resources (resource based), 2) administrative efficiency, and 3) risk management (Combs and Castrogiovanni, 1994).

### **Measures of Growth & Impact**

There are many possible measures of franchise firm growth and impact. For example, D’Amboise and Muldowney (1988) use number of employees and annual sales as measures of growth. Erramilli and Rao (1993) similarly use employees, while Lee and Tsang (2001) use

growth of sales and profit. More recently, Delmar et al., (2003) define a business as high growth if it ranks in the top ten percent in any one of six categories: 1. absolute total employee growth 2. absolute organic employee growth 3. absolute sales growth 4. relative (%) total employee growth 5. relative (%) organic employee growth 6. relative sales growth. Such programs are most interested in assisting firm growth in terms of job creation (employee growth) while business owners and managers are typically interested in other goals. In this study, we will look at three output measures: jobs, payroll and output. In addition to direct numbers, we will also look at the percentages of these measures in each state.

### **Barriers**

While there are a myriad of barriers to business growth, most parties interested in firm growth wish to know which are the most significant. In general, lack of resources is a barrier for small firms. Barney (1991) identifies three general types of resources: 1. physical capital (physical assets, location, trade names, etc.) 2. human capital (training, experience, judgment, etc) 3. organizational capital (formal reporting systems, coordinating mechanisms, etc.)

Barriers self-reported by entrepreneurs and small business owners may be different from barriers observed by outside individuals. Owners and managers typically cite external barriers such as access to capital and education of available work force as major barriers to growth (Chrisman et. al.1987; Gundry and Welsch 2001). Other areas such as cultural and regulatory differences have also not been directly integrated into the research on this area (Fladmoe-Lindquist, 1996). Conversely, other scholars find that other individuals, such as lenders, service providers or public sector assistance personnel, report internal factors as barriers to growth. These include management skills, lack of planning, and poor accounting practices. Thus, it is not surprising that Elango and Fried (1997) also found that lack of managerial abilities and legal barriers are major obstacles to the spread of franchising. Therefore, barriers and how to deal with them are an important consideration.

How can the barriers to franchising's economic impact be quantified and measured? Economic freedom provides one possible perspective.

### **Economic Freedom**

"Economic freedom is the right of individuals to pursue their interests through voluntary exchange of private property under rule of law. This freedom forms the foundations of market economies," (Huang, et al., 2004, p.12).According to Easton & Walker, (1997, p.328) "we have to establish a framework for considering the issues of ownership and reliance on the market." Economic freedom provides this framework. "In a nutshell, economic freedom is the right of an individual to keep what he earns, produce what he wants, and compete in product and labor markets of his choosing, subject to the restriction that he cannot use force or fraud to further his interests," (Huang, et al., 2004, p.12).

Economic freedom is a concept which has been increasingly studied. According to Huang et al. (2004), "There has been an explosion of academic research on this theme...". For example, The Heritage Foundation in Washington, D.C. and the Wall Street Journal have jointly published an annual report titled Index of Economic Freedom since 1995. The Fraser Institute in Vancouver and the Cato Institute in Washington, D.C., have similarly co-published another cross-country

annual report since 1996 titled Economic Freedom of the World. The first study on U.S. economic freedom was conducted in 1999 by Byars et al., and a 2004 study by the Pacific Research Institute, *U.S. Economic Freedom Index: 2004 Report*, “is an effort to update, refine, and improve on this seminal work,” (Huang et al., 2004, p.12).

This concept of ownership has important implications for economic activity. For example, "Personal ownership of self is an underlying postulate of economic freedom. Because of self ownership, individuals have a right to choose-to decide how they will use their time and talents," (Gwartney & Lawson, 2003, p.406). This includes deciding when and where to invest in a new venture such as a franchise. In other words, the presence of economic freedom will allow the choices of individuals to decide what and how goods and services are produced (Gwartney & Lawson, 2003). These decisions then impact other economic aspects. Easton & Walker, (1997), for example, argue that more economic freedom is associated with higher levels of income as well as faster rates of income growth, *ceteris paribus*. In fact, these authors found support for this hypothesis, "changes in economic freedom have substantial effects on the steady-state level of income. They are fully comparable to those associated with physical investment, schooling and workforce growth," (Easton & Walker, 1997, p.332). What this study does not address, however, is how or why economic freedom has these effects. We propose that hurdle rate theory may provide an explanation.

### **A HURDLE RATE EXPLANATION**

The hurdle rate model, from the field of finance, “generally reflects the minimum rate of return that an investment must provide in order to be acceptable to managers of a firm,” (Liesch and Knight, 1999, p.387). Government barriers such as time and money expended in complying with regulations, as well as taxation, increases the cost of a venture such as a franchise investment. Thus, for a given expected return, lower levels of economic freedom reduce the rate of return of an investment in a new business. Stated differently, reduced economic freedom increases the hurdle rate for new business formation. Our proposed model is similar to Liesch and Knight’s (1999) application of the hurdle rate model to information internalization and enterprise internationalization. In the context of franchising expansion, the hurdle rate model represents the process from an entrepreneur’s exposure to an entrepreneurial opportunity through information search to the decision to invest in a franchise.

The X-axis in Figure 1 is the market economic freedom. The Y-axis illustrates the aggregate cost (in money, time and effort) of establishing an entrepreneurial venture such as a franchise in a market.

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Insert Figure 1 about here

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As a market’s degree of economic freedom decreases, the corresponding costs of new venture investment increase as shown. While the desired return from an entrepreneurial investment will vary with each entrepreneur, an increase in the cost of the investment will raise the relative hurdle rate. Markets with decreasing economic freedom thus represent an increase in the

relevant hurdle rate associated with costs of investment in a new business. This applies to both franchisors and franchisees.

For example, Elango and Fried (1997) found that franchisors need to reach a minimum size in order to cover transaction costs of expansion, although what exactly this minimum size is has not been clearly defined. Huszagh et al. (1992) demonstrated that experience and size are important considerations in franchisors' international expansion decisions. Large franchisors which typically have greater resources and experience, for example, consider overseas market entry as a natural extension of domestic business (McIntyre and Huszagh, 1995). Similarly, Julian and Castrogiovanni (1995), found that domestic U.S. franchisor expansion efforts depend on both market opportunities and firm capabilities.

We therefore propose that an entrepreneur's decision to expand into a certain market via a franchise investment will be affected by the market's economic freedom. Reduced economic freedom will limit franchise expansion that might otherwise have occurred. Therefore, using franchising as a proxy for investment in new ventures, we expect that markets with greater economic freedom will see a greater economic impact from franchising. Specifically, in this study, we use a hurdle rate model to hypothesize that individual states' economic freedom will have a mediating effect on the impact of franchised businesses. Our research model is presented in Figure 2.

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Insert Figure 2 about here

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### **Hypotheses**

H1: States with greater levels of economic freedom will exhibit greater numbers of jobs caused by franchising as a percent of state jobs than states with lower levels of economic freedom.

H2: States with greater levels of economic freedom will exhibit higher levels of payroll caused by franchising as a percent of state payroll than states with lower levels of economic freedom.

H3: States with greater levels of economic freedom will exhibit greater levels of franchising output as a percent of total state output than states with lower levels of economic freedom.

### **Methods**

Franchise impact data for all fifty states was reported in the International Franchise Association's *Economic Impact of Franchised Businesses*. Specifically, we used data pertaining to franchising's impact in three areas (jobs, payroll and output) in 2001. Data on economic freedom comes from the Pacific Research Institute's *U.S. Economic Freedom Index 2004 Report*. This report is a composite of data gathered on 143 variables from 1995 to 2003 and reports the economic freedom index value for each state (Huang et al., 2004). Data for control variables is from the U.S. Census Bureau and is also for 1991.

Franchise impact was measured with three dependent variables. These variables are percent of total jobs in the state attributable to franchising, percent of total payroll in the state attributable to franchising, and total output in the state attributable to franchising. Numbers attributable to franchising are a wider measure than numbers directly in franchising. That is, not only are jobs directly in franchising counted, but jobs created as a result (suppliers, consultants, etc.) of

franchising as well (Price, 2004). Percentages are used to account for scale effects due to the wide variation in state size.

Economic freedom, the independent variable, is measured on a scale index of 1 to 50 with 1 being the least free and 50 being the most free. The control variables are total state employment, state unemployment percentage, and educational employment by state (both high school and above and bachelors and above).

## **Results**

We began the analysis by examining the correlation between the independent, control, and dependent variables (Table 1). Ordinary least squares regression was then used to test the hypothesized relationship between economic freedom and franchising impact (Table 2). Model 1 shows the impact of economic freedom and the four control variables (total employment, unemployment percentage and educational attainment) on percent of jobs by state attributable to franchising. Model 1 was significant ( $p < .01$ ) and had an  $R^2$  of .477, indicating that the variables explained a significant portion of the percent of jobs attributable to franchising variance by state. The “Economic freedom” variable was significantly ( $p < .01$ ) related to the percent of jobs. None of the control variables was significantly ( $p < .01$ ) related to percent jobs, although educational attainment (bachelors or higher) was significant ( $p < .01$ ) before the addition of economic freedom.

Model 2, Table 2, shows the impact of economic freedom and the control variables on the percent of payroll attributable to franchising by state. This model was also significant ( $p < .01$ ) and had an  $R^2$  value of .412, also indicating that the variables included in the analyses explained a significant portion of the percent of payroll by state variance. The economic freedom variable was significantly ( $p < .01$ ) related to percent of payroll attributed to franchising by state. Model 3, Table 2, shows the impact of economic freedom on percent of total state output attributable to franchising. Model 3 was also significant ( $p < .01$ ) with an  $R^2$  value of .206, indicating that the included variables once again explained a significant portion of the variance seen in percentage of state output attributable to franchising. Once again, the economic freedom variable was significantly ( $p < .01$ ) related franchising impact on the state level.

The first two regression models provided strong support for hypotheses 1 and 2. As hurdle rate theory would predict, franchising had a proportionately greater impact in the areas of jobs and payroll in states with greater levels of economic freedom. Similarly, the third regression model provided strong support for hypothesis 3: franchising had a proportionately greater impact on output in states with greater economic freedom. Although the relationship between economic freedom and state output is strongly supported, economic freedom appears to have a greater impact on jobs and payroll than on output.

## **DISCUSSION**

Franchising plays an important role both domestic and international business, yet previous franchising research tends to ignore the true impact of franchising and possible determinants (Shane and Hoy, 1996). Furthermore, few, if any studies have examined the role of economic freedom and investment hurdle rates on franchising expansion and economic impact. This study

applies both of these concepts to examine franchising's economic impact. Specifically, we sought to study what explains the wide variation of franchising impact by state.

In general, our findings provided strong support for applying a hurdle rate model to franchising's economic impact using state economic freedom as a proxy for the cost of investment in a franchise business. This indicates that greater levels of economic freedom will make it more likely for entrepreneurs to choose to invest in a new franchise business or expand existing franchise businesses. Economic freedom's positive impact on jobs, payroll and output by state indicates that greater levels of economic freedom do lower the hurdle rate for franchising decisions. The impact of economic freedom was found to persist even after controlling for total state employment, unemployment rate, and educational attainment.

### **Implications and Limitations**

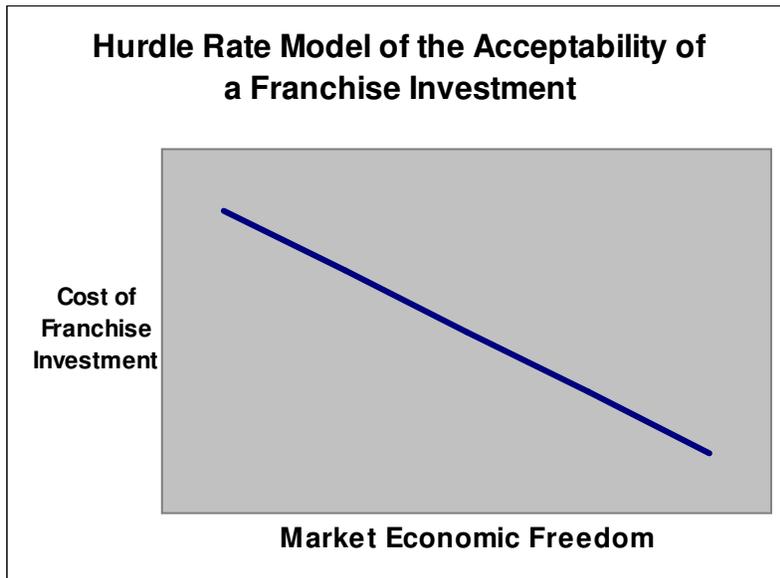
This study has important implications for researchers, entrepreneurs, and policy makers. Intuitively, one might expect franchising's economic impact to have a roughly linear relationship with a state's economic size and performance. However, this was not found to be the case. While we found that economic freedom does affect franchising's impact, future research should look at other categories. For example, we did not differentiate between different types of franchising (business format franchising as opposed to product distribution models). We also did not differentiate between franchisor-owned and franchisee-owned establishments. In addition, our study only looked at United States data. Future research should look at national levels of economic freedom and the resultant impact on franchising. Finally, this study provides a cross-sectional view of economic freedom's impact on franchising. Longitudinal studies should provide additional insight to the relationship between these phenomena.

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**Figure 1**



**Figure 2**

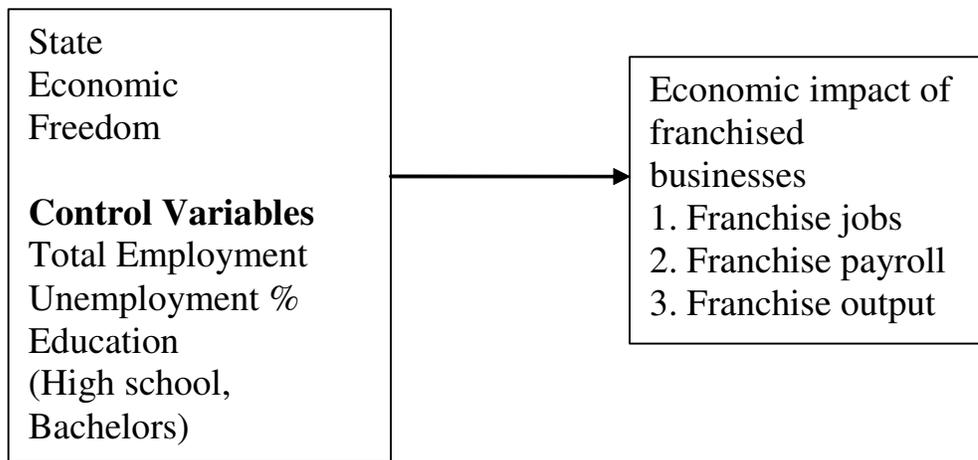


Table 1

## Correlation Matrix

| Variable            | 1       | 2      | 3       | 4      | 5       | 6      | 7      | 8    |
|---------------------|---------|--------|---------|--------|---------|--------|--------|------|
| Mean                | 23.92   | 2197   | 3.90    | 85.48  | 24.93   | 14.31  | 12.1   | 9.85 |
| SD                  | 4.91    | 2326   | .95     | 3.96   | 4.31    | 2.56   | 2.47   | 2.1  |
| 1. Economic Freedom | 1       |        |         |        |         |        |        |      |
| 2. Employment       | .492**  | 1      |         |        |         |        |        |      |
| 3. Unemployment     | .294*   | .078   | 1       |        |         |        |        |      |
| 4. High School      | -.226   | -.302* | -.366** | 1      |         |        |        |      |
| 5. Bachelors        | -.194   | .159   | -.366** | .527** | 1       |        |        |      |
| 6. Percent Jobs     | -.521** | -.205  | .085    | -.267  | -.499** | 1      |        |      |
| 7. Percent Payroll  | -.528** | -.253  | .021    | .161   | -.447** | .967** | 1      |      |
| 8. Percent Output   | -.344*  | -.063  | -.008   | -.191  | -.158   | .809** | .851** | 1    |

\*\*p&lt;.01

\*p&lt;.05

Table 2

## OLS Regression Results

|                   | Model 1<br>Percent Jobs<br>(Standard Error) | Model 2<br>Percent Payroll<br>(Standard Error) | Model 3<br>Percent Output<br>(Standard Error) |
|-------------------|---|--|---|
| Economic Freedom  | .564 (.072)**                               | .512 (.074)**                                  | .483 (.073)**                                 |
| Employment        | .040 (.000)                                 | .003 (.000)                                    | .052 (.000)                                   |
| Unemployment      | .074 (.348)                                 | .026 (.356)                                    | .054 (.353)                                   |
| High School       | -.222 (.096)                                | -.121 (.099)                                   | -.327 (.098)                                  |
| Bachelors         | -.252 (.090)                                | -.275 (.092)                                   | .119 (.091)                                   |
| Constant          | 37.08 (7.963)**                             | 28.94 (8.15)**                                 | 28.11 (8.08)**                                |
| R Square          | .477  | .412   | .206  |
| Adjusted R Square | .418  | .346   | .116  |
| F-Statistic       | 16.54**                                     | 12.13**  | 7.99**  |

Two-tailed significance values indicate: \*\*p&lt;0.01 \*p&lt;0.05 n=50

# Capacity building- Is this a conscious approach to change?

## Role of Support Organisation in Capacity building.



### Shakeel Abro

SPO Strengthening Participatory Organisation

This research paper explores the concept of the “Capacity building”, examining its contours and its potential in enabling organizations (grassroots level voluntary organizations) to meet the challenges of the demanding milieu in which they now operate.

#### *Researcher:*

Researcher Mr. Shakeel Abro is working in SPO Strengthening Participatory Organisation Pakistan as senior coordinator Projects. He did his Masters in Business Administration-MBA with specialization in Marketing and Masters in Economics. He is doing his M. Phil in Development Studies from Sindh Development Studies Center. He has completed a year long training course in Managing People and Organizations from LUMS under LUMS-McGill (Canada) NGO Management Program for Pakistan. Institute of International Education Development-IIED San Francisco under Leadership Development Mechanism (LDM) awarded him a fellowship for undertaking an International development course on Management of Community Based Services from Nairobi-Kenya. He has an extensive field and office experience in Community Development, Administration and Management. He has his internship experience with Pakistan National Shipping Corporation-PNSC Karachi. He is affiliated with International Association for Community Development-IACD U.K. He got appreciation from World Bank Washington for Pakistan Country Assistance Strategy-CAS assessment visits. Commonwealth Foundation-UK granted him sponsorship for

organizing a series of training seminars at Commonwealth Peoples Festival Oct2001, at Brisbane-Australia.

Parallel to this experience he invested his valuable time by participating in various seminars, workshops, training program's and exposure visits like Grameen Bank Bangladesh, BRAC and Proshika. In the IT field he has command over MS-Office includes MS-Word, Excell, PowerPoint and MS-Project2000 package and Epiinfo software. He is using frequently Internet and online computer use. He is good at report writing and has written regular progress reports and Research Papers.

He initiated his career by a joining an NGO working in Primary Health Care, Micro Enterprise, Quality Education, Water and Sanitation, Community Organization with their capacity building. He established NGO's first office in a very sensitive area and successfully led a 34 professional team. He has a special interest in Human Resource Development both at organizational and grass root level. At present he is working with a Multi Donor Supported National Organization engaged in providing technical support in trainings and project designing to NGOs. Priority areas are Health, Education, Agriculture and Environment.

### ***Introduction/Abstract:***

This paper has emerged from the research undertaken by the researcher in the field area of NGO where he works. A partner CBO was selected to study and to better understand how capacity building is implemented in practice, what actually happens, what works and why. The need of this research is realized in wake of the situation that despite 50 years of development assistance and investment, there remains an unacceptable level of poverty and inequality in the world and specifically in Pakistan. It will be argued that local communities, their institutions, networks and governments need to be strengthened so that the people themselves can play an effective role in identifying their own problems and lead development in their own context. Capacity building in this regard, particularly from its holistic perspective, is considered to be the best approach to strengthening capacities at individual, organizational and societal levels and to bringing a balance between micro-and-macro development initiatives. Many development professionals believe "capacity building" is a very useful tool, and the international aid community is placing growing emphasis on it as a key to reducing poverty and hunger.

This paper revolves around the critical assessment of the capacity development efforts undertaken by the Strengthening Participatory Organization (SPO), a national support NGO in Pakistan, and more specifically how SPO's approach can contribute to achieve the rights-based development objectives.

This paper reveals the results of a CBO, which was selected and was assessed at two levels. Before training and after training. Assessment tool in practice was Capacity building Indicators-CBIs through Learning Information System LIS . The background of this research is the term 'capacity-building' which has become almost synonymous with 'development' in many aid circles. Almost all the donors, The World Bank, international NGOs, and some local NGOs are prioritizing capacity building. It is therefore critical to analyze carefully the practice of capacity building to ensure that we learn from others' experience and avoid the danger that the term 'capacity-building' becomes merely a cosmetic

and meaningless addition to all proposals and policies. Capacity building is a conscious approach to change which, if taken seriously, has very radical and far-reaching implications not only for skills and behaviours, but also power dynamics within and between organizations.

This paper seeks to contribute to our understanding of capacity-building by analyzing a number of specific capacity-building interventions, drawing out the issues and insights from practice. It also highlights the consequent implications, particularly for NGOs involved in developing strategies for capacity-building. It is aimed at all development professionals engaged in capacity-building, but has particular relevance to NGOs, and capacity-building providers.

### **Why capacity building?**

Many contributors to the debate now suggest a greater emphasis on people in organizations as ;

*'Companies realize that in order to remain competitive they must utilize their human resources more efficiently'* (Morgan A. 1996:24).

In the introduction to his book *Imaginization* (Morgan 1993), Garreth Morgan reminds us that;

*'an organization has no presence beyond that of the people who bring it to life'*.

This concurs with Egan's (1988:46) view that,

*'people make things happen in companies and institutions'*

while Handy (1994:152) counsels that,

*'we must make people our assets'*.

Fisher & Torbert (1995) and Harvey-Jones (1994) stress that

*unless people in an organization are transformed, the impact of change is limited.*

Therefore it seems that if organizations are to respond successfully to rapidly changing circumstances, this process is dependent on the people in the organization to forge the new path to progress.

It comes from experiences of many development organizations that one way of facilitating this process is to create a learning process where people can learn from their own experiences. Many scholars also suggest that

***'people are continually learning how to learn together'* (Senge 1993:3).**

In fact McKergon (1994:16) reports that

*'learning, both by individuals and in organisations, is proving to be one of the key business topics of the 1990s'*.

One convincing reason for this focus on learning is that it is seen as a means of gaining competitive advantage. As Mayo (1995:14) reports'

*'the pace of change needed in today's world makes flexibility and rapid effective learning key competitive advantages'*,

For creating a learning organization we need to view capacity building from a holistic perspective, rather than addressing human, societal and institutional development issues in parts. Studying different parts and hoping thereby to capture the whole, it is argued that we need to generate a picture of the whole through exploring the relationships between the

various parts, because it is through these relationships that the complexity of the whole emerges.

Capacity building at best promises a process whereby individuals, groups, organizations and societies enhance their abilities to identify and meet development challenges in a sustainable manner. It makes local communities, organizations, and governments of developing countries key actors and places them in the center for their own development.

## **Development Context**

### ***Development in Pakistan***

Pakistan has started the new millennium with more hope. Starting from a position of extreme vulnerability at the end of 1990s- a financial crisis, domestic tensions and external isolation- it has achieved a remarkable turn around. A major factor behind this is strong leadership in the country with internal cohesion and a clear sense of direction. The government is engaged in fundamental political, institutional, economic, social and gender transformation of Pakistan's transition towards a modern Islamic state.

### ***Social Sector Development in Pakistan***

Pakistan inherited an agrarian economy with poor physical and social infrastructure. At the time of independence, only 13.2% of the total adult population was literate (8.6% of the adult female population). There were only 8,413 primary schools, 2,190 middle schools, 408 high schools, two universities and no professional colleges in the country. The health situation was even bleaker, with only 13,769 hospital beds and fewer than 1,500 registered doctors.

Development policy during the first decade was characterised by three features: First, the emphasis was on the establishment of import-substituting industries. Although consumer goods were being substituted by domestic production, all the machinery needed for the capital intensive industrialisation had to be imported. Second, the agriculture sector suffered seriously from official neglect in resource allocation with the result that the overall economic performance was hampered by stagnation in this sector in the 1950s. Finally, miserly allocations for education and health established a pattern of neglect in the provision of social services, particularly for the poor.

The early 1960s were again a period of substantial economic growth. Similar high priority was accorded to industrial development and the infrastructure base was strengthened through investments in transport, water and power which was supplemented by foreign aid. The 1965 war led to the first in a series of disruptions of the aid flow.

Aid resumption in the latter part of the 1960s was accompanied by a further change in focus. Agriculture now became the primary recipient of aid as the impact of the Green Revolution began to be felt. This also gave the wrong signal to the policy makers that there was no need to worry about population growth - Pakistan could feed itself. As a consequence, the government was able to delay hard policy choices.

The most significant economic development was during the late 1970s and 1980's due to the dramatic growth in remittances from the Middle East. These were however accompanied by accumulating structural imbalances in the economy. It was during the 1980s that the natural consequences of the gross neglect of the social infrastructure also began to appear. The quality of existing public education and health facilities deteriorated while the unmet demand for primary education and health set the agenda for increased and more efficient use of resources in the social sectors. To suggest that the government began to accord high priority to the social sectors would be an exaggeration. However, resource allocations towards the end of the decade do represent an increase from the low base that had plagued human development in Pakistan throughout its previous history.

Since 1988, successive governments in Pakistan have been committed to the policy initiatives necessary to implement social sector programmes. The National Finance Commission which met in April 1991 (for the first time in 15 years) was a significant move in clarifying the respective responsibilities of the central and provincial governments in relation to human development. The impetus to social policy change and increased spending has been a result of the government's realisation that poor performance in the social sectors has not only hampered other development objectives but also affected Pakistan's image in the region and the world.

### ***Role of NGOs as Agents of Change***

The role and perspectives of NGOs in Pakistan have grown and evolved over the years. Mainly charitable and philanthropic organisations at the time of independence, NGOs have stepped increasingly into welfare-oriented roles as the state system failed to deliver. In the 1970s, they shifted towards development and community based initiatives. Over the last decade or so, organisations with the specific objective of mobilising and organising targeted communities for development activities have emerged. Most NGOs are supported by community contributions, local donors, and government funds. In recent years, support from international donors has also become available.

Among NGOs working in the area of social, agricultural and rural development, three types are significant. The first are the national level capacity building and/or funding organisations. These include SPO, SAP and the NGO Resource Centre (NGORC). The second are the more regionally focused support organisations such as Sungi and Pattan. They work directly with community based organisations to transform their orientation from being welfare oriented to participatory development and afterwards support their development projects. The third type are the Rural Support Programmes that have followed the Aga Khan Rural Support Project (AKRSP) model of forming village or community organisations and enhancing productive investment activity. Prominent among this is National Rural Support Programme (NRSP).

In a 1991 study, the UNDP and SPO compiled a list of 5,833 NGOs. In 1994, a TVO Study updated this information base and identified 8,547 NGOs. After excluding religious organisations, professional and commercial associations, employee unions, housing societies, clubs, clinics and hospitals, 4,545 organisations remained. Of these, 1,998 did not exist or could not be found. A more recent survey of 200 NGOs from the same sample showed that

more than two-thirds of the NGOs surveyed are involved in the provision of education in one form or another, whereas more than half of them are also providing health and nutritional services. Of the NGOs working in social sectors, the survey showed that twice as many are concentrated in the urban than in the rural areas.

In essence, the NGOs play an important role in the social sector development and their impact is significant. As commented by World Bank CAS 2002 that *NGO implemented program of building social and physical capital and extending micro credit schemes under the PPAF is a very successful scheme.*

### ***SPO's Niche and Distinctiveness***

Since its transformation from a bilateral project to a Pakistani NGO, SPO has carved out a distinctive niche for itself. SPO has become recognised as a leading proponent of participatory development in Pakistan and is heavily engaged in capacity building of Community Based Organisations (CBOs). Among all organisations strengthening the development capacity of rural communities SPO has a unique position and role in development with innovative capacity building strategies. SPO's partner organisations enjoy independence and a strong self-help orientation. When it comes to ownership and sovereignty, even the AZTs and WOSs which SPO has helped to form and capacitate, are never regarded as being owned or managed by SPO. From the outset, they and their communities are encouraged to value and protect their independence and legal entity.

Similarly, SPO's national presence, democratic and horizontal structures help to ensure that whilst there is a common image and pursuance of SPO's Mission, the regional centres operate in a decentralised decision making environment which is responsive to both the local needs and corporate standards. Another distinctive feature relates to the issue of gender. All of SPO's policies, procedures and programmes are regularly checked to ensure an increasing level of gender equity. The principles of gender equity are applied at all tiers of SPO management, from the composition of the general body and elections of the Board of Directors to the hiring and training of programme and administrative staff from SPO in-house practices to capacity building of partner organisations.

Furthermore, the creation of and support to Participatory Development Coalitions (PDCs) are unique to SPO. They are part of SPO's phased approach to ensuring long term support to partner CBOs. They provide a natural exit point for SPO allowing it to reduce its direct support following its contact cycle of capacity building. At the same time, through its PDCs, SPO is able to encourage the development of self-sustaining area-based capacity building organisations which respond directly to their member CBOs.

All of this has helped develop and strengthen SPO's niche as a truly national rural development support organisation which is attracting national and international recognition, in its own right.

## *How SPO builds the capacity /SPO Programming*

### **Contact Cycle for Capacity Building**

The CBO Capacity Building Contact Cycle is the focal point of SPO's approach to social development. A typical cycle normally lasts three years and includes five main elements:

- 1. Area Survey for CBOs Selection:** The Contact Cycle begins with a survey of suitable areas in the country. Areas where SPO already has contacts are given preference. Support and information from other CBOs is requested to study the accessibility and the law and order situation of a particular area. Efforts are also made to find out whether other support agencies are working there and whether there exists any secondary baseline data prepared by other agencies. The role and communication of the area with the Social Welfare Office is another element that is taken into consideration while assessing whether SPO's potential for the area and whether there is good potential for positive replication of SPO capacity building program.
- 2. Identification, Assessment and Selection of CBOs:** The next step is identification of potential partner CBOs which are situated with access to each other. This step relies on extensive field work, personal scouting of the area, meeting with potential CBOs, reviewing existing documentation of local groups and assessing if the selected groups will be receptive to SPO program. A list of CBOs in the area is prepared and invitations to SPO's "orientation meeting" are sent to all organisations on the list. Attendance, interest and response exhibited by the CBOs at these meetings and the mutual information shared helps in assessing the CBO interest in SPO. There are direct one-to-one meetings between SPO and individual CBOs as well as group activity with several CBOs to develop a rapport. At this stage, a Rapid Organisational Appraisal (ROA) is undertaken with each CBO. The ROA includes institutional mapping, socio-economic profile of the area, organisational history of the CBO, historical prospective of the CBO and comparison with other development ventures in the area. This step concludes with the mutual selection of about six to eight CBOs to participate in the Contact Cycle as a cluster.
- 3. Cluster Formation:** CBOs selected to participate in the Contact Cycle are then organised into a cluster. SPO Programme Co-ordinators and CBOs prepare a Partnership Plan (PP) adapting to the needs of each of the selected CBOs through a process called Participatory Organisational Review (POR). The POR process includes checking on the desirable qualities, essential qualities and killer characteristics in order to help CBOs realise their strengths and weaknesses and also help them understand their optimum potential.
- 4. Capacity Building:** The PP sets in motion a cycle of training in Development Planning and Management (DPM), technical assistance and feedback, networking, linkages, funding of selected projects accompanied by continuous monitoring and follow-up. The DPM training modules were developed in 1992 and have since been improved upon in the light of CBOs needs and SPO experiences gained in the field. DPM courses are designed so that CBOs become thoroughly familiar with development concepts and approaches; and develop appropriate skills in organisational management as well as project planning, development, implementation and monitoring. These skills are essential if CBOs are to play an active role in their community's development.

## DEVELOPMENT 1

- Emergence of society
- What is development?
- Charity vs. Development
- Participatory Development

## GENDER AWARENESS 2

- Sex vs. Gender
- Gender Roles
- Gender division of Labor
- Women's Multiple Work Load
- Power Relations
- Practical and strategic Gender Needs

## RIGHT-BASED APPROACH 3

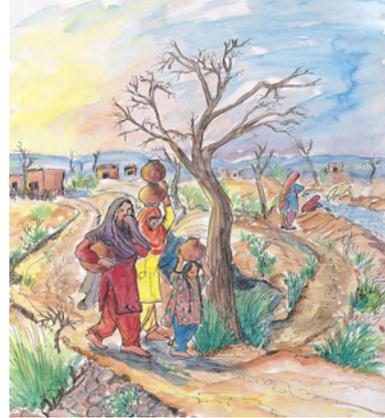
- An Introduction to Human Rights
- Introduction International Laws
- Why Focus on Women and Children?
- Accountability
- Rights Principles
- Advocacy (Concept)
- Advocacy framework

## POLITICAL PARTICIPATION 4

- Forms of Human Social and Political Organizations
- The State and its Role
- Democracy
- What is politics?
- Political structure of Pakistan
- Local Government in Pakistan
- From Information to strategy and Action

## ENVIRONMENTAL AWARENESS 5

- What is Environment?
- Eco System
- Environmental Issues -A
- Environmental Issues-B



### Putting learning into practise:

After attending each training CBOs have to transform their knowledge into practice and SPO Staff conducts followup visits in the CBO target areas to further reinforce the knowledge imparted. SPO also provides funds for small projects that have been conceived and developed by the CBO thus putting into practice the skills acquired during DPM. Technical assistance and backstopping is provided by SPO during project implementation to ensure that these CBOs get the most out of these small projects in terms of capacity building.

**5. Reduced Support:** Once a CBO Contact Cycle is completed, SPO begins to pull away to a point where the relationship with the CBO is limited to contact and networking. By this time, the CBO has attained the ability to manage its work independently, to carry out networking, linkages and training, and to share expertise within its own cluster as well as with CBOs in other clusters. The CBOs are also encouraged to develop linkages with donors, government departments and other support agencies/organisations for long term funding and sustainability.

### **Approach of SPO:**

SPO's approach differs from other Pakistani NGOs in the sense that it concentrates on developing **capacity building partnership plans** with clusters (groups of 7-8 CBOs/WOSs) instead of individual community based organisations. Once the CBOs are identified or the WOSs formed, SPO groups these into a geographical cluster for capacity building activities. There are two major advantages in doing so: firstly, this approach minimises SPO's human and financial efforts put into capacity building of individual organisations and is therefore an efficient and cost effective way to impart capacity building. Secondly, the formation, strengthening and sustainability of a cluster encourages mutual co-operation among member organisations and provides an opportunity for member organisations, and in turn their individual members, to understand, develop consensus on and co-operate in the development of their common geographical area.

Linkages are encouraged among member CBOs/WOSs so that a local base of information and support services is established at each cluster level. The focus of SPO is to enable local groups make decisions related to resources themselves i.e. acquire and use local and external resources in a way that ensures greater participation and accountability in the use of development resources. These clusters once capacitated, can then provide a focal point for development activities in the area and are the first step in becoming Local Area NGOs and later PDCs.

### **The Learning Information System**

Central to SPO's desire of developing into a learning organisation is the Learning Information System (LIS). In order to learn from it's experience, SPO has to make it's monitoring and reporting system more efficient and the information produced more accessible and available. To assist in this area, SPO has been developing a computerised system, the LIS. The LIS is a database of performance information which SPO uses in a variety of ways including:

1. Tracking the transformation of Community Based Organisations (CBOs) into development organisations (CBDOs) - The LIS has a 5 point maturity scale, in addition to a range of Capacity Development Indicators (CBIs) that are used to represent the different steps of the transformation. These steps can be examined on screen or printed out for a particular CBO or a cluster of CBOs.
2. Tracking the progress of CBOs through SPOs contact cycle - Each month the LIS receives data from the regions on the steps of the contact cycle completed for each CBO. This data is then compiled into tables which show the progress of the CBOs in each of all clusters.

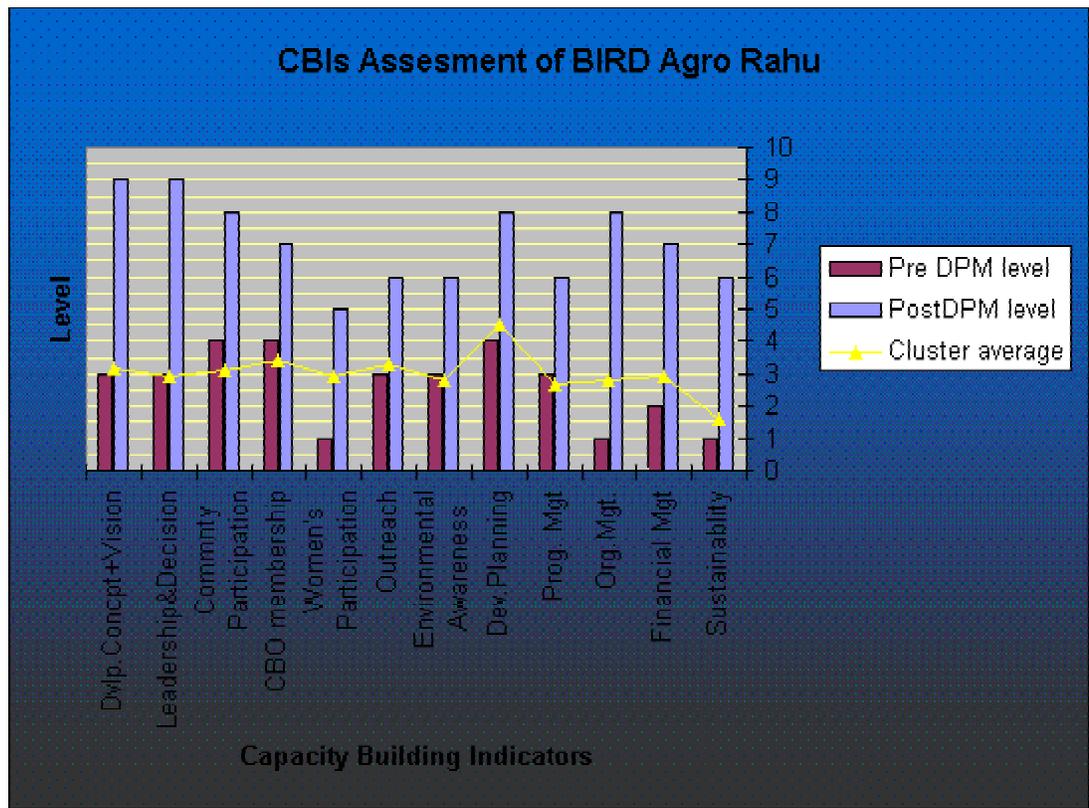
3. Learning about the effectiveness of its capacity building inputs - By measuring the process of transformation over time, including baseline information, SPO can learn about how CBOs respond to different components of the contact cycle, why some CBOs progress faster than others, even in the same cluster, why particular inputs may be more effective than others, and how some inputs may need to be customised for different regions.
4. Producing monthly reports of activities undertaken versus planned - The LIS compiles activity data from all the regions which is printed out in graph or table form
5. Preparing for field and monitoring visits - The LIS is used to print background information on the CBOs to be visited

The LIS has been a useful tool for SPO in the continuous enhancement of its performance through applied learnings. SPO has also shared its experience with other NGOs in Pakistan. SPO is committed to improving and extending this tool to other areas of its operations in a phased and realistic manner.

## Case study of a partner organization :

### Assesment of a Partner Organisation through application of CBIs-Capacity building indicators

|   |   |                            |
|---|---|----------------------------|
| 3 | 9 | 3.2Dvlp.Concpt+Vision      |
| 3 | 9 | 2.9Leadership&Decision     |
| 4 | 8 | 3.1Commnty Participation   |
| 4 | 7 | 3.4CBO membership          |
| 1 | 5 | 2.9Women's Participation   |
| 3 | 6 | 3.3Outrech                 |
| 3 | 6 | 2.8Environmental Awareness |
| 4 | 8 | 4.5Dev.Planning            |
| 3 | 6 | 2.7Prog. Mgt               |
| 1 | 8 | 2.8Org.Mgt.                |
| 2 | 7 | 2.9Financial Mgt           |
| 1 | 6 | 1.6Sustainability          |



|   |                        |               |                                    |          |
|---|------------------------|---------------|------------------------------------|----------|
| 1 | CBO                    | below 35%     |                                    |          |
| 2 | CBO with some lackings | 35-55%        | <b>Result of CBO Pre DPM level</b> | <b>1</b> |
| 3 | CBDO with some gaps    | 55-69%        | <b>Post DPM Level</b>              | <b>4</b> |
| 4 | Operational CBDO       | 70-84%        |                                    |          |
| 5 | Ideal CBDO             | 85% and above |                                    |          |

**CBO below 35%**  
**Operational CBDO**

## **Stages and Characteristics of CBO**

### **Development concept and Vision(Ideal CBO)**

CBO is totally oriented to developmental approach of self help and empowerment.

CBO's activities contributes to the achievement of Vision and Mission

CBO has developed a strategic plan for next five years.

### **Leadership and Decisionmaking.(Ideal CBO)**

Secondline leadership in place.

Leadership monitors the performance and review the strategy.

Member feel positive about all decisions.They feel that their concerns about these were heard and discussed.

Leadership is participatory.All opportunities are shared with solved as appropriate.

All problems are recognised and solved as appropriate.

### **Community Participation(Operational Development Oriented)**

Every body benefits or is allowed to avail equal benefits from CBOs work.

Community participates in identifying planning,managing & supervising programmes.

Majority of the community is invoved in key decisions.

### **CBO Membership(Operational Development Oriented)**

More than 70% of the poor and middle class householdsa are represented.

65% of households are represented.

75% of members attend every meeting/50% participate.

75% of the members pay membership fee.

### **Women Participation(Development oriented with some gaps)**

Some of the CBOs activities are addressing women issues.

Women issues are discussed through male community.

Women membership initiated.

Women are consulted before making decision.

### **Outreach(Development oriented with some gaps)**

CBO is well known within its community.

CBO is a member of district level networks.

CBO is in contact with line departments but the relation is formal.

The CBO has received funding but has yet to acquire sufficient credibility to be considered by other donors.

### **Environment Awareness(Development oriented with some gaps)**

Members activity seek information on environment.

CBO consciously practice traditional conservation methods.

Members have attended in depth training on impact assesment.

### **Development Planning(Operational development Oriented)**

Management has a comprehensive system for program development and implementation.

This system can provide required information to donor

The budget reflects program plans. the budget is controlled on an ongoing basis.

### **Program Management(Developmenty oriented with some gaps)**

Informal system exists to monitor program activities.

CBO prepares reports on demand of donor but do not share with other stakeholders.

Basic evaluation is carried out on demand of donor.

### **Organisational Managemen(Operational Development Oriented)**

Adminstrative procedures and manuals exist but are not referred to regularly.

Regular meetings are held with preplanned agenda and appropriate action is taken on decisions.

CBO has achieved most its targets planned during last year.

**Financial Management(Operational Development Oriented)**

Financial procedures and reporting systems are in place and function partially. Funds are managed for each project separately.

Independent audits or external financial reviews are performed periodically on donor's request.

Internal audits are being conducted on an ad hoc basis.

CBO occasionally produces accurate and complete financial reports which it makes available to the management and donor.

**Sustainability(Development oriented with some gaps)**

CBO has mobilised significant in kind contributions from within its own community

e.g.(voluntary labour/use of space/technical assistance)

The PO has a shared vision but as yet lacks the understanding and skills to interact with other development partners.

Members have skill to plan manage the projects but they are not confident enough.

**Conclusion:**

Findings of this paper concludes that the “capacity building” is a very useful approach but we need to view capacity building from a holistic perspective, rather than addressing human, societal and institutional development issues in parts. Studying different parts and hoping thereby to capture the whole, it is argued that we need to generate a picture of the whole through exploring the relationships between the various parts, because it is through these relationships that the complexity of the whole emerges.

This paper concludes that the Capacity building should be seen as a process whereby individuals, groups, organizations and societies enhance their abilities to identify and meet development challenges in a sustainable manner. It makes local communities, organizations, and governments of developing countries key actors and places them in the center for their own development.

Paper also concludes that this process should be monitored with some monitoring tool like LIS that provides continuous feedback on set indicators how the CBO is moving towards the path of capacity building.

# **DEVELOPMENT OF WOMAN'S BUSINESS IN UNDEVELOPED ENTREPRENEURIAL SURROUNDING – THE CASE OF SERBIA**

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## **Abstract**

The women's business in Serbia belongs to the most dynamic domains of the development of real private sector and strongly marks the process of privatization of economic activities. The space half opened by the institutional possibility to privatize the development in early nineties of last century, stimulated a large number of women in Serbia to take their economic fate in their own hands. Emphasis in the development of woman's business took place, first of all, in the creation of new jobs for that part of population which is the victim of the existing model of restructuring the economy and enterprises. Accordingly, the engagement of women in Serbian business is mainly based on self-employment and foundation of shops and micro enterprises, in classic service activities. However, moreover, the woman's business due to its cumulative influence to the whole privatization of production and employment represents one of the key factors of changes in the socio-economic system of Serbia. The basic limitations for the development of the modern woman's business in Serbia take place in an antientrepreneurially oriented national surrounding. In spite of the political and institutional transformation of Serbia, existing situation continuously shows that the distribution of political power, in a large extent, also influences the distribution of economic results and that, on this basis, the limitation of individual economic freedom is not favorable for the dynamic development of entrepreneurship and small business. An additional difficulty for the position of women in business represents a patriarchal cultural and social heritage. For this reason, for women's entrepreneurs in Serbia, the creation of their own business is not the single challenge but also the foundation of organizations (business associations and networks) having as their basic function – efficient actions in the process of making political decisions in the sphere of economy.

## **Introduction**

Changes imposed by the restoration of capitalism, restructuring of economy and privatization of enterprises cannot be imagined without a substantial access to the problem of the development of women's business. The development of the women's business represents a dynamic, insufficiently known and for the society of Serbia wholly new phenomenon. It is unclear and imprecise whether and how many economic, social and political currents are or are not going in the favor of women's business. The development of this business, in foregoing fifteen years in Serbia took place in the characteristic circle of economic recession and intensive social partitions where the low rate of employment in the production factor generated a low demand and the low demand a low production leading to the further diminution of production. This is the reality of Serbia. The exit from such situation should be found, according to the

principles of functioning of modern market economies, in processes stimulating entrepreneurial spirit and maximization of efforts, otherwise neglected, as: originality, ability to run a business, executive knowledge in creation – all mentioned in order to develop and implement new organizational principles and technologies with high competitive values and high profitability. However, Serbia, although situated directly at the frontier of the second (by its significance) global pole of the socio-economic development is far away from this process. For this reason, the purpose of this work is to indicate everything insufficiently known and visible within the problem of treating the women's business in Serbia as a development component in resolving the problems of an undeveloped entrepreneurial surrounding.

In accordance with this, in the work will be treated the following aspects: (1) Why the actual privatization of the economic life of Serbia did not give a strong impulse to the development of the women's business? (2) What is the (potential) role of the woman's business in restructuring the economy and privatization of enterprises in Serbia, to the criteria of modern market economy, especially in the segment of self-employment and development of micro and small enterprises? and (3) What should be done to stimulate and promote the woman's business in Serbia, within a generally antientrepreneurially structured socio-economic surrounding featuring strong patriarchal traditions?

### **Privatization of economy and economic development and woman's business in Serbia**

The problem of restructuring the economy and privatization of enterprises, in the present research, is treated, first of all, from the standpoint of the privatization of development, id est the establishment and development of new, privately owned enterprises that should move the society and economy of Serbia from its development lethargy which lasts already twenty five years (the last year with a valuable rate of economic growth was 1979). In this context, the actual process of the restructuration of economy and privatization of enterprises owned by the state of Serbia is characterized by the fact that there is the lack i. e. insufficiency of market rules, meaning that social and economic problems are not alleviated and removed – on the contrary, they are deepened.

The space, half-opened by the institutional possibility of the privatization of development, stimulated a large number of women in Serbia to take their economic destiny in their own hands, in the first line by the self-employment and establishment of shops or micro-enterprises, mainly in service activities. The basic data concerning the role of woman's business in Serbia are given in the Table 1.

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Table 1 about here

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At the first sight, information on the dimension of small business and entrepreneurship are very impressive. When comparing these data with the number of inhabitants, the result, in Serbia, in 2003, is 69 shops, small and medium size enterprises per 1.000 inhabitants. However, because, in the same year, only 67.000 were active small and medium enterprises (due to very liberal legislation between 1990 and 1994, a very large number of private enterprises was registered, but their major part never carried out a market operation and, due to an undeveloped

economic administration, such enterprises were not erased from the register of enterprises); that way, the above ratio may be corrected to 41,5 shops and small and medium enterprises: this figure is slightly lower than the average ratio of European Union. However, while the shops, small and medium enterprises in EU participate in the creation of its GDP with 40% - 60%, depending on the member country, their participation in Serbia amounts to 20% - 25% (here should be taken into account that the national product per capita, with reference to the internal purchase prices in Serbia, amounts to only 20% of the average of EU). But, let's return to the woman's business. The presented data, fragmentary due to the undeveloped national statistic service, demonstrate that the woman's business in Serbia has very poor dimensions. An average woman's business unit is a shop where its female owner is the single employee running a business or rendering some other classic services. The comparison between the male and female business gives a conclusion that the woman's entrepreneurship in Serbia is a very rare resource. The rate of entrepreneurship in last 15 years, after the liberalization of the right to private property (also including unsuccessful attempts to open shops and enterprises in this period) in Serbia, for women amounts to only 29,6 per 1.000 women aged 18 and more years while, the same rate, for men, amounts to 144,4 per 1.000 or, relatively, 5 times more.

The qualitative and quantitative analysis of the development of the woman's business in Serbia and researches carried out in order to identify the reasons of its failures and missings show that the basic difficulties of the wider penetration of entrepreneurship should be observed within a context that national reformers, in fact do not accept the basic rules of the market economy. Namely, the social and political elite of Serbia undoubtedly understands and performs the privatization as an standard for the external valuation of the success of reforms and not as a means for the establishment of the new (national) entrepreneurially oriented ambient of an economic system. The establishment of the private property instead of the state owned sector (Serbia belongs to countries where in the short period of only fifteen years the attempt of the privatization in all of three known forms was made: after an initial attempt to introduce so called "popular" capitalism in the spirit of Thatcherism, the privatization process was continued with an institutionally unsettled process of the concentration of the property in the hands of a (new) national financial oligarchy and, after the change of the dominant political option, at the end of 2000, was supplemented with the take over of the property of enterprises with the monopoly and oligopoly control of national markets by transnational corporations or investment funds located in exotic states, probably with the dominant influence of our home capital) is treated as an goal per se and not as a factor which should, first of all, contribute to the amelioration of living condition of the mayor part of population via the massive activation of entrepreneurial abilities and individual savings (so, e. g., only the annual inflow on the basis of financial assignments of our workers employed in foreign countries amounts to 11% of the value of GNP) in order to, combined with the higher degree of economic freedom, provide basic conditions for a stable and democratic development.

When considering, in this context, the development of the woman's business in Serbia, we come to particular paradox. The relatively small share of woman's business in the privatization of economy and economic development in Serbia should not be attributed to discrimination between sexes, as the manifestation of a very strong patriarchal culture and its social and political heritage. Poor results, however, first of all, are the reflexion of the distribution of power as the consequence of the simultaneous action of internal political, managerial and organizational structure and external political and economical regulation which generates a socio-economic surrounding for the promotion and progress of unable and

incompetent entrepreneurs, managers and expert teams (relating to the criteria of modern market economy) as shows also the “iceberg top” discovered in the attempt of subsequent taxation of extraprofiters from the last decade of last century and so called “entrepreneurs” as well, characterizing Serbia, still two centuries after becoming the independent state and this can be considered as inadequate, taking care that, in contrast to many other countries, Serbia realized its independence autonomously, through the particular form of peasant revolution with strong antifeudal features and requests for economic freedom (first of all: trade freedom and private property rights).

In this sense, it can be concluded that the development of the woman's business as an instrument for the privatization of economy and economic development, in Serbia, did not reach a point where its problem may be treated from the standpoint of providing the real equality of sexes in the realization of entrepreneurial activities (because, also, males as entrepreneurs, especially in small business, are really discriminated). The explanation of this statements leads us to the next aspect of analysis – the consideration of relation between the problem of restructuring the economy and enterprises and the development of woman' business.

### **Place and role of woman's business in restructuring economy and enterprises in Serbia**

Economy and enterprises restructuring in Serbia, in this research, is defined as their adaption to dominant criteria, standards, mechanisms and rules of the global surrounding, on the principles of an open economy. The measure for the definition, of the succes of structural adaptation is the capability of the whole economic structure of Serbia and each individual enterprise as well – to create and to implement new technologies, products and service having high competitive performances and great profit. Unfortunately, Serbia, as other (post) communist states in Central and South-East Europe, has not succeeded to wholly find proper answers to key questions related to the above defined notion of the restructuring of the economy and enterprises. This statement is not denied even by successes in the transformation of the socio-economic structure in eight ex-communist countries which, on May 1 st. 2004, joined European Union as members. The real range of the development of national entrepreneurial capabilities in these countries is best reflected in the fact, that after 15 years, within them, none at all valuable national company or an authentic (entrepreneurial) project, belonging to the top of global entrepreneurial enterprises, were not formed.

That what directly and the most heavily affects the realization of activities concerning the restructuring of enterprises and economy in Serbia, this is the drastic recession of production (actual GNP in Serbia amounts only to 50% compared with its maximum value realized in the very far 1986, after five years of stagnation - Author's note). Basic reasons for such a situation should be looked - for in the reduction of the exploitation of all disposable production factors - work, soil and capital. Serbia, 15 years after the restoration of capitalism (the period of the domination of political option represented by Slobodan Milošević is rather the prove of the ability of the ancient political elite to accept, without any prejudice, the new (capitalistic) rules of game than and not of the tenacity of communism) came into a situation to have to perform, via exorted improvisations, minimal structural adaption indispensable to prevent the deeper fall of the whole society and collapsing economy. For this reason, it is very important to examin all possibilities to increase the production by using disposable resources under the criteria of individual entrepreneurial and developmental rationalism. This demonstrates, from the standpoint of unused resources, that the causes of difficulties in the operation of the real sector in Serbia

should not be located in such factors as: the lack of own money, expensive credits, obsoleted equipment and apathetic labor and so on but, first of all, in economic, social and political blocades preventing the demonstration of real entrepreneurial initiatives. This hypothesis is based on the following arguments.

Serbia belongs to societies in which, traditionally, as the basic reason of the blockade of efforts for the modernization of its social and economic structure, the shortage of capital is declared. Changes in the macroeconomic sphere, during the last 5 years, characterized by: (1) several times repeated attempts to introduce a hard budgetary policy (mainly, under the pressure of the International Monetary Fund, often implicitly attributed with negative connotation because the political and economic elite does not want to openly declare that the reason of inflationary disturbances is, mainly, the consequence of irregularities in fulfilling financial obligations taken over, the consequences thereof, in a large extent, also bears the small business), (2) the liquidation of banks being the bearers of key dubiousness in the financial sphere, (3) Figures on the potential value of the home capital, collected on the basis of data on the conversion value of the thesaurized savings of Serbian population in the currencies withdrawn after the introduction of EURO and similar, convincingly demonstrate that (definitively) it should be necessary to abandon the dogma that the basic reason of national problems in the modernization of the operation of economy is the lack of capital. In fact, it became evident, with the restoration of capitalism that the main economic problem in Serbia was the lack of good enterprises and reproduction projects. Actually, the national financial system is in such a situation that even the (modest) volume of capital circulating in official financial flows has not sufficient possibilities to be placed in (real) projects which, as their final (economic) result may provide the repayment of invested external financial means (of course, under the real rate of interest) and, on the other hand, provide an appropriate profit to enterprises or entrepreneurial activities. The essence of Serbian economic problems is the undeveloped entrepreneurial surrounding in which, as mentioned above, dominate stimuli for the promotion and progress of unable and incompetent entrepreneurs, managers and expert teams.

Under the light of these ascertains, it should be also necessary to define the role of the woman's business in restructuring the economy and enterprises in Serbia and this is, first of all, concentration to the autonomous creation of new jobs. From a macroeconomic aspect, their business should create incomes for that part of the population which represents the victims of the existing model of restructuring the economy and enterprises. This may be defined as an "art" to create the impossible. However, because the major part of the population is in the net of lost existential equilibrium, an exit should be found out. And, in this way imposed global (on national level) and individual action displaces reasoning towards specific "woman's" values integrated into independent, private and non-profit organizations which should have an important role in overcoming common socio-economic barriers to the more efficient organization of the small business. For this reason, a challenge for female entrepreneurs in Serbia is not only the creation of their own business but also the foundation of organizations (business associations and networks) having as their basic function – efficient actions in the process of making political decisions in the sphere of economy. However, for the efficiency of these institutions, it is necessary to define, exactly, their goals, provide sufficient human and financial resources, develop the efficient strategy and policy of representation and promotion and reasonably resolve their managerial and financial problems.

## **Possibilities for the stimulation and promotion of woman's business in Serbia**

The provision of conditions for entrepreneurship to become the holder of economic development, involves the creation of a stimulation policy as the part of the whole macroeconomic policy. As a curiosum, it is needed to note that the first programme for the stimulation of entrepreneurship in Serbia was made more than 3 decades ago on the basis of the constitutional structure of Ex-Yugoslavia, allowing a limited private initiative in the development of small enterprises. After that, practically in the periods of time of ca 5 years, new political supports to the development of entrepreneurship took place. And, after the elimination of the major part of blockades on private initiatives, in early nineties of the last century, periodic campaigns for the stimulation of entrepreneurship continued. So, during 2001, started a very ambitious project for the development of private entrepreneurship in Serbia favorizing the development of small and medium enterprises. However, poor results in its implementation impose the serious analysis of the efficiency of public infrastructures in the initiation of the development of entrepreneurship in Serbia. The basic feature in these programs is their relative scientific correctness being the consequence of important influences of market ideas on professional economic science. On the other side, small or zero effects of their implementation show that an attempt to implement market ideas in an anti-market system suggests their non-conformity with the real mechanism of the regulation of economy and economy development. From the historical point of view, three essential remarks may be given to their contents. The first one is the underestimation of the undevelopment of market infrastructure; the second one is the overestimation of the efficiency of administration infrastructure and the third one, as the most controversial, is the installation of a subvention system in the stimulation of development. Namely, the basic mechanisms for the stimulation of the development of entrepreneurship, in all mentioned projects, were non-commercial credits (with negative rates of interests and long grace periods). Such orientation is directly transplanted from the dominant system of financing the development of the state sector of economy and its results were similar because they stimulated the distributive instead of entrepreneurial orientation. Of course, because demands for so defined subventions are unlimited, it seems that the problem is in the lack of capital and not in the quality of subventioned entrepreneurial actions. Due to the untransparency of the operation of economic administration, it is not possible to estimate the dimension of the engagement of public funds to this purpose, but as an illustration, it can be mentioned that someones, the appearance of one of the key capitalistic actors on the economic stage of Serbia put into connection with the public support to his project of development of even 50 small enterprises in Kosovo. Probably it is superfluous to note that, until now, details concerning the amount of public financial means invested into the realization of this project, are unknown but one thing is sure - none of these enterprises does not function. For this reasons, the Authors plead for another access to public support to woman's business. Anyhow, priority should be given to measures which bring more regularity and transparency in the conception and realization of the system for the development stimulation of entrepreneurship. In this sense, a start basis for the stimulation and promotion of woman's business should be an initiative that the Government of Serbia i. e. it's Ministry of Economy and Privatization as well as Ministry for Work and Social Policy initiate the elaboration of the project "Strategy and policy of the development of woman's business in the Republic of Serbia". The basic target of this project should be to identify a way how to use woman's potentials in order to speed up reform processes in Serbia.

The contents of the project, according to the Author's point of view, should be as follows:

- Development of an education system for women, in order to develop abilities and skills necessary for the creation of their own business.
- Foundation and development of the local business associations of women being active in business and their linking into a national network.
- Organization and realization of media campaigns for providing the public support for women's entrepreneurship and their organization into local associations and unions on national level.
- Specific problems of women relating to external financial means.

Priority in the public support to women's entrepreneurship should have specialized training programmes in the function of the development of business skills, use of these knowledge's for founding their own shops or micro enterprises and contacts with other women – entrepreneurs. In order to illustrate our view of the contents of a local training programme for women wishing to start their own business, we are presenting here a 6-days workshop:

- Day 1: Small (micro) enterprises and marketing.
- Day 2: Small (micro) enterprises and management.
- Day 3: Small (micro) enterprises and financial engineering.
- Day 4: Basics of business legislation.
- Day 5: Associating and linking women in business.
- Day 6: Case(s) of successful local women's business.

In addition to the training programmes for women who intend to run their own business or who already are in the business and have needs for an additional education, particular training programmes should be organized for young girls (12 to 16 years) in order to stimulate the entrepreneurial spirit of younger population.

The basic function of the local women's business associations should be:

- Spread of free market ideas;
- Promotion of the role of private sector;
- Stimulation of the development of entrepreneurial spirit;
- Promotion of women-business owners;
- Education of women being in business;
- Creation of business networks in the function to support woman's business;
- Creation of woman's lobby and its actions within the framework of local, regional and national political structures and similar.

The business associations should provide: the diminution of the influence of some business barriers, realization of business contacts, increase of self-confidence of business women, encouragement and stimulation of other women to make business and to open enterprises and, indirectly, easier access to financial markets. As mentioned above, the major part of woman's business is small in size and a small number of women in Serbia use modern communications means – and the local business associations united in the national network should have a key role in the easier provision of accesses to business information and expression of public attitude.

The particular aspect of the development of women's business in Serbia should represent specialized medium campaigns for the provision of public support and understanding for woman's entrepreneurship and association into local business unions. A particular significance,

these campaigns should have in overcoming prejudices linking the woman's business and business associations with "feministic" ideas resp. their identification as a marginal group against males – this is very specifically reflected in a society loaded with patriarchal traditions.

One of very frequent women's problems in Serbia is the problem how to provide an external financial support for their ideas and activities. To understand the real essence of this problem, the most important is to identify the necessary type of financing. For this reason, it is necessary to make distinction between: (1) provision of basic capital, (2) provision of capital for business expansion, (3) joint venture of capital or another form of more sophisticated joint venture. When considering this problem, it is necessary to take care of the specifics of national situation. First of all and anyhow the most important is that in Serbia do not exist well established institutional bases for the hypothecary and collateral crediting of business. Only after the good institutional regulation of the problem of this external financing to the criteria and standards of an open market economy, it is possible to think on the introduction of additional regulation adapted to the specific needs of women's business.

### **Instead of conclusion**

The woman's business in Serbia belongs to the most dynamic domains of the real private sector and strongly marks the process of the privatization of economic activities. A space half-open by the institutional possibility of the privatization of development in early nineties of last century stimulated a large number of women in Serbia to take their economic fate in their own hands. Analyses demonstrate that the engagement of women in business is mainly based on self-employment and foundation of shops and micro enterprises within classic activities. However, in addition to this, the woman's business, due to its cumulate influence to the total privatization of production and employment, is one of the key factors of changes in the socio-economic system of Serbia. But, the negative effects of the privatization of inherited (communist) economic structure (like: radical diminution of production, expansion of "shadow" economy and growth of poverty) devaluate, to a large extent, these achievements because, women as a whole are the most jeopardized and their freedom for economic emancipation is largely limited under the light of this assertion, it should be necessary to define the role of woman's business in restructuring the economy and enterprises in Serbia and this is, first of all, the creation of new jobs. Their business should create incomes, in the first place for that part of population which represents the victims of the existing model of restructuring the economy and enterprises.

The distribution of political power which is, unfortunately, directly connected to the distribution of economic results and, on this basis, to the limitation of individual economic freedom, is not favorable for the development of entrepreneurship and small business. The position of women in business is additionally more difficult due to cultural and social heritage. For this reason, for woman's entrepreneurs in Serbia the creation of their own business is not a single challenge but also the foundation of organizations (business associations and networks) having as their basic functions an efficient activity in the process of making political decisions in the sphere of economy.

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Table 1.

## Woman's business in Serbia in 2003

| SHOPS                             |                                      |              |                    |                               |
|-----------------------------------|--------------------------------------|--------------|--------------------|-------------------------------|
| No                                |                                      | Total number | Women as owners    | Share of woman's business (%) |
| 1.                                | Total number of entrepreneurs        | 244.893      | 62.041             | 25,33                         |
|                                   | Their structure:                     |              |                    |                               |
| 1.1.                              | Manufacturing                        | 38.003       | 8.421              | 22,16                         |
| 1.2.                              | Construction                         | 14.484       | 1.187              | 8,20                          |
| 1.3.                              | Hotels and restaurants               | 19.159       | 5.535              | 28,89                         |
| 1.4.                              | Wholesale and retail trade; repair   | 80.663       | 28.916             | 35,85                         |
| 1.5.                              | Transport, storage and communication | 29.508       | 525                | 1,77                          |
| 1.6.                              | Health and social work               | 3.062        | 1.304              | 42,59                         |
| SMALL AND MEDIUM SIZE ENTERPRISES |                                      |              |                    |                               |
| No                                |                                      | Total number | Women as managers: | Share of woman's business (%) |
| 1.                                | Total number of enterprises          | 272.634      | 25.183             | 9,24                          |
|                                   | Their structure:                     |              |                    |                               |
| 1.1.                              | Manufacturing                        | 28.196       | 2.790              | 9,63                          |
| 1.2.                              | Construction                         | 7.246        | 512                | 7,07                          |
| 1.3.                              | Hotels and restaurants               | 3.782        | 190                | 5,03                          |
| 1.4.                              | Wholesale and retail trade; repair   | 110.669      | 7.143              | 6,45                          |
| 1.5.                              | Transport, storage and communication | 5.270        | 271                | 5,14                          |
| 1.6.                              | Health and social work               | 1.792        | 400                | 22,23                         |

Source: Internal data of the Agency of statistics of the Republic of Serbia – Calculation made by Author.

# **THE USE OF PRACTICES AS A TOOL TO CREATE COMPETITIVENESS**

**-A study of the relationship between the use of Best Business Practices in manufacturing SMEs and the managers experience on how their outcomes contributes to their firms competitiveness**

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## **ABSTRACT**

This paper reports an analysis on the attitude of managers to how the outcomes of their use of Best Business Practices have contributed to competitiveness of their firm. The study focus on the following questions:

- Does managers' attitude to the contribution to competitiveness differ depending on their strategy and use of Best Business Practices?
- Is it a difference between managers opinion depending on the size of their firm?

Traditionally a common view on strategy has been conceptualized as a situational choice of generic strategies (e.g. Porter) assuming a type of contingency based view of the firm. During the last decade and still dominating is the focus on core competencies or distinctive capabilities assuming a resource based view of the firm (RBV). But where do the capabilities come from? It is generally acknowledged in research that these often intangible or tacit

capabilities are developed through experiential learning or learning by practicing. This is the basis of a “practice based view of the firm” (PBV), often assumed in quality theories and methodologies, as a variant or specification of RBV. It is in PBV assumed, based on research findings, that there are practices that, in combination and when effectively linked together, can be expected to consistently improve operational performance and thus provide firms who adopt them with an advantage over those that do not.

Thus good business practices, and the learning and knowledge creation developed through using them, can be thought of as the base or foundation on which distinctive capabilities and hence competitive advantage is built

## **INTRODUCTION**

Traditionally a common view on strategy has been conceptualized as a situational choice of generic strategies (e.g. Porter) assuming a type of contingency based view of the firm. During the last decade and still dominating is the focus on core competencies or distinctive capabilities assuming a resource based view of the firm (RBV). But where do the capabilities come from? It is generally acknowledged in research that these often intangible or tacit capabilities are developed through experiential learning or learning by practicing. This is the basis of a “practice based view of the firm” (PBV), often assumed in quality theories and methodologies, as a variant or specification of RBV. It is in PBV assumed, based on research findings, that practices used in combination and effectively linked together, can be expected to consistently improve operational performance and thus provide firms who adopt them with an advantage over those that do not.

Thus good business practices, and learning and knowledge creation developed through using them, can be thought of as the base or foundation on which distinctive capabilities and hence competitive advantage is built.

### **From resource based view to a practice based view of the firm**

RBV has been able to make fruitful theoretical progress in the field of strategy research, e.g. in explaining *sustained* competitive advantage as resource endowment in different respects are sticky (Barney, 2001), as well as the explanation of the existence of the firm as such as superior in coordination of resources compared to the contractual interactions and price mechanisms of the market (Teece, et.al., 1997).

At the same time at the level of action oriented research, consulting and strategic management praxis, conceptualization and approaches to strategy has during the least decades been focused on business processes and practices and the search for “best practice” in different areas. Instead of a pyramidal, functional and hierarchical organization of business, a process based, horizontally, oriented and boundary spanning organization of business activity focused on customer value and quality has been advancing. These developments has not primarily been led by theoretical ideas but by practical management concepts and approaches like Sociotechnical Systems Design, Total Quality Management, Reengineering, Lean Production, Process Improvement, Benchmarking, ABC and Balanced Scorecard accounting and controlling and more recently Six Sigma approaches. A core element in this embedded “theory of the firm” is the focus on the actual character of business practices and processes, their performance measurement, control, redesign and improvement. At the level of academically formulated theory of strategy and theory of the firm, these dominant trends in the reality of business and its strategic management does not seem to have been fully recognized and been incorporated in theories of the firm and of strategy.

In the Swedish research group for studies in 5 different regions we have focus on how a practice based view of the firm (PBV) is related to a resource based view, and in which respects it can have potentially advantages compared to that view. It should be recognized that RBV have a number of strengths as an explanatory framework as well as a guide for strategy development. It is focused on the unique features of a company in the form of heterogeneous, firm specific resources having VRIN characteristics – valuable, rare, inimitable, and no substitutable. Through this focus RBV can clarify the important differentiating aspects of strategy and how to maintain and lever them for sustainable competitive advantage.

The focus on resources, although not denying but still have a tendency to loosing in sight the fact that what a firm actual does or can do, that is, the type of practices it is performing or can perform, or the organizing of processes as systems of activity to realize certain operationally valuable goals, is the touchstone of what it can accomplish economically. The RBV defender could of course say that efficient and excellently performed practices and processes are eminent examples of resources. But the question is whether if this subsumptive conceptual strategy is explanatory helpful. We believe that it is theoretically more fruitful to recognize a practice based view of the firm and strategy (PBV) as a variant or modification of RBV.

### **From capabilities to practices<sup>i</sup>**

It is fruitful to make a distinction between capabilities and dynamic capabilities. Capabilities is what a firm can do, in other words the performance of different business practices that in different ways, and in coordination, contribute to the creation of value for customers.

Dynamic capabilities is what a firm can do in the area of innovation, e.g. product development practices, or learning processes and practices for improving on what it does (e.g. benchmarking, learning by doing), that can be seen as its different types of business practices.

Capabilities come close to organizational routines (Nelson&Winter, 1982), routines as codified and/or institutionalized ways of doing things that is a form of practices. But capabilities are in many cases at a level of abstraction from concrete business operation and including an assumed potentiality of what a firm would be able to do. To this extent it is not directly observable and recordable.

It is significant that Eisenhardt&Martin (2000: 1106) assume an organizational and empirical perspective rather than an economic and formal modeling perspective. This enable them to recognize that dynamic capabilities consist of specific business processes which often have extensive empirical research streams associated with them, and there are “best practice” in their performance. The introduction of the concept of “best practice” and its connecting to dynamic capabilities as these authors do based on empirical findings from research, also have theoretical implication that challenge some basic assumptions of RBV. Firstly, there are commonalities across effective firms in capabilities or performance of different business processes, both operative processes as well as innovative processes. Secondly, there are equifinalities of different development paths, implying that firms starting from different points of departures and moving along different tracks still are moving in similar directions in terms of “best practice” features of processes. Thirdly, firms are able to emulate elements of better practices of other firms through different kinds of learning processes. Besides research results, the whole idea of benchmarking testify to this fact (e.g. see Zairi, 1999, 1996), as well as ideas connected to industrial district and cluster approaches.

Practices is what a firm is actually doing or have done so that there is a record of performance as well as some element of continuity in behavior and its results (otherwise it hard to recognize as “a practice”, not only sporadic behavior). Best practices are business practices

that can be found in a population of firms that can show a track record of comparatively very high operational performance of the particular business practice or process in the population.

Eisenhardt&Martin (2000) is somewhat wavering in the implication for maintaining, moderating, limiting or even leaving RBV. As dynamic capabilities cannot have VRIN characteristics, one possible implication is that their connection to resources is the crucial issue; “the value for competitive advantage lies in the resource configurations that they create, not the capabilities themselves” (ibid: 1106). In other formulations dynamic capabilities attain a more important role for competitive advantage. It lies in using dynamic capabilities “sooner, more astutely, or more fortuitously than the competition”, e.g. product development practices, to create resource configurations that have that advantage (ibid: 1117). And in high velocity markets, they argue that the RBV framework breaks down, as the firm must rely on dynamic capabilities in the form of simple selection oriented routines focused on rapidly seizing opportunities for more temporary and transient advantage rather than resource building and leveraging. From a PBV point of view, these arguments indicate the importance of moving closer to best practice in performance of different business process. Furthermore, if operational performance of business practices is focused on, there is a further issue what features are most important for efficient operation. Sticky, firm specific resources are the RBV answer that research has proved to be important, but there may also be other features. There is also the further issue concerning where the capabilities come from. It is generally acknowledged in research that these often intangible or tacit capabilities are developed through experiential learning or learning by practicing, something that a practice based view can account for.

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**Insert Table 1 about here**

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Does this mean that RBV is to be replaced by PBV? Barney in commenting on the article tries to realign the arguments of Eisenhardt&Martin (2000) to the RBV camp. The application of dynamic capabilities “sooner, more astutely, or more fortuitously” is itself a capability or a matter of luck, something that the traditional RBV logic can account for. Also the ability to be alert to changes and change quickly and the value of these capabilities depending of market context is according to Barney is “perfectly consistent with traditional RBV logic” (Barney, 2001: 631). Although we believe Barney’s discussion too easily subsumes the arguments under the RBV hat, we will not in this context take the argument further. It should be recognized that RBV is relevant in the sense that efficient practices and processes can be acknowledged as types of resources, as well as are using resources in its performance. The theoretical and empirical issue is how far this is helpful for explaining and guiding strategic management in creating competitive advantage. In this context we will only point to some significant differences in emphasis between RBV and PBV, see Table 1, seeing it as too early to take a stand to what extent PBV should be given an independent status or seen as a variation of RBV.<sup>ii</sup>

### **Conceptualizing and modeling a practice based view**

It should be noted that PBV and its modeling creates conceptual, theoretical and measurement problems of its own.

There is a distinction between *Best practices* and *Good practices*. Best can be defined in relation to the specific business process. It was first defined pragmatically (e.g. see Rescher,

1977) in terms of operational performance of the business process where it is used. It can be a combination of common and more firm specific elements, but empirical research indicate as Eisenhardt&Martin (2000) say that there are significant common features in business practices. It is very difficult to observe best practice, so an alternative is to define levels of good practice

International research on business capability issues demonstrates that there is a link between the practices adopted and processes within businesses and their performance. Those businesses that adopt a coordinated and cooperative approach to development generally outperform firms that do not follow this approach. This coordinated and cooperative approach has often been denoted “best practice” (Knuckey et al, 1999:19)

The cooperative way is the one in which firms and their employees undertake business activities in all key processes – leadership, planning, people, customers, suppliers, community relations, production and supply of products and services, and the use of benchmarking. These practices, when effectively linked together, can be expected to lead to sustainable world class outcomes in quality, customer services, flexibility, timeliness, innovation, cost and competitiveness. (Barney, J, 1991; Australian Manufacturing Council, 1994)

The logic behind best practice is simple. Because operational outcomes are key contributors to competitiveness and business performance, and because best business practice should improve operational outcomes, good practice should lead by implication to improved competitiveness. Best practice should lead to world class performance. (Kaplan, R S, & Norton, D P, 1996; Knuckey et al ,1999:23; Kotter, J P & Heskett, J L, 1992; Prahalad, C K & Hamel, G, 1990)

However, in the past few years, the notion of “best practice” has increasingly become recognized as a moving target. What was earlier considered as best practice is not necessarily today regarded as best practice. Similarly, in attempting to manage the complex relationships between and within firms, there is no single set of “best practices” – there are too many variables. Instead, we speak of good practice, business improvement and business excellence. These are practices that jointly appear to provide firms that adopt them with an advantage over those that do not. (Lamming, 1996)

Good business practices can be regarded as the base or foundation on which the firm’s distinctive capabilities and competitive advantages are built. So to maintain these and to develop them further demands a continual reinvestment and development of processes and practices (Normann, R & Ramirez, R, 1994). The reputation of a firm, for example, is a function of its history in areas such as customer service practices, customer satisfaction and delivery performance. But reputation does not last forever - it needs to be assessed and possibly enhanced. (Senge, P M, 1990)

If we visualize a firm’s ultimate goal as international competitiveness, we can picture business practices as segments of the base of a globe. Each segment needs to be in place and effectively linked with others to provide a strong foundation. The absence of one may make the whole break down, thus threatening competitiveness and stability. Firms that are successful in achieving this leverage could be assumed to have the characteristics of learning organizations. (Knuckey et al., 2002)

## **RESEARCH QUESTION AND METHODOLOGY**

The research questions covered in this paper are:

- Does managers' attitude to their practices contribution to competitiveness differ depending on their strategy focus and use of Best Business Practices?
- Is it a difference between managers opinion depending on the size of their firm?

The approach for answering this question is to use empirical data collected by the use of a Best Business Practice Survey (BBPS) and analyze if managers of firms that hold a higher focus on strategy factors also have practices in place to support their strategy hold the attitude that these have competitive and also hold a positive attitude toward these practices contribution to their firms.

### **The business practices and performance model**

The Swedish research team chooses to use a questionnaire, adopted from the Business Practices Models used in the *Leading the Way* (1994) and *Gearing Up* (1999) studies, with some adaptations to the Swedish context. There were two reasons for this choice:

1. The models had worked well in practical surveys
2. It made comparisons possible between Swedish and New Zealand data.

The 1999 survey model comprises key modules or components:

- Structure
- Strategy
- Practices
- Outcomes
- Business results

**Structure** denotes data of size and industry. **Strategy** relates mainly to the choice of products, markets, positioning and focus. The traditional list of competitive priorities was examined: i.e. cost, quality, flexibility, delivery and innovation. Strategizing encapsulates

*Leadership & planning* activities in the firm. It examines the nature of direction setting, whether it is long-term and consultative, and whether it facilitates firm culture and values, and the relationship of the business with its community.

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**Insert Figure 1 about here**

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Structure, strategy, practices and outcomes are obviously inter-related. The inter-linking of these components represents the dynamic nature of business, where components rarely operate in isolation in the long run. For example, the focus of practices built up by the firm often reflects its business strategy. In this paper the element 'Business Assets and structure' will not be covered.

### **ASSESSING BUSINESS PRACTICES AND PERFORMANCE**

The study was based on a comprehensive survey questionnaire developed in New Zealand, and based on the structure of Business Practices and Performance Model. Respondents were asked questions on each element of the model. Questions on strategizing and practices required subjective responses while questions that examined operational outcomes in some cases required quantitative responses.

In analyzing the results, questions were grouped into six categories of processes: Leadership & planning, Customer focus, Quality & supplier focus, Employee practices, Information & benchmarking, and Innovation & technology.

The questions were generally based on a Likert-type (rating) scale, with the response to each question then scored on a range between zero and one with the "worst" answer given the

value of zero and the “best” answer a value of one. A similar scoring system was used for questions on operational outcomes.

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**Insert Figure 2 about here**

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These scores were then summed for each firm across the different practices. Each practice score was standardized to give it a value of 100. The six practice scores were then summed and standardized to provide a single score out of 100 for overall practices. The same procedure was applied for operational scores.

This scoring system resulted in two main indexes (see Figure 2):

- the strategizing/practices index provides an overall assessment of an enterprise’s efforts to achieve business improvement (should be read as strategizing AND practices index)
- the operational outcomes index provides an overall assessment of the extent to which practices have been converted into operational outcomes.

When assessing the progress of a firm, both indices are considered simultaneously.

Businesses with high scores in strategizing have made the most progress in adopting the full range of these practices. If they also have a high score on the operational outcomes index, this indicates that their practices are being converted into outcomes.

The progress of each firm towards sustainable advantage can in this model be indicated by plotting its position on a set of axes representing Business practices and Operational outcomes. The horizontal axis represents the strategizing/practices index values, and the vertical axis represents the operational outcomes index values. The closer a plant is to the top right-hand corner of the graph, the closer it is likely to be achieving sustainable high performance. The graph of the distribution of firms according to their scores is shown in Fig.

3. This shows the expected “oval” form indicating that good outcomes are associated with good practices.

### **Empirical Data**

Data for this study was gathered through five postal surveys among manufacturing business owners/managers in the middle part of Sweden.

The data was gathered in four regions and one city during the years 2001 to 2003. The actual regions were West Sweden (2001), The County of Örebro (2001), The county of Dalarna (2002), The County of Sörmland (2002/2003) and the City of Gothenburg (2003).

The Questionnaires were sent to all (2107) manufacturing sites with ten and more full time employees in these five regions. The questionnaires were addressed to the manager/owner of the sites. After one to two postal reminders, a total of 741 filled in questionnaires were returned in such a good quality that they could be used. Respondents who failed to present complete information were excluded.

So in total, responses from 741 manufacturing sites firms (460 small, 206 medium and 75 large) are discussed here, resulting in an overall response rate of 35,2 %. The size definitions are small (10-49 employees), medium sized (50 – 249 employees) and large (500+ employees).

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**Insert Table 2 about here**

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## **RESULTS AND DISCUSSION**

## **Distribution of the results**

The distribution of the results in relation to the indexes *Operational outcomes* and *Practice* is shown in the graph below. The regression equation is:

$$\text{Operational outcome} = 42,7 + 0,359 \text{ Practices}$$

with  $S = 9,00060$   $R\text{-Sq} = 23,9\%$   $R\text{-Sq}(\text{adj}) = 23,8\%$

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**Insert Figure 3 about here**

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### **Class 1 - World Class**

Thirty-nine (39) of the work sites (5,3 %) have both practices and outcomes of 75 or higher.

This group of firms is likely to be international competitive and compare to the world's best.

In this group are 46,2 % small, 25,6 % medium sized and 28,2 % large firms

### **Class 2 - Firm Foundation**

Three hundred-and-eleven (311) of the work sites (42,0 %) have practice and outcomes of 60 or more. These firms have a strong foundation of practice and performance but world class

performance is likely to require a continued focus on improvement. In this group are 47,6 % small, 34,4 % medium sized and 18 % large firms

### **Class 3 - Over Performers**

One hundred and sixty-nine (169) of the work sites (22,8 %) have strong operational outcomes (scoring 60 or more) which may not be based on best practice techniques. In the

long-term, these outcomes may not be able to be maintains without improvements to

practices. In this group are 79,9 % small, 19,5 % medium sized and only 0,6 % (1 firm) large firms

### **Class 4 – Under Performers**

Sixty-four (64) of the work sites (8,6 %) have a good foundation of practice (scoring 60 or more) but do not have operational outcomes to the same level. In time these practice should result in improved outcomes. In this group are 54,7 % small, 39,1 % medium sized and 6,3 % large firms

#### **Class 5 – Weak Foundation**

One hundred and fifty-eight (158) of the work sites (21,3 %) show both practices and outcomes below 60. These sites should look to extensively develop their capabilities to enjoy improved operational outcomes. In this group are 78,5 % small, 19,6 % medium sized and 1,9 % large firms

#### **Important Factors in Business Strategy**

The firm managers answered one question about how important different factors are for their business strategy. As can be seen in table 3 most of them claimed that the factors are very important. As many as 100 (13,5 %) mean that all five factors are very important while only 4 of them claim all five was not important at all in their business strategy.

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**Insert Table 3 about here**

---

As further can be seen in the table was innovation the factor that have the less portion of managers that claim that the factor is very important.

Here I therefore take innovation as an example to examine if the strategy focus seems to influence how well the firms have implement the practices related to the strategy.

Figure 4 show the mean values on the sub index innovation and technology for the firms that indicated different degree of importance on innovation in their business strategy. As can be seen the ones that think innovation are very important have the highest mean value and then the mean values decrease with less and less importance. This shows that managers that hold

innovation as an important strategy factor also implement practices that support innovation and technology.

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**Insert Figure 4 about here**

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The next question is: Do they think that Innovation has been to a great help in their competitive positioning?

I will use the answers to question 12.2 (figure 5) to analyze that.

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**Insert Figure 5 about here**

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Figure 6 shows that it was only 30,9 % of all respondents that hold the opinion that innovation have been greatly helpful. That figure rank innovation as the third less helpful factor according to all respondents.

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**Insert Figure 6 about here**

---

Analyzing the share, of firms that holds the attitude that respectively factor have been greatly helpful in improving the business's competitive position, for the two groups World Class and Weak Foundation shows that there are great differences (figure 7)

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**Insert Figure 7 about here**

---

Measuring the distance between World Class Firms and Firms on Weak Foundation by dividing the figures for World Class with the figures for Weak Foundation shows how many times larger the portion of World Class firms are that hold the attitude that the factors have been greatly helpful in improving the business's competitive position (see figure 8).

---

**Insert Figure 8 about here**

---

As can be seen, the largest distance is on Innovation and Technology followed by Information and Benchmarking. Earlier analysis of data from one of the regions (Ahlström Söderling 2003) indicated that, accepting the assumption that market leaders have some competitive advantages, *Market leaders* more often use benchmarking and also seems to be more innovative by introducing new products as well as new processes.

The last question then is:

Do the firms, that claim that innovation has been greatly helpful, have practices in place to support innovation?

A way to analyze that is to look at the distribution on the sub index Innovation and Technology for the two groups greatly helpful vs. the rest of firms.

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**Insert Figure 9 about here**

---

As figure 9 shows have 66,0 % of the "greatly helpful" firms' index values above 60 while the other group only have 29,8 %. This indicates that the managers that claim that innovation and

technology has been greatly helpful to the improvement of their firm's competitive position have practices in place for innovation and technology.

## **CONCLUSIONS**

The empirical data indicate that the focus on strategic factors influence the implementation of practices and that the managers impression on how the results of the practices contribute to the firms competitive position is a function of the operational outcomes of well implemented practices.

The other initial question: Is it a difference between managers opinion depending on the size of their firm have not been addressed in this paper but the data show no significant difference between managers in different firm sizes.

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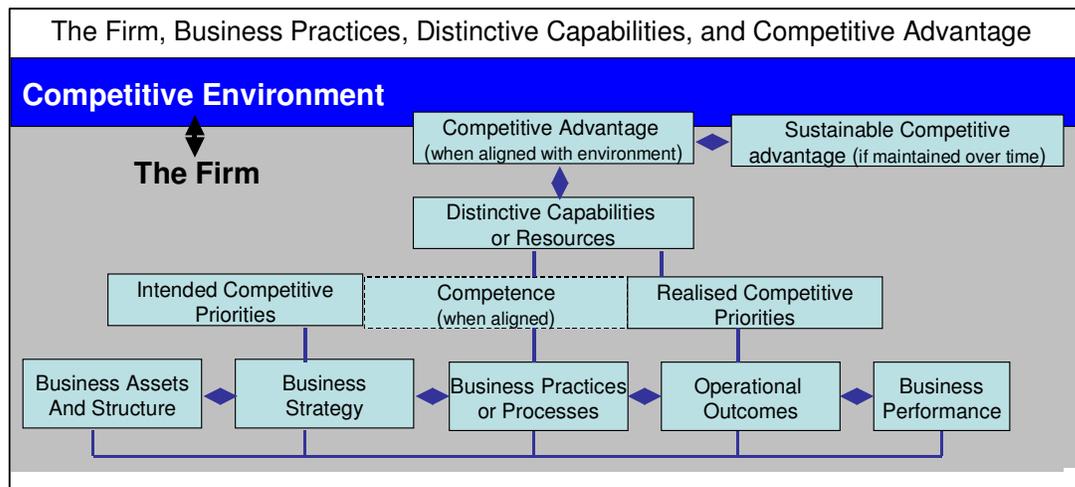
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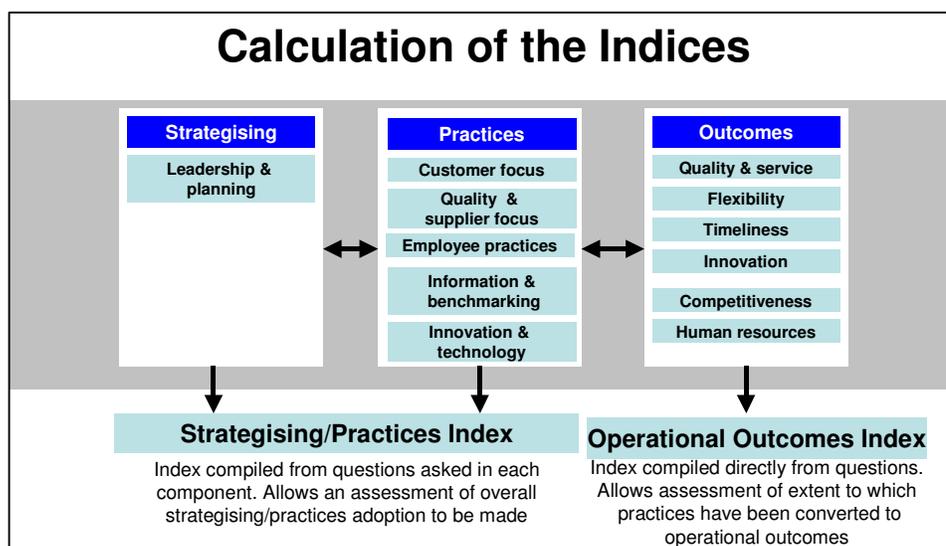
**Table 1: Comparison of Resource based view and Practice based view from a strategic perspective**

|                                      | Resource based view   | Practice based view   |
|--------------------------------------|---|---|
| Conceptualization of the firm        | Bundle of resources   | Network of business practices   |
| Basis of competitive advantage       | Firm specific assets  | Operational efficiency in performance of practices                                |
| Measure of competitive advantage     | VRIN (valuable, rare, inimitable, no substitutable resources/resource combinations) | Closeness to best practices in different process areas, coordination of practices |
| Process of strategy development      | Path dependence   | Equifinality of paths   |
| Development of competitive advantage | Dynamic capabilities as ability to use and develop resources                        | Learning approaches and practices to improve existing business practices          |

**Figure 1: Business Practices and Performance Model** (Source: Knuckey et al., 2002)



**Figure 2: Calculation of the indices** (Source: Knuckey et al., 2002)

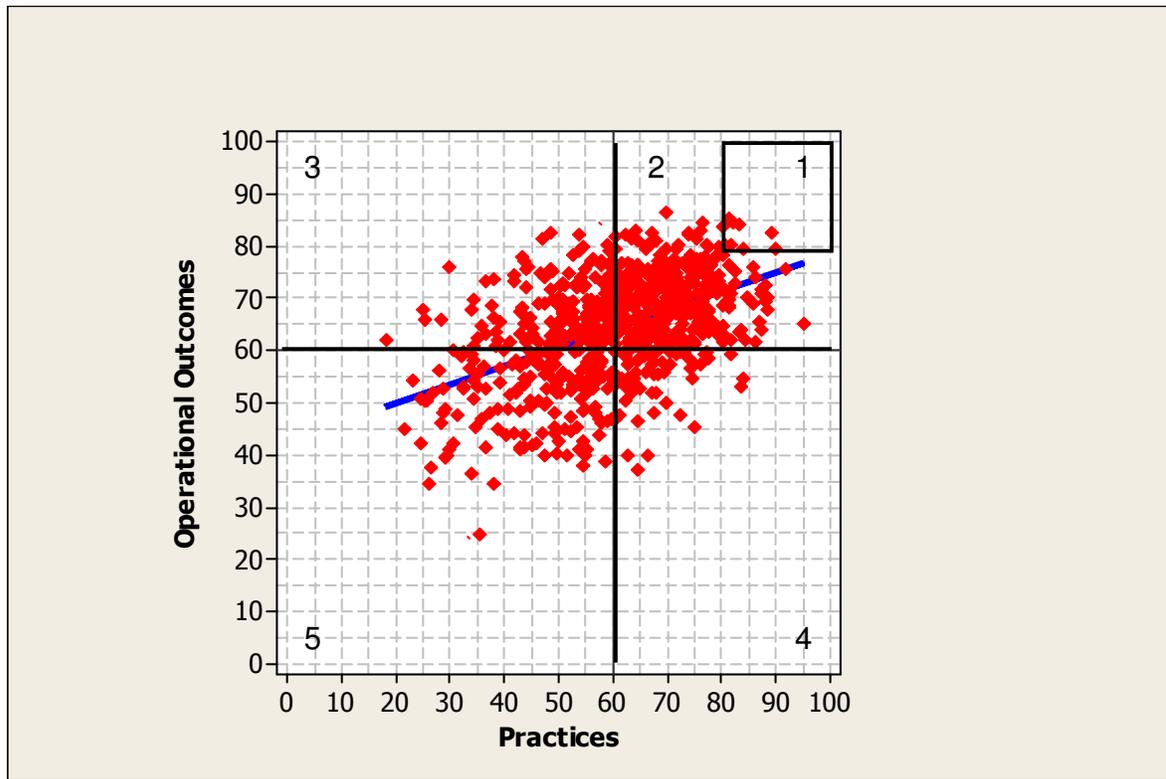


**Table 2 Some data from the different studies**

| Region                   | Questioners sent out | Used responses | Response rate | Share of total |
|--------------------------|----------------------|----------------|---------------|----------------|
| Dalarna                  | 327                  | 127            | 38,9 %        | 17,1 %         |
| Gothenburg               | 665                  | 207            | 31,6 %        | 27,9 %         |
| West Sweden <sup>1</sup> | 536                  | 172            | 32,1 %        | 23,2 %         |
| Örebro                   | 304                  | 153            | 50,3 %        | 20,6 %         |
| Sörmland                 | 275                  | 83             | 30,2 %        | 11,1 %         |
| Total                    | 2107                 | 741            | 35,2          | 100 %          |

<sup>1</sup> Norra bohuslän, Dalsland, Fyrstad and Sjuhäradsbygden but not Västra and Östra Skaraborg

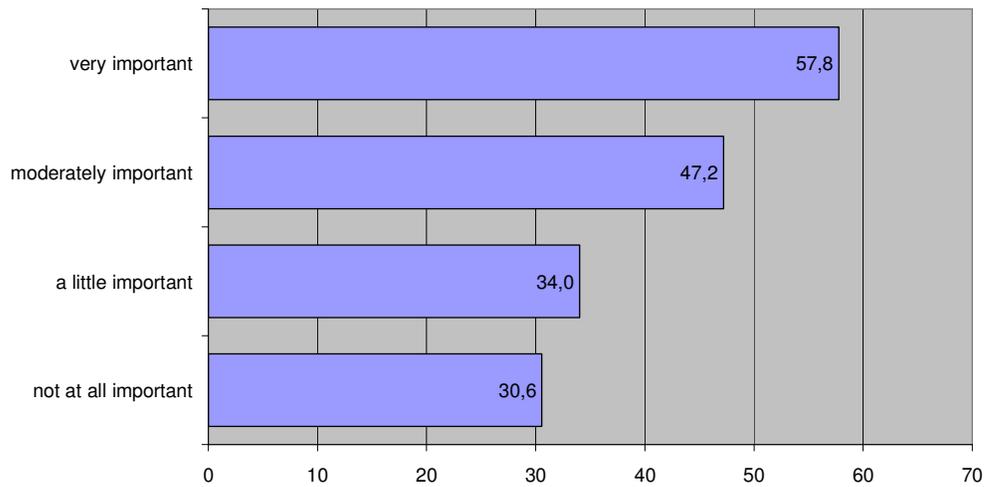
**Figure 3 The relationship between practices and operational outcomes**



**Table 3 How important are the following types of strategy for your business**

|             | not at all<br>important | a little<br>important | moderately<br>important | very<br>important | don't<br>know | N   | N* |
|-------------|-------------------------|-----------------------|-------------------------|-------------------|---------------|-----|----|
| Price       | 0,0%                    | 2,0%                  | 23,5%                   | 74,3%             | 0,1%          | 735 | 6  |
| Quality     | 0,0%                    | 0,1%                  | 5,0%                    | 94,6%             | 0,3%          | 738 | 3  |
| Flexibility | 0,0%                    | 2,4%                  | 31,0%                   | 65,9%             | 0,7%          | 735 | 6  |
| Delivery    | 0,6%                    | 1,1%                  | 16,9%                   | 80,7%             | 0,8%          | 724 | 17 |
| Innovation  | 0,5%                    | 9,9%                  | 40,5%                   | 48,1%             | 1,0%          | 736 | 5  |

**Figure 4 Mean Values for subindex Innovation and Technology for different opinions of the importance of innovation in firm strategy**

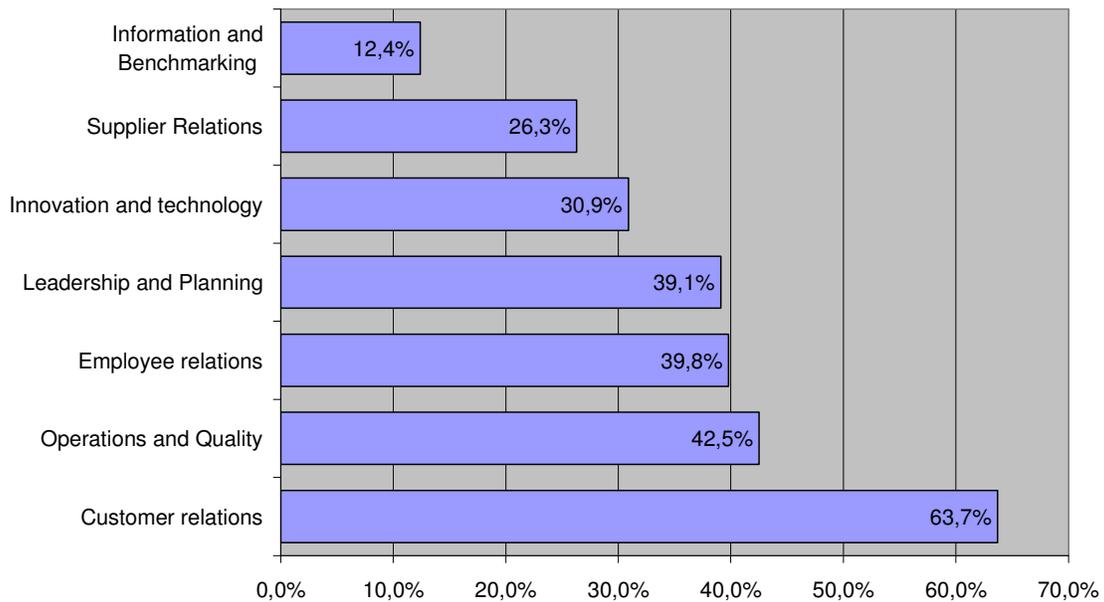


**Figure 5 Question 12.2 in the questionnaire**

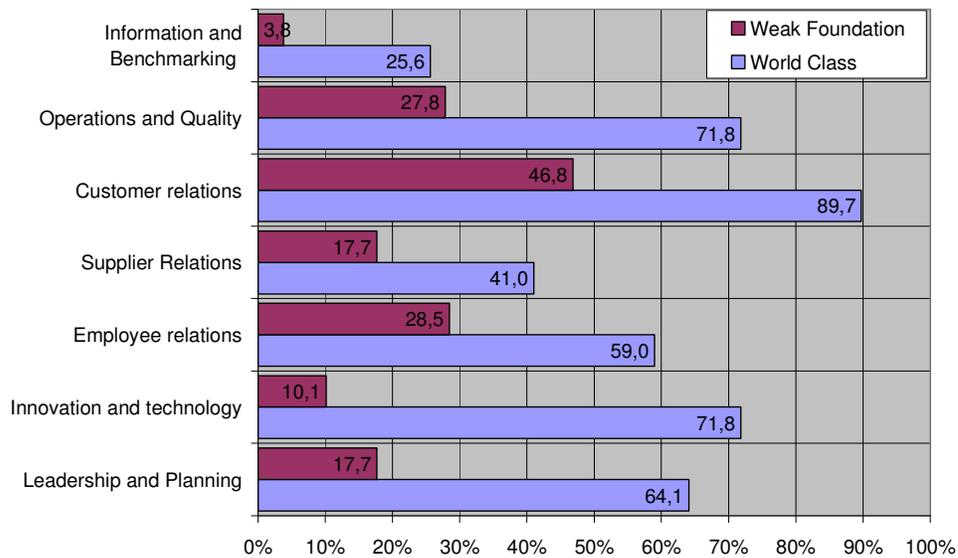
**12.2** Tick one circle for each item  
**Over the LAST THREE YEARS** how helpful has each of the following been in improving this business's competitive position:

|                                | not at all helpful    | a little helpful      | moderately helpful    | greatly helpful       | don't know            |
|--------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| - leadership and planning      | <input type="radio"/> |
| - innovation and technology    | <input type="radio"/> |
| - employee relations           | <input type="radio"/> |
| - supplier relations           | <input type="radio"/> |
| - customer relations           | <input type="radio"/> |
| - operations and quality       | <input type="radio"/> |
| - information and benchmarking | <input type="radio"/> |

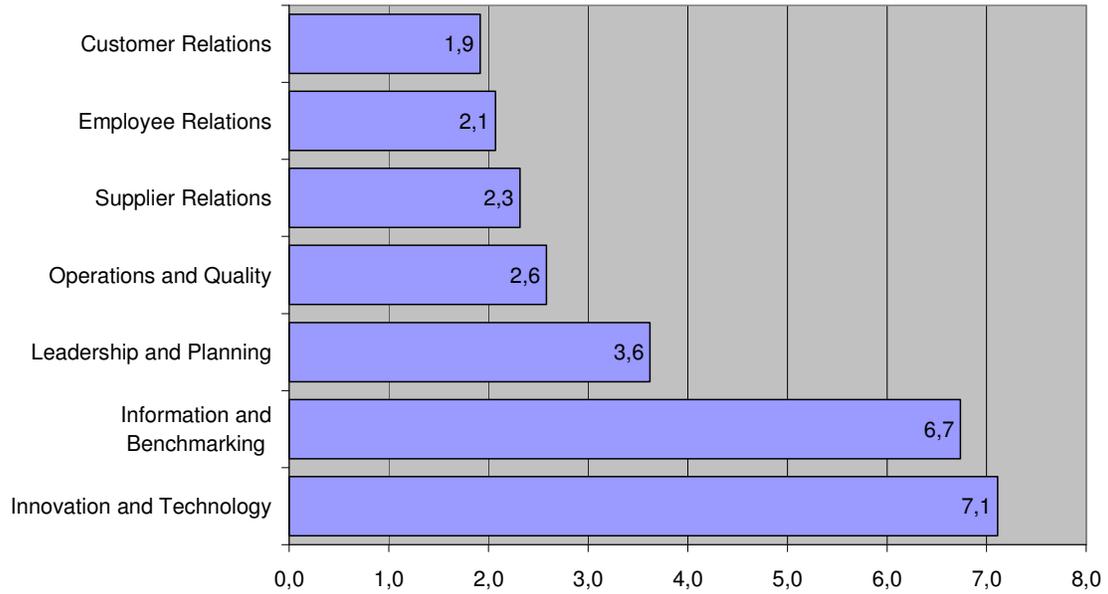
**Figure 6 Share of the respondents that claim that the factor has been greatly helpful**



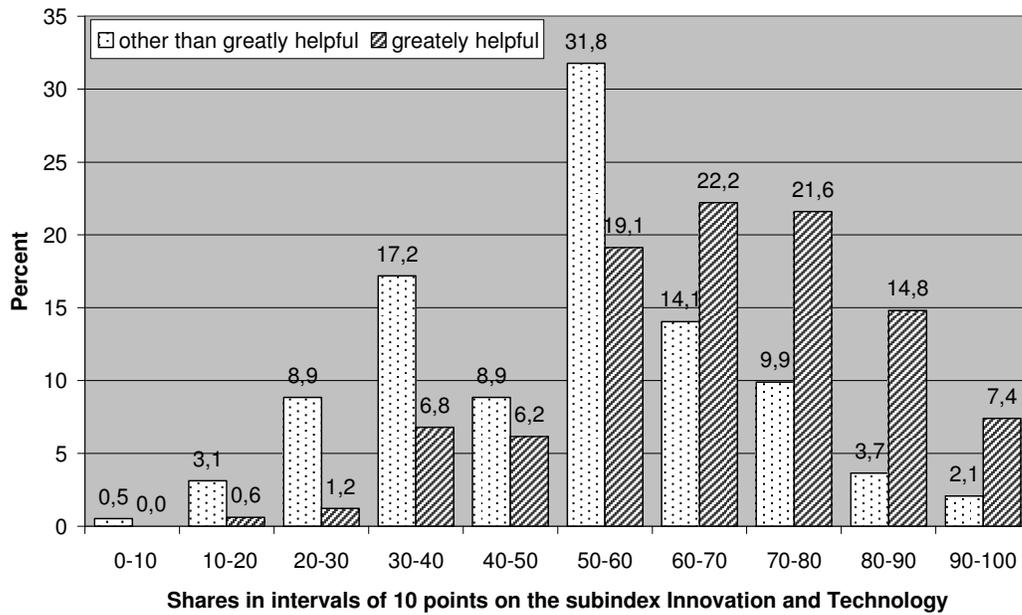
**Figure 7 Share of World Class respectively Weak Foundation Firms**



**Figure 8 Relative distance between World Class and Weak Foundation Firms**



**Figure 9 Distribution on the sub index for Innovation and Technology for firms with the attitude that innovation has been greatly helpful in relation to the rest firms**



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<sup>i</sup> This discussion is in some parts earlier published in a working paper by Ragnar Ahlström Söderling, Erik Lindhult, Jan Sundqvist, Per Magnus Wijkman presented at 17<sup>th</sup> Nordic Conference on Business Studies in Reykjavik, 14-16<sup>th</sup> of August 2003

<sup>ii</sup> Another interesting theoretical issue is the relation of PBV to a Schumpeterian, evolutionary view (Nelson&Winter, 1982) also popular today. The importance in PBV of innovation in the sense of improving operational performance of business process in line with best practice is an interesting link to such a view.

## **WOMEN ENTREPRENEURS IN JORDAN**

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### **Abstract**

This research explores some of the reasons why Jordanian women choose to develop their entrepreneurial business.

A total of 65 women were interviewed. 30.8% of them were employed before starting own Business. 53.8% were married and 35.4% had bachelor degree while 32.3% are between 25 and 30 years old.

The research revealed that the majority of Jordanian women enjoy what they do and initially ventured for personal reasons, to gain autonomy.

Jordanian women have benefited from family and/or husband support in influencing them to start a business, in managing their businesses and in coping with the demands of running the business from encouragement to assistance in finance, business advice.

Women feel there is a lack of network of businesswomen or women in similar fields of business to exchange information, discuss issues and seek advice on common topics all of which is vital for business success. In addition, due to the collectivist nature of Jordanian society, the majority includes their families, colleagues and business associates is seeking advice. Some women have suggest that relationships and knowing the right people in the right places can help women overcome some of the hurdles in the business and facilitating the processes involved, obtaining fairer deals and gaining business opportunities.

## **INTRODUCTION**

Female entrepreneurship has been rising slowly but continuously over the past 30 years, only 6 per cent of all women classify as entrepreneurs, as compared to more than 12 per cent of men. Moreover, female entrepreneurs more commonly create and retain micro enterprises, they may have had less chance than most men to accumulate the resources necessary to start up and run a successful business.

Are women entrepreneurs face specific problems in setting up a business that are different from those faced by male entrepreneurs?

When it comes to women entrepreneurs, it appears that only a small part of entrepreneurial motivations are acknowledged as gender-based. Instead, "pull" and "push" factors are now a common way of explaining different motivations for women to start a business (Brush, 1990; Buttner and Moore, 1997). Push factors are elements of necessity such as insufficient family income, dissatisfaction with a salaried job, difficulty in finding work and a need for a flexible work schedule because of family responsibilities. Pull factors relate to independence, self-fulfilment, entrepreneurial drives and desire for wealth, social status and power (Duchéneaut, 1997).

It is suggested that starting up a new venture becomes an "imaginable act" when the entrepreneur can refer to a role model who tried it before (Shaper, 1975). This factor is therefore likely to be equally applicable to both women and men.

Jordanian women live in economy, which has been largely influenced by two main factors.

First, the dearth of natural resources. Second, the political situation. (Abdel Karim, 1989).

Jordan which adopt an economic system based on free enterprise and private initiative (National Planning Council, 1981; The Jordanian National Charter, 1990), played a pioneering part through participating with the private sector in implementing large and medium –scale projects and providing incentives and an appropriate entrepreneurial climate for private investment.

This study was conducted in 2004 and its goal was to state why Jordanian women establish their own small business firms.

To understand Jordanian women entrepreneurs' motives and determination, it is useful to consider their role in society, and the effect of environmental forces that they encounter in their daily lives, the family lies at the core of society playing a major role in political, economic, social and religious spheres. Jordanian are conscious of each other's family memberships, identities and status, they links facilitate access to institutions, jobs and government services (Sabbagh, 1996, pp. 194-5). Gender differences are enshrined in the Muslim Holy Book, the Qur'an, and in the Shari'a, the Islamic Law. A woman's primary role in the family is as a wife and mother. Many employers feel that these roles will interfere with women's work productivity. Hence, there is a tendency for them to give priority to men in terms of employment and promotion, even where women have the same qualifications.

Because a major proportion of the literature on women entrepreneurs has focused on English speaking countries, it was decided to carry out this research in an area where a different language was used and which therefore identified a different Western culture in the form of a developed economy. For this reason, the research was conducted in Jordan

More specifically, the major research question for this study is what are the reasons of Jordanian women entrepreneurs to start up business?

## **REVIEW OF RELATED LITERATURE**

The research literature on women entrepreneurs from developing economies is recent, for example, Adler and Israeli (1994). Scherer et al. (1990) concluded that men had a higher rate of entrepreneurial activity than women.

The following section is an overview of prior studies that describe women entrepreneurs

Muriel Orhan; Don Scott (2001) identified a number of situations that relate to women's decisions to become entrepreneurs, namely "dynastic compliance", "no other choice", "entrepreneurship by chance", "natural succession", "forced entrepreneurship", "informed entrepreneur" and "pure entrepreneur".

Green; J David; M Dent; A Tyshkovsky (1996), Outlines the methodology and results of a study into entrepreneurship in the new Russian economy. Asks whether the Russian entrepreneur can be characterized as similar to entrepreneurs identified in research in Western economies.

Roger Henderson; Martyn Robertson (2000), suggest that generally positive images of entrepreneurship are hampered by a lack of identifiable role models, poor media presentation of individuals or small firms, and lack of encouragement from important influencers on career choice.

Roger Henderson; Martyn Robertson (2000), States that women can be differentiated by behavioral and motivational factors in their desire to start up in business in United Kingdom

Robert D Hisrich; Zhang Fan (1990), presents the business status, individual background, and social context of China's women entrepreneurs by analysing the information from a survey of 50 women entrepreneurs in China.

Jean Lee (1996) Aims to uncover the characteristics of a typical woman entrepreneur in Singapore; the motivational needs of women entrepreneurs; and the factors influencing the motivational needs of women entrepreneurs.

Jeffrey W Alstete(2002), indicate that there are several reasons why individuals considering entrepreneurship would continue with their goal of founding a business, including greater control of their destiny, increased satisfaction, more money, and creating a legacy for their family and children.

Augusta C Yrle; Sandra J Hartman; Kenneth R Walsh (2004), showed that complex technology, security, and reliability present significant challenges to the entrepreneur or small business owner about to enter the e-business arena.

Joan Winn (2004), give some insight as to the nature of the problems and perceptions faced by women as managers and entrepreneurs.

Robert D Hisrich; Sevgi Aysel Öztürk (1999), focuses on the characteristics, performance, and problems of women entrepreneurs in one developing economy - Turkey. The results indicate that while the women entrepreneurs exhibited many similarities with their counterparts in other countries they differed in other aspects such as in their reasons and motivation for starting a venture and problems encountered.

Lina Nearchou-Ellinas; Ioannis S Kountouris (2004), describes the findings of a unique nationwide research on female entrepreneurial activity in Cyprus.

Spinder Dhaliwal (2000), interview evidence gathered from both Asian women entrepreneurs in their own right and Asian women working in family enterprises, and seeks to provide a clearer picture of the roles, responsibilities and relationships of these two groups.

Gerard McElwee; Rahma Al-Riyami (2003), study presents a preliminary report of an exploratory, qualitative investigation of the role of Omani women entrepreneurs in Muscat. It establishes the factors that motivate women to become entrepreneurs.

Atsedie Woldie; Adebimpe Adersua (2004), highlights the position and role of female entrepreneurs in the economic development of Nigeria.

Gerda Siann; Alexa Clark (1992), Looks at the results of studies which concern Muslim attitudes to work possibilities for them compared with the majority races in Great Britain. Questions whether "stereotyping" is to blame for lack of opportunities in various "acceptable" careers or the attitudes of prospective employers to women generally and ethnic women in particular. Also examines ethnic family attitudes to education and choice of occupation for their daughters. Concludes that the dissemination of information in the various vernacular languages is to be recommended to aid in the community's organization for career development in further/higher education.

Ashraf R El-Ghannam (2002), Outlines important changes in the role of women in Arab societies, particularly in urban areas. Considers what factors impede or contribute to women's work in all economic sectors in an attempt to explain and determine the relationship between their activities and social, educational, economic, cultural and health factors. Suggests that findings are related to family size, fertility rates, illiteracy and population per nurse. Recommends increasing job opportunities and more labor saving technology as ways to increase opportunity for Arab women.

## **METHODOLOGY**

The information that was gained from the participants was analyzed and was then combined with information from previous research in order to develop a consolidated model of female entrepreneurial and why they start own business.

### **INSTRUMENT**

The instrument utilized for primary data collection was a questionnaire (Appendix 1), considering the purpose of the present work; the main elements of the research questionnaire deserving mention that it used before by Al-Riyami and Al-Fahal (2003) to study women entrepreneurs in Oman: some barriers to success. Questions measured on a 5-point Likert scale.

A pilot version of the questionnaire was tested in Jordan. Following the factor analysis, Cronbach's alpha reliability coefficients were calculated. The reliability for each variable was above the 0.7 level deemed acceptable by Peterson (1994).

Each questionnaire included a cover letter from the researchers stressing the importance of the study and requested prompt completion of the survey.

### **DATA COLLECTION**

A total of 77 women participated in this study. Of the 70 returned questionnaires, five questionnaires had to be withdrawn from the sample because of mistakes in filling them out and insufficient answering patterns. As a result, 65 usable questionnaires formed the effective sample size.

Data were collected by means of personal interviews. A random sample of Jordanian women in several cities was asked to fill out the questionnaire. On average, it took the respondents about 15 minutes to fill out the questionnaire. Other data collection methods such as mail and telephone were also considered, but collecting the data by means of personal interviews turned out to be the best option.

### **DESCRIPTION OF STUDY PARTICIPANTS**

A total of 65 women were interviewed. 30.8% of them were employed before starting own Business. 53.8% were married and 35.4% had bachelor degree while 32.3% are between 25 and 30 years old.

### **LIMITATION**

Respondents in this study were Jordanian women from one major kind of industry which is handicrafts and that limits the generalisability of the findings. This limitation provides an opportunity for further research.

A second limitation of this study is that the questionnaire were used to measure why Jordanian women start up own business. Using the questionnaire may have enhanced the results of the present study. This limitation also provides an opportunity for future research to improve researchers' understanding of reasons of Jordanian women to establish own business.

### **RESEARCH VARIABLES AND NULL HYPOTHESES**

On the level of the reasons of entrepreneurial Jordanian women to start own business 14 reasons are stated, with responses on a five-point Likert scale.

Ho (1): The experience of Jordanian women before starting own Business is not significantly related to the reasons of starting own business.

Ho (2): Jordanian women status is not significantly related to the reasons of starting own business.

Ho (3): Jordanian women education is not significantly related to the reasons of starting own business.

Ho (4): Jordanian women age is not significantly related to the reasons of starting own business.

### **DISCUSSION OF RESULTS**

To answer the research question: what are the reasons of Jordanian women entrepreneurs to start up business? Mean and standard deviation were calculated for all variables (reasons) [Table 2](#).

From the table we can conclude that the major reason is economic necessity (mean = 5.00) followed by family encouragement (mean =4.9077), but the least reasons are Occupy oneself and Challenge (mean = 4.1077).

This means that Jordanian women entrepreneurs have economic problems and this finding goes along with the finding of other researchers.

## **HYPOTHESES TESTING**

**Test of Hypothesis 1:** Hypothesis 1 was formulated to verify the effect of the experience before starting own Business on the reasons of starting own business.

The hypothesis measures the reasons of starting own business as indicated by 14 reasons (variables).

One Way Analysis Of Variance (ANOVA) were used to test the hypothesis and the results show that except for four reasons related to " Perceived Presence of Business ", " Corporate downsizing ", " Family encouragement " and " Ambition" the remaining variables all show a significant positive correlation between the level of the experience before starting own Business on the reasons of starting own business.

Furthermore, Tukey posttest, which used to find which level of the experience before starting own Business has higher score than the others reveal that Households feel that (Make others happy) and (Self –recognition) are some of the reasons to start own business than the women who used to be a student before starting own Business. The mean difference is significant at the .05 levels.

Thus, we cannot reject Hypothesis 1 and conclude that experience before starting own Business is related to the reasons of starting own business.

**Test of Hypothesis 2:** Hypothesis 2 was formulated to verify the effect of the women status (married or single) on the reasons of starting own business.

T-test were used to test the hypothesis and the results show that married women feel more than single women that the reasons to start up business are: " Make others happy ", "Challenge", " Social Ambition " and "Independence".

The mean difference is significant at the .05 levels.

Thus, we cannot reject Hypothesis 2 and conclude that status is related to the reasons of starting own business.

**Test of Hypothesis 3:** Hypothesis 3 was formulated to verify the effect of the women education on the reasons of starting own business.

One Way Analysis Of Variance (ANOVA) were used to test the hypothesis and the results show that except for four reasons related to " Finance", " Perceived Presence of Business ", " Challenge ", " Family encouragement " and " Occupy oneself " the remaining variables all show a significant positive correlation between the level of the education on the reasons of starting own business.

Furthermore, Tukey posttest, which used to find which level of education has higher score than the others reveal that women with Master Degree feel that "Make others happy" and " Enjoyment "are some of the reasons to start own business than the women who has Diploma or less before starting own business.

Also women with Master Degree feel that "Social Ambition" is the reason to start own business more than the women who has Bachelor Degree.

Women who have PH.D Degree feel that "Corporate downsizing ", " Independence" and "Self -recognition" are some of the reasons to start own business.

Thus, we cannot reject Hypothesis 3 and conclude that education is related to the reasons of starting own business.

The mean difference is significant at the .05 levels.

**Test of Hypothesis 4:** Hypothesis 4 was formulated to verify the effect of the women age on the reasons of starting own business.

One Way Analysis Of Variance (ANOVA) were used to test the hypothesis and the results show that all the reasons except for " Job dissatisfaction "show no significant positive correlation between the level of the age on the reasons of starting own business.

Furthermore, Tukey posttest, which used to find which level of age has higher score than the others reveal that women with 35 years old and above feel that " Job dissatisfaction "is the reasons to start own business more than the women who 30 Years -less than 35 years old and more than the women 25 years old - less than 30 years old

Thus, we cannot reject Hypothesis 4 and conclude that age is related to the reasons of starting own business.

The mean difference is significant at the .05 levels.

## **CONCLUSIONS**

The results show that except for four reasons related to " Perceived Presence of Business ", " Corporate downsizing ", " Family encouragement " and " Social Ambition", the remaining variables show a significant positive correlation between the level of the experience before starting own Business and the reasons of starting own business.

Married women feel more than single women that the reasons to start up business are: " Make others happy ", "Challenge", " Social Ambition " and "Independence".

Women with Master Degree feel that "Social Ambition" is the reason to start own business more than the women who has Batchelor Degree.

Women with 35 years old and above feel that " Job dissatisfaction "is the reasons to start own business more than the others.

The administrative system makes gender distinctions although some women feel they get more assistance than men receive and have to spend less time queuing for government services. However, there is a consensus that processes need to be simplified and fees need to be reduced. Some women feel the government concentrate on prices rather than quality and specialization in certain services. Due to a lack of the required skills and the right work attitudes locally and the difficulty of obtaining labour clearances to employ expatriates, this hampers business growth and has an adverse impact on their businesses.

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## Appendix 1 Questionnaire

First Part: Personnel Information:

Experience before starting own Business:

- Employee
- Households
- Student

Status

- Married
- Single

Education

- Diploma or less
- Bachelor Degree
- Master Degree
- PH.D Degree

Second Part: Variables:

| Variable                       | Strongly Agree | Agree | Neutral | Disagree | Strongly Disagree |
|--------------------------------|----------------|-------|---------|----------|-------------------|
| Enjoyment                      |                |       |         |          |                   |
| Finance                        |                |       |         |          |                   |
| Job dissatisfaction            |                |       |         |          |                   |
| Perceived Presence of Business |                |       |         |          |                   |
| Occupy oneself                 |                |       |         |          |                   |
| Make others happy              |                |       |         |          |                   |
| Self-recognition               |                |       |         |          |                   |
| Economic necessity             |                |       |         |          |                   |
| Challenge                      |                |       |         |          |                   |
| Corporate downsizing           |                |       |         |          |                   |
| Family encouragement           |                |       |         |          |                   |
| Social                         |                |       |         |          |                   |
| Ambition                       |                |       |         |          |                   |
| Independence                   |                |       |         |          |                   |

Table (1)  
Sample size

|   |    |       |
|---|----|-------|
| Experience before starting own Business |    |       |
| Employee                                | 20 | 30.8% |
| Households                              | 18 | 27.7% |
| Student                                 | 27 | 41.5% |
| Status                                  |    |       |
| Married                                 | 35 | 53.8% |
| Single                                  | 30 | 46.2% |
| Education                               |    |       |
| Diploma or less                         | 14 | 21.5% |
| Batchelor                               | 23 | 35.4% |
| Master Degree                           | 26 | 40%   |
| PH.D Degree                             | 2  | 3.1%  |
| Age                                     |    |       |
| Less than 25 years old                  | 6  | 9.2%  |
| 25 years old - less than 30 years old   | 21 | 32.3% |
| 30 Years -less than 35 years old        | 15 | 23.1% |
| 35 years old and above                  | 23 | 35.4% |

Table (2)  
Mean and Standards Deviations for all variables

| Variable                       | Mean   | Std. Deviation |
|--------------------------------|--------|----------------|
| Enjoyment                      | 4.2000 | 1.0338         |
| Finance                        | 4.8462 | .5371          |
| Job dissatisfaction            | 4.4923 | .8315          |
| Perceived Presence of Business | 4.6000 | .6801          |
| Occupy oneself                 | 4.1077 | .8501          |
| Make others happy              | 4.6615 | .6909          |
| Self -recognition              | 4.6000 | .5534          |
| Economic necessity             | 5.0000 | .0000          |
| Challenge                      | 4.1077 | .9540          |
| Corporate downsizing           | 4.6769 | .7312          |
| Family encouragement           | 4.9077 | .4584          |
| Social                         | 4.8154 | .4291          |
| Ambition                       | 4.4462 | .7506          |
| Independence                   | 4.6769 | .7927          |

# **WHICH ENTREPRENEURS EXPECT TO EXPAND THEIR BUSINESSES? EVIDENCE FROM SURVEY DATA IN LITHUANIA**

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## **Abstract**

This paper presents an empirical study based on a survey of 399 small and medium size companies in Lithuania. Applying bivariate and ordered probit estimators, we investigate why some business owners intend to expand their firms based on growth expectations, while others do not. Our main findings provide evidence that the characteristics of the owners matter. Those with higher education and 'learning by doing' attributes either through previous job experience or additional entrepreneurial experience are more likely to expand their businesses. In addition, the model implications include that the intentions to expand are correlated with exporting and with size of the enterprise: medium and small size companies are more likely to grow than micro enterprises and self-employed entrepreneurs. We also analyse the link between the main perceptions of constraints to business activities and growth expectations and find that the factors, which are perceived as main business barriers, are not necessary those, which are associated with low growth expectations. In particular, perceptions of both corruption and of inadequate tax systems are main barriers to growth.

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## **1. INTRODUCTION**

In this paper, we focus on the factors affecting enterprise growth in the transition country context. We use a data sample based on a survey of 399 SME owners in Lithuania. Lithuania provides an excellent example of a transition country that has successfully transformed its status from a centrally planned Soviet republic to a fast-growing, sovereign, market-oriented and democratic EU member state. We are specifically interested in the factors affecting two types of growth expectations: intention to increase the number of employees and intention to increase business turnover. Though growth expectations might be viewed as a subjective assessment, a number of authors have indicated that business growth is at least partially determined by the entrepreneur's motivations and intentions for the business (Bird, 1988; Davidsson, 1991; Kolvereid, 1992; Cooper, 1993; Herron and Robinson, 1993; Cliff, 1998; Wiklund et al., 2003). In addition, by asking entrepreneurs about their expectations regarding the future, we alleviate the problem of endogeneity, unlike the typical situation where growth indicators are explained by some contemporary characteristics of firms.

In our analysis, we incorporate a set of explanatory variables including human capital measures, firm level attributes, sectoral affiliation and export behaviour. In addition, we include perceptions of the main external barriers, i.e. taxes and corruption into account as they may have an influence on growth expectations.

Our study provides the following contributions. Firstly, our data is unusually rich in its representation of both micro enterprises and self-employed entrepreneurs. This allows us to more accurately compare the effect of firm size on growth aspirations for all SME size categories. Our results indicate that while small and medium firms expect to grow, the smallest firms i.e. micro firms do not; thus there seems to be a stagnant pool of very small enterprises. This finding contradicts a negative link between size and employment growth found in other studies (Faggio and Konings 2003; Bechetti and Trovato 2002) We argue that the discrepancy stems from the fact that the smallest firms are being typically underrepresented in other studies<sup>1</sup>. Secondly, we are able to test the effect of the two most significant business barriers on growth aspirations. Here we find that both the high level of taxes as well as corruption are identified as negatively related to growth aspirations. Thirdly, the characteristics of the owners matter. Those with higher education and 'learning by doing' attributes either through previous job experience or additional entrepreneurial experience are more likely to expand their businesses.

This paper is organised as follows. Section 2 presents relevant literature in terms of theoretical developments and empirical findings. Section 3 describes the survey and resulting sample of entrepreneurs. Section 4 presents the variables used in our estimation model and Section 5 presents our results. Section 6 concludes.

## **2. LITERATURE ON DETERMINANTS OF SME GROWTH**

We now turn to a brief literature review. First we argue that the growth of businesses and employment growth in particular are key performance indicators for SMEs. Next, we discuss findings on the determinants of growth.

## **2.1 Business performance measures**

Even though no consensus regarding the definition of small business performance exists, venture profitability and increase in employees are two ways in which business performance is typically measured (Chandler and Hanks 1993; Robinson 1999; Vesper 1996; Watkins et al. 2003). However, the profitability indicator is problematic in the context of SMEs for two reasons. Firstly, SMEs frequently rely on simplified accounting where the measures of profit are not clear-cut. Secondly, it is typical for many new firms to follow a period of losses or low profitability in the initial phase of their existence. Thus, growth and growth expectations may be a better measure of performance. As argued by Johnson *et al.* (2000): 'Employment growth is perhaps the most important measure of performance from a welfare perspective. A private sector is successful in a post-communist country only to the extent it manages to create jobs'. (p. 13). Similar conclusions are supported by other authors. For instance Klapper *et al.* (2002) stress that the SME sector is the most dynamic part of transition economies. One may also note, that the importance of employment creation by the SME sector is also crucial in high income economies, as documented by Lopez-Garcia (2002) who confirms the role of SMEs as absorbing employment released from both industry and agriculture, by creating jobs in the service sector. And finally, while we focus on employment, the issue of growth can also be captured by the investment dimension, as in Fries *et al.* (2003).

Growth can be either measured by backward looking accounting and employment data or by forward looking expectations of owners. As the data is typically generated by surveys, there is a serious risk of substantial measurement error if data for several past years is collected. Moreover, in case of new recent start-ups there is not much past history to rely on, which leads to the sample selection bias. In addition, some studies have indicated that perceptions of performance may be more insightful indicators than objective measures because perceptions draw on the insider's knowledge (Osborn et al. 1980; Watson et al. 2003) of firm's goals, strategy, structure and processes. Though it is not without controversy, there is increasing evidence indicating that attitudes such as intentions to grow a business can be used to predict behaviour (Davidsson 1991; Wiklund et al. 2003).

## **2.2 Determinants of growth**

The results of a number of studies indicate that both business and business owner characteristics can influence business growth. Existing studies have shown that human capital as measured by work experience, education and other skills that increase knowledge accumulation are not only important characteristics of entrepreneurial capacity (Sexton and Upton 1985) but have a positive influence on both firm survival, growth (Cooper et al. 1994) and entrepreneurial performance (Cooper and Gimeno-Gascon 1992; Chandler and Hanks 1998). Education seems to provide the knowledge base and analytical and problem-solving skills to more effectively deal with the demands of entrepreneurship (Watson et al. 2003). In a study of the influence of venture teams on venture performance, Watkins et al. (2003) find a significant and positive relationship between perceived venture growth and higher levels of education and work experience. They also found that younger business owners with fewer employees were significantly more likely to grow their ventures than the sample as a whole. However other studies have indicated that middle aged entrepreneurs are more likely to grow their businesses than other age groups (Burns 2001). Business sector may have an influence on these results with younger entrepreneurs growing their firms faster in IT sectors (Burns 2001). As a result, the relationship between business owner's age and business growth is still not completely understood.

Work experience can further supplement an entrepreneur's education with more practically based skills for venture performance. However perhaps even more importantly, previous entrepreneurial experience i.e. in having started up another private business may increase the likelihood for growth in the current business. This is a result of 'learning by doing' in which the entrepreneur improves their skills and chances for business success by building up their entrepreneurial experience. The different roles, which are played by the technically related work experience and by the entrepreneurial experience, may be linked to the recent empirical work based on the distinction between the two alternative views of entrepreneurship (Lazear 2004). Namely, the first view is based on belief 'that entrepreneurs are technical specialist who base their new companies on innovation' (*Ibid.*, p. 208). If this view is correct, both previous sector-relevant job experience and specialist education may be critical factors determining entrepreneurial success. An alternative view however is that entrepreneurs are 'generalist', 'jacks of all trade', as their main role is in co-ordinating a range of activities, about which they need some sufficient amount of knowledge. In our interpretation and application of Lazear's (2004) results, previous entrepreneurial experience and a more broad type of education may be more conducive to entrepreneurial success.

On a related theme, in a review of literature on the antecedents to business start-up and growth, Storey (1994) found reasonable evidence indicating a negative relationship between being unemployed before starting a business and subsequent business growth. Though unemployed individuals experience a strong push into self-employment, they may not have the skills needed to grow the business and may have lower growth aspirations.

Studies in Western countries have indicated that gender affects business development. More specifically, female businesses tend to be smaller and are less likely to grow than male-owned businesses (Cooper et al. 1994). A study by Cliff (1998) indicates that female business owners tend to have lower growth thresholds for their businesses than men, which can partially explain the tendency for women to have smaller businesses with lower turnovers. However, in a study of Norwegian entrepreneurs, Kolvereid (1992) did not find any significant differences between male and female entrepreneurs in terms of growth aspirations. Similarly, in transition countries such as Lithuania, growth aspirations of female entrepreneurs are not different from male entrepreneurs (Aidis 2003).

A study by Faggio and Konings (2003) on five transition countries shows a negative relationship between firm size and firm growth indicating that smaller firms are likely to grow faster than larger firms. However, as stressed by the authors, the small firms are heavily underrepresented in their sample. Similarly, Becchetti and Trovato (2002) found a negative link between size and growth (and positive with age of business), controlling for a wide range of factors, albeit again their sample contains firms with more than ten employees only. On the other hand, the results reported by Fries *et al.* (2003), based on a large cross-country sample from transition economies including micro firms, indicate a positive, albeit non-linear relationship between growth (as measured by both revenues and assets) and size. Similar findings are reported by Batra *et al.* (2003), using the WBES survey. Batra *et al.* show that while the difference between medium and small size companies in growth rate is not significant, it becomes significant in relation to large firms, which grow faster.

Another important determinant of growth relates to the international versus domestic orientation of sales. As confirmed by Beck *et al.* (2002), utilizing a large cross-country survey, for which 80 percent of firms are small and medium sized, exporting is a highly significant factor affecting firm growth. Similar results based on the same sample are

reported by Batra *et al.* (2003). In addition, Becchetti and Trovato (2002), found a positive, albeit marginally insignificant effect of exporting on growth for their sample of Italian firms.

Three studies, which focus directly on the link between business barriers and growth, are Johnson *et al.* (2000), Beck *et al.* (2002) and Batra *et al.* (2003). The latter two are both based on the WBES survey conducted by World Bank in 80 countries between mid 1998 and 2000. The econometric findings of the studies vary, and they are not fully compatible, as the survey instruments are different and the size distribution of firms in the samples differ. The first study (Johnson *et al.* 2000) does not cover firms with less than ten employees. Perception of barriers is captured by assessment of the extent of 'extralegal payments' in the business sector in which the company operates, and by assessment of the credibility of courts in enforcing contracts. On both measures, no significant effects on firm growth was found (Johnson *et al.* 2000).

On the other hand, Beck *et al.* (2002) relies on a more extensive range of indicators, and a larger sample with wide cross-country variation. They consider three dimensions: quality of financing, quality of the legal system, and corruption, all three based on 7-11 detailed questions with answers based on 6 point Likert scale. If a single dimension is included in the specification separately, all three turn out to have highly significant negative effect on firm growth. The effect of corruption becomes insignificant, when the three are included jointly, possibly due to multicollinearity. Another interesting finding is that the significance of these factors vary with the size of company: 'small firms report the highest financing and corruption constraints, whereas large firms report the highest legal constraints' (Beck *et al.* 2002, pp. 13-14). Similarly, using the same sample but different specifications, Batra *et al.* (2003) find that financing, high taxes and corruption are significantly and negatively associated with business sales growth.

In a related study in Lithuania, Aidis (2004) found that business barriers do not influence the business in isolation but have an inter-related effect. For instance, business owners who were affected by formal barriers such as the tax level and business legislation were found to be more likely affected by informal barriers such as governmental corruption at the national level and the implementation of business regulations. In our study, we are interested in testing if the main business barriers identified by SME owners, namely taxes and corruption would have a negative effect on growth aspirations.

### **3. SURVEY AND SAMPLE CHARACTERISTICS**

Our analysis is based on data collected by one of the authors in Lithuania. From September - December 2000, Lithuanian language questionnaires were sent out to private business owners throughout Lithuania. Due to the inability to obtain accurate lists of operating private businesses in Lithuania<sup>2</sup>, the survey was not based on a random sample and most addresses were obtained through the membership lists of various entrepreneurship organizations. This may have resulted in a bias for businesses that are older and have higher turnovers than the average private business in Lithuania. The response rate was high, at fifty percent. Of the 505 respondents, 399 were business owners<sup>3</sup>.

### 3.1 Growth

Our analysis of growth intentions is based on responses to the following question from the survey:

- In the next five years, do you think that your business will:  
(please mark all relevant responses):*
- (a) increase the number of employees*
  - (b) increase turnover*
  - (c) decrease the number of employees*
  - (d) decrease turnover*
  - (e) stay the same*
  - (f) I don't know*

The question is asked in a depersonalised, objective mode, i.e. about expectations, not intentions or strategies of the owner, to avoid possible bias. The respondents would typically assume that growth is something positive and might be inclined to present themselves in a better light, if asked about their intentions and potential. The wording applied here suggests that it is not only the entrepreneur, who is responsible for the enterprise development.

The analysis was greatly facilitated by the fact that all respondents who declared an expected increase in employment, also declared an expected increase in turnover, but not vice versa. These results lead to the following ranking, presented in Table 1.

Table 1 about here

As the number of responses in the lowest category is relatively small, combining it with the one above may be reasonable, as illustrated by an alternative categorisation (b) above. We estimated alternative models, using both specifications (see below). In particular, we applied the ordinal probit estimator, where, for a sequence of cut points:  $k_0, \dots, k_i, \dots, k_n$  (with  $k_0$  corresponding to  $-\infty$  and  $k_n$  to  $+\infty$ ), the probability of observing an outcome  $i$  is given by:

$$P(\text{outcome} = i) = P(k_{i-1} < X\gamma + u < k_i) = \Phi(k_i - X\gamma) - \Phi(k_{i-1} - X\gamma) \quad (1)$$

where  $X\gamma$  is a matrix of explanatory variables with a corresponding (column) vector of coefficients and  $\Phi(\cdot)$  refers to the standard normal cumulative distribution function.

In addition to this model, we also applied a simpler binary probit model, with the dependent variable distinguishing between the entrepreneurs predicting employment growth and all other outcomes:

$$P(\text{outcome} = 1) = \Phi(X\gamma) = \int_{-\infty}^{X\gamma} \phi(t) dt \quad (2)$$

## 4. VARIABLES DEFINED

In deriving the set of explanatory variables, we draw from the literature discussed in section 2. Our particular interest is in the link between perceptions of business barriers and growth expectations. The difference in explanatory power of barriers may not correspond to their direct ranking. To give an example, demand and financial constraints, typical for hard-budget market economy are commonly perceived as a major nuisance, as confirmed by the survey results. Yet it does not imply these have the most impeding impact on growth. Assessment of

the importance of given obstacles may indicate problems in everyday business, which the entrepreneurs may be able to overcome nevertheless. Quite a different set of factors may influence the decisions to develop and expand.

The survey generated data on a number of characteristics that are consistent with our prior expectations on a possible set of determinants of growth. Firstly, we have size, as measured by employment. The variable distribution is highly skewed to the left, with 43 observations in the self-employed category, i.e. with no employment other than the owner of the business (see Table 2). For that reason, we categorise the employment variable, using the four size categories, as recommended by the standard EU definition. The benchmark category is 'self employed' and we introduce dummy variables for micro, small and medium size enterprises correspondingly (see Table 2). Three observations with employment above 250 are eliminated from the analysis. Testing for the relationship between size and growth expectations is important, since as indicated in section 2, the link between the size and growth of enterprises remains a highly debated issue in the literature.

We are also interested in examining if human capital variables such as sector-relevant job experience, entrepreneurial experience, starting from employment or non-employment, education, age and gender are related to growth intentions. In particular, the first two may be perceived as proxies for the distinction between 'specialist' and 'generalist' human capital, as defined by Lazear (2004). We include these as well as firm level variables such as export orientation, location and sectoral affiliation in our estimations. Export orientation provides us with an indication of the influence of internationalized business operations on business growth. Capital city location is included in order to control for the effects of rapid economic growth concentrated in the capital city as compared to the rest of the country. This specific capital city development vs. underdeveloped smaller cities characterizes many transition countries. Finally controlling for sector effects is a standard for these types of estimations.

For all of the barriers included in the survey questionnaire, figure 1 below illustrates the frequency of responses identifying a given barrier as one of the three most important ones.

Figure 1 about here

Our estimation strategy was to include dummy variables for seven barriers, which were most frequently identified. It turned out that only those related to taxes and corruption were significant. In addition, there is multicollinearity between the tax dimensions, which makes the coefficients sensitive to small changes in specification and data, i.e. not robust and problematic to rely on. There is no single straightforward solution to this problem. Our response was to restrict ourselves to the two of the most important business barriers, namely 'taxes to high' and 'corruption at the national level' and exclude 'frequent changes to tax policies' and 'ambiguity of taxes'. However, interpreting the results, one should bear in mind that the retained tax indicator should not be narrowly related to the level of taxes, but interpreted as a proxy for a broader cluster of problems with tax system.

The results of three specifications are reported below. Our dependent variable relates to expected growth categorised into four ranks, as described above, where the highest rank is the expected positive growth of both employment and turnover. In the first specification, we use the dependent variable with four categories and include indicators for human capital, exporting, location, employment size categories, sectoral controls and perceptions of barriers,

as described above. In the specification two, we use three categories of expected growth (instead of four) as dependent variable and in specification three we compress the dimensions further, by using expected employment growth as a binary variable, to see if the results are robust to the modification. See Appendix 1 for a summary of the independent and dependent variables used in our estimation model.

## 5. RESULTS

All the estimation results are presented in Table 2. Unemployed prior to starting a business, age and gender are not significant as predictors of growth expectations. Age is highly insignificant, while gender is marginally significant in one specification, and insignificant in others. Interestingly, the sign of the gender coefficient is positive in all specifications, indicating that the impact of gender may be very different from that observed in high income countries; if anything women entrepreneurs have higher growth aspirations than their male counterparts. Unemployment prior to starting a business also has the expected negative sign. The other human capital measures are either significant or marginally insignificant depending on the specification. In particular, we found no evidence that the 'specialist' experience is more relevant than 'generalist' or vice versa. Both seem to matter, as documented by coefficients on experience in the same sector of activity and on entrepreneurial experience. Though 'learning by doing' through previous job experience and entrepreneurial experience does have a positive effect. In addition, we found a clear general positive effect of higher education. On the firm level, we can see a clear positive effect of exporting, and positive, albeit insignificant effect of business being located in the capital city. Sectoral affiliation is mostly insignificant, apart from some negative effect on growth expectations of 'services activities other than trade'.

Size effects are clearly important. Medium, small and micro size companies expect to grow, while the self-employed express little interest in developing their business. Moreover, the coefficients in Table 2 are neatly ordered according to size group: the larger the size category, the more likely is that the company will grow. Here, our results are consistent with those obtained from research based on samples, which include the smallest firms, as in Fries *et al.* (2003). It may also be interpreted as providing support for the arguments presented by Earle and Sakova (2001) theorizing that in transition countries, own account workers (business without employees) a more likely a form of hidden unemployment than a form of entrepreneurship. This is clearly a point of concern for policy makers.

Taxes and corruption have a negative effect on growth aspirations throughout. The result is consistent with the literature discussed above. In the case of corruption it also indicates that this barrier, while not named as very important by the majority of entrepreneurs (see Figure 1), has a detrimental effect on growth where encountered.

## 6. CONCLUSION

Our study focused on factors affecting the growth of new firms, which is arguably the key indicator of business performance and entrepreneurship as well as an important factor in overall economic development. In particular, we discover that growth expectations differ according to firm size, with small and medium size enterprises expecting growth and micro firms and self-employed less so. Arguably, we are able to detect these effects, due to a broad

coverage of size dimension by our sample. Analysis of the results in the available literature shows that the link between size and growth is sensitive to sample coverage. We also analyse the link between the perceptions of barriers by business owners and their growth expectations. Both taxation and corruption were found to be significant barriers to the growth aspirations of SMEs in our sample.

An interesting but not surprising result was the significant influence of private business experience on intention to grow in the current business. This effect may be more important in the transition context than in advanced western countries since 'entrepreneurial' skills were never taught (directly or indirectly) in the centrally planned system. Our results seem to indicate that 'learning by doing' has proved to be an important form of human capital in the transition context.

Finally, we are able to confirm two further results, consistent with the literature. Firstly, export orientation is an important factor facilitating growth of small firms. Secondly, human capital matters: higher education of entrepreneurs is correlated with higher growth expectations. Further research in this area would be useful in order to model the interactions between the characteristics of entrepreneurs, perceptions of barriers and growth expectations in more detail.

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Appendix 1: Variables defined

| <b>Independent Variables</b>  | <b>Characteristic</b>   | <b>N</b> | <b>Mean</b> | <b>SD</b> |
|---|---|----------|-------------|-----------|
| <b>Human capital</b>  |   |          |             |           |
| <i>Higher education</i>   | One if the respondent has a university education, zero otherwise.   | 393      | 0.72        | 0.45      |
| <i>Job experience in same sector</i>                                      | One if the respondent has previous employment experience in the sector where they started their own business, zero otherwise.   | 389      | 0.48        | 0.50      |
| <i>Experience with other business</i>                                     | One if the respondent had started a private business besides their current business, zero otherwise.  | 395      | 0.02        | 0.14      |
| <i>Unemployed prior to starting</i>                                       | One if the respondent had not been in employment prior to starting their private business, zero otherwise.  | 395      | 0.73        | 0.26      |
| <i>Business owner's age</i>   | Continuous variable measuring business owner age.   | 390      | 42.76       | 8.77      |
| <i>Age<sup>2</sup></i>  | Age variable squared  | 390      | 1905.2      | 787.9     |
| <i>Female</i>   | One if the respondent is female, zero otherwise.  | 396      | 0.25        | 0.43      |
| <b>Firm level attributes</b>  |   |          |             |           |
| <i>Exporting</i>  | One if the business is exporting, zero otherwise.   | 396      | 0.48        | 0.50      |
| <i>Location: Vilnius</i>  | One if the business is located in Vilnius, zero otherwise.  | 394      | 0.26        | 0.44      |
| <i>Micro</i>  | One if the business has less than 9 employees, zero otherwise.  | 396      | 0.34        | 0.48      |
| <i>Small</i>  | One if the business has 10 to 49 employees, zero otherwise.   | 396      | 0.39        | 0.49      |
| <i>Medium</i>   | One if the business has 50 to 249 employees, zero otherwise.  | 396      | 0.16        | 0.37      |
| <i>Turnover*</i>  | Ordinal variable indicating annual business turnover for 1999. Five categories: (1) up to \$ 25 000 USD; (2) \$ 25 001 – 125 000 USD; (3) 125 001 – 250 000 USD; (4) \$ 250 001 – 1 250 000 USD; (5) more than \$ 1 250 000 USD.                                      | 388      | 3.00        | 1.39      |
| <b>Barriers</b>   |   |          |             |           |
| <i>Taxes</i>  | One if 'taxes are too high' is considered one of the three most important business barrier, zero otherwise.   | 368      | 0.63        | 0.48      |
| <i>Corruption</i>   | One if 'corruption at the national level' is considered one of the three most important business barrier, zero otherwise.   | 368      | 0.16        | 0.37      |
| <b>Sectors</b>  |   |          |             |           |
| <i>Retail trade</i>   | One if the business is engaged in retail trade, zero otherwise.   | 396      | 0.25        | 0.43      |
| <i>Wholesale trade</i>  | One if the business is engaged in wholesale trade, zero otherwise.  | 396      | 0.15        | 0.36      |
| <i>Busin. services.</i>   | One if the business is engaged in business services, zero otherwise.  | 396      | 0.14        | 0.35      |
| <i>Other services</i>   | One if the business is engaged in other service activities besides business services, zero otherwise.   | 396      | 0.17        | 0.38      |
| <i>Construction</i>   | One if the business is engaged in construction, zero otherwise.   | 396      | 0.04        | 0.19      |
| <b>Dependent Variables</b>  | <b>Characteristic</b>   | <b>N</b> | <b>Mean</b> | <b>SD</b> |
| <i>Growth expectations (using four ranks)</i>                             | Ordinal variable indicating the respondent's growth aspirations in the next five years. Four categories: (1) decrease turnover or employment; (2) the same or don't know; (3) increase turnover, but not employment; (4) increase employment and turnover.            | 393      | 3.08        | 0.98      |
| <i>Growth expectations (using three ranks)</i>                            | Ordinal variable indicating the respondent's growth aspirations in the next five years. Modified to three categories: (1) the same or don't know or decrease turnover or employment; (2) increase turnover, but not employment; (3) increase employment and turnover. | 393      | 2.81        | 1.32      |
| <i>Growth expectations (positive employment growth as binary outcome)</i> | One if the respondent plans to increase employment in the next five years, zero otherwise.  | 399      | 0.46        | 0.50      |

N = total number of observations; SD = standard deviation.

\* = The survey turnover was reported in the Lithuanian national currency, the Litas. The exchange rate used here is the official 1999 exchange rate: \$ 1USD = 4 Litas.

Table 1: Categorization of answers for the question on growth expectations

| <i>a. variable 'future'</i><br>(four categories) | frequency of<br>answers: | <i>b. variable 'future_3c'</i><br>(three categories)         | frequency of<br>answers: |
|--|--------------------------|--|--------------------------|
| (4) increase employment and turnover             | 182                      | (3) increase employment and turnover                         | 182                      |
| (3) increase turnover, but not employment        | 83                       | (2) increase turnover, but not employment                    | 83                       |
| (2) the same or don't know                       | 106                      | (1) the same or don't know & decrease turnover or employment | 128                      |
| (1) decrease turnover or employment              | 22                       | (missing)  | 6                        |
| (missing)  | 6                        | Total  | 399                      |
| Total  | 399                      | Total  | 399                      |

Figure 1: Percentage of entrepreneurs identifying a given dimension as one of the three most important business barriers.

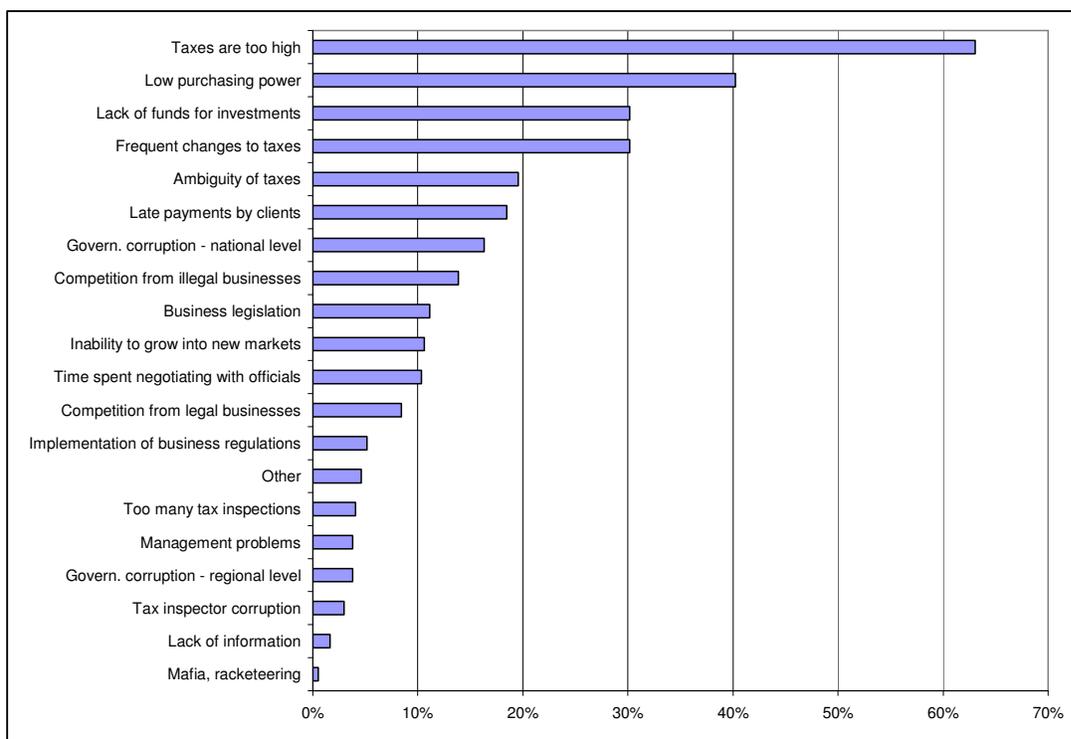


Table 2: Results

|  | (1)  | (2)   | (3)   |
|--|--|---|---|
|  | growth expectations<br>(ordered using four<br>ranks) | growth expectations<br>(ordered using three<br>ranks) | growth expectations<br>(positive employment<br>growth as binary<br>outcome) |
| <i>Human capital:</i>  |  |   |   |
| higher education   | 0.37* (0.15)   | 0.34* (0.16)  | 0.26 (0.18)   |
| job experience same sector   | 0.20 (0.13)  | 0.25† (0.14)  | 0.26† (0.15)  |
| entrepreneurial experience   | 0.27* (0.13)   | 0.32* (0.14)  | 0.18 (0.15)   |
| Unemployed prior to starting   | -0.24 (0.25)   | -0.15 (0.27)  | -0.26 (0.30)  |
| business owner's age   | -0.08 (0.06)   | -0.09 (0.07)  | -0.09 (0.07)  |
| age2   | 0.0008 (0.0007)                                      | 0.0010 (0.0007)                                       | -0.0010 (0.0008)  |
| female   | 0.16 (0.15)  | 0.23 (0.16)   | 0.18 (0.18)   |
| <i>Firm level attributes:</i>  |  |   |   |
| company is exporting   | 0.34* (0.14)   | 0.31* (0.14)  | 0.22 (0.16)   |
| location: Vilnius  | 0.14 (0.15)  | 0.16 (0.15)   | 0.04 (0.17)   |
| <i>Firm size: number of employees ( reference category: self employed)</i> |  |   |   |
| micro  | 0.49* (0.23)   | 0.68** (0.25)   | 0.56* (0.28)  |
| small  | 0.57* (0.23)   | 0.82*** (0.25)  | 0.82** (0.28)   |
| medium   | 0.80** (0.28)  | 1.05*** (0.299)                                       | 1.00** (0.33)   |
| <i>Barriers</i>  |  |   |   |
| taxes  | -0.31* (0.14)  | -0.35* (0.14)   | -0.35* (0.16)   |
| corruption   | -0.41* (0.17)  | -0.34† (0.18)   | -0.31 (0.20)  |
| <i>Sectors (reference category: manufacturing)</i>                         |  |   |   |
| construction   | 0.02 (0.35)  | 0.05 (0.36)   | 0.16 (0.38)   |
| retail trade   | 0.04 (0.18)  | 0.11 (0.19)   | 0.15 (0.21)   |
| wholesale trade  | -0.05 (0.21)   | -0.03 (0.22)  | 0.11 (0.23)   |
| business services  | -0.25 (0.22)   | -0.21 (0.23)  | -0.23 (0.25)  |
| other services   | -0.37† (0.21)  | -0.52 (0.22)  | -0.30 (0.25)  |
| Log likelihood   | -382   | -325  | -213  |
| LR $\chi^2$  | 55***  | 62***   | 40**  |
| Pseudo R <sup>2</sup>  | 0.07   | 0.09  | 0.09  |
| No of observations   | 338  | 338   | 339   |

## Notes

- (i) estimator: ordered probit for specifications 1- 2; binary probit for specification 3,  
(ii) three companies with employment above 250 excluded from estimation,  
(iii) standard errors in parentheses,  
(iv) significant at: †0.10 \*0.05 \*\*0.01 \*\*\*0.001,  
(v) ancillary parameters (and constant in specification 3) not reported, and available on request.

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**Endnotes**

<sup>1</sup> See sections 3 and 4 below. Amadeus Database has been a popular source of firm level data, with the smallest firms truncated; a recent paper utilizing it for employment growth estimations is Faggio and Konings (2003). WBES World Bank survey and EBRD surveys are better in this respect, albeit the samples are still skewed; see: Beck *et al.* (2002), Batra *et al.* (2003), Fries *et al.* (2003). All those authors notice the problem.

<sup>2</sup> As in many other transition countries, an accurate list of legal enterprises in Lithuania does not exist. Previous surveys attempted using the official list of registered businesses from the Lithuanian Department of Statistics indicated that the official register was rife with non-existent businesses or inaccurate addresses. See Aidis (2003) for further discussion.

<sup>3</sup> A business owner met the following criteria: they had their own business, it was still in operation and their main business activities were not in the agriculture sector.